CESTNICK

TAX MATTERS

How to plan ahead for postelection tax changes

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED JULY 1, 2021

My friend Jason was expecting a tax refund of $1,200 this year. As it turns out, he made a mistake and the taxman sent him a cheque for $1,750. "Tim, I'm 50 years old and, after all these years, I now believe in Santa Claus."

It's rare when a taxpayer is pleasantly surprised by the government. The truth is, we should all be expecting more tax surprises in the future – but these won't be pleasant, given the likelihood of tax increases to pay for pandemic support measures. When will this happen? Likely after the next election – which many are expecting this year.

THE PROGNOSIS

Keep your eye on the taxation of capital gains. Currently, just one-half of capital gains are taxed. I think this will change. Look no further than the United States, where the Biden administration has proposed to increase the tax rate on capital gains for taxpayers with income over $1-million. The change would see these folks paying tax on their capital gains at the same rate as regular income – currently as high as 40.8 per cent federally.

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It's highly likely that our government, particularly if the Liberals form a majority or collaborate with the NDP after an election, will follow the U.S. and increase capital gains taxes. Those who should be most concerned are those who may sell real estate or businesses because those assets often give rise to substantial capital gains, which will put a taxpayer squarely in the crosshairs of any change to capital gains tax rates.

THE TREATMENT

So, what is one to do about this?

1. Do nothing. This is easiest. If you own an asset that has appreciated in value, but you don't expect to sell it in the next few years, you may choose to do nothing and simply deal with any taxes when you eventually sell or transfer the asset – or pass away. Hey, if tax rates on capital gains don't change, you'll be glad you did nothing.

2. Consider selling today. If your plan is to sell an appreciated asset in the next few years, you might consider selling today, which means paying tax prematurely – but at today's tax rates. In the case of real estate, valuations are currently high, which has spurred many investors to liquidate holdings – and lock in their capital gains at today's tax rates to boot. In the case of portfolio investments, you could simply rebalance your portfolio today, which can give rise to capital gains taxed at current rates.

If you do realize capital gains you might also consider ways to soften the tax hit. You could, for example, sell other assets with accrued capital losses to offset the gains.

Another idea is to donate part of your sale proceeds to charity. Suppose, for example, that you sell real estate and realize a $1-million capital gain. The tax could be about $250,000, depending on your province and income level. If you were to donate about $500,000 to charity, you'd be entitled to a donation tax credit to offset most of the taxes on the capital gain. Now you'll be out of pocket the amount donated to charity, so you might consider purchasing life insurance to reimburse your estate for that $500,000 upon your passing. You can even finance those insurance premiums so that the bank covers the cost and minimizes the impact on your cash flow. The bank loan could be paid off with part of the insurance proceeds later.

3. Transfer assets to a corporation. A corporation can be set up (a lawyer can help with this) and you can transfer some of your appreciated assets to your corporation. You'll continue to own and control the company along with its assets. When you make the transfer, you can choose to trigger any capital gains on the assets in order to lock in your gains at today's tax rates. Alternatively, you can transfer those assets at your ACB, or adjusted cost base – your cost to acquire the assets - in which case you won't realize any capital gains. You can make the transfer today without deciding whether you'll trigger a gain or not. If the tax rate on capital gains does increase before you're required to file your personal or corporate tax return (whichever is earlier) for 2021, you can elect to trigger capital gains at the current tax rate. Otherwise, you can allow that transfer to take place at the ACB and trigger no tax. Speak to a tax pro about the pros and cons.

4. Transfer assets to your spouse. You can also transfer assets to your spouse or common-law partner, which generally takes place on a tax-deferred basis since you'll be deemed to have made that transfer at your ACB. But you can elect to trigger the capital gain on the transfer, paying tax at current rates. Again, you don't need to decide which way to go until it's time to file your 2021 tax return.

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