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TAX MATTERS

There's time before year-end for investors to save tax

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My grandfather once explained to me the difference between knowledge and wisdom: Knowledge is knowing that tomatoes are fruit, but wisdom is knowing that you shouldn't put tomatoes in a fruit salad. Very wise. And when it comes to investing, you want to be wise about the things you do – including reducing taxes on your portfolio. Here are a dozen tax-saving moves investors should consider before year-end.

Asset allocation and location. Year-end is a good time to consider rebalancing your portfolio to adjust your asset allocation and therefore your risk level going into 2022. As for asset location, consider holding highly taxed interest-bearing investments in your registered plans (such as a registered retirement savings plan, registered retirement income fund, tax-free savings account or registered education savings plan) to the extent possible, where that income will be tax-sheltered. Outside of your registered plans you'll generally want to hold growth investments since capital gains are more tax-efficient.

Investment expenses. You can deduct investment counselling fees, interest on investment loans, and other carrying charges if they relate to non-registered investments and you pay these before year-end. Sorry, but fees related to your registered plans are not deductible.

Interest deductibility. If you're paying non-deductible interest costs, consider using cash or other investments to pay down your non-deductible debt, then reborrow to replace those investments to earn income. When you borrow to earn investment income, you'll be able to deduct your interest costs. Do this before year-end to maximize interest deductions for this year and going forward.

Realize capital gains. If you were planning to sell an investment before year-end at a profit, you might want to delay this until January so that your capital gain won't be taxable until 2022. On the other hand, if you have capital losses to use up, have very little other income, or you're concerned that tax rates on capital gains might increase next year, selling before year-end can make sense.

Realize capital losses. If you have investments that have dropped in value it could make sense to realize those capital losses before year-end if you have capital gains this year, or in the past three years (2018, 2019 or 2020), to apply those losses against. This could allow you to recover taxes that you might have previously paid.

Capital gains reserves. You may be able to defer the tax on a capital gain, by claiming a capital gains reserve, where you've sold an asset and are collecting your proceeds over more than one year (the maximum deferral is five years). If you're concerned that tax rates on capital gains will be increasing in the future, it could make sense to pay tax on more of your capital gains today (that is, claim less of a reserve) to take advantage of today's tax rates on capital gains.

Timing your investments. If you're planning to invest in a mutual fund, consider waiting until 2022 if the fund is likely to make a taxable distribution before the end of 2021. Otherwise, you'll pay tax sooner than necessary. Also, if you're going to invest in an interest-bearing security with a maturity of one year or longer, consider waiting until 2022. This way, you won't have to pay tax on any accrued interest until 2023 – the year of the first anniversary of the investment.

Options contracts. If you have any options contracts with accrued capital losses, consider closing out those contracts before year-end. You'll be able to use those losses to offset capital gains this year, or in 2018, 2019 or 2020.

Donate securities to charity. Charities need our help today more than ever. Consider donating eligible securities that have appreciated in value since our tax law will eliminate the taxable capital gain on these securities, in addition to providing the tax relief for the donation itself – a double benefit. Do this before year-end for 2021 tax savings.

TFSA withdrawals. If you're 18 or older, consider contributing to a TFSA to use up any accumulated contribution room. And if you're planning to make a withdrawal from your TFSA soon, consider doing this before year-end since withdrawals are not added to your TFSA contribution room until the beginning of the year after the withdrawal.

Home Buyers' Plan. If you're thinking of making a withdrawal from your RRSP under the Home Buyers' Plan, consider waiting until after year-end to extend, by one year, the time for buying your home and repaying the amounts withdrawn.

Give investments to a child. If you have any investments that have dropped in value, consider gifting them to a child before year-end. You'll be allowed to claim the capital loss to offset capital gains, and you'll pass any future tax liability on future growth to your child. You'll also minimize probate fees at the time of death since you won't own the assets any longer.

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