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TAX MATTERS

Seven creative tax moves to make when markets are tanking

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There are many ways to lose money. Take Marie Holmes, for example. Ms. Holmes was a Powerball lottery winner in 2015 who won US$188-million then rapidly burned through some of her winnings by bailing her boyfriend (drug dealer Lamarr "Hot Sauce" McDow) out of jail – several times. The bailouts cost her US$21-million.

Others have lost money in more conventional ways – like declines in the equity markets. At the time of writing, the S&P 500 is down more than 18 per cent year-to-date and the S&P/TSX is down more than 7 per cent. The difference between losing money in the market and paying a friend's bail money is that the former can actually give rise to some creative planning ideas. Let me share seven ideas today.

1. Realize losses to recover taxes paid. Take a look at the tax returns you filed for 2021, 2020 and 2019. Did you report any capital gains on any of those returns? If so, and if you currently have non-registered investments that have declined in value, you may want to realize some capital losses by selling some of your losers. You'll be able to claim those losses when you file your tax return for 2022 and can carry the losses back to 2021, 2020 or 2019 to recover taxes you paid on capital gains in those years.

2. Watch the superficial loss rule. If you're going to sell some losers to realize capital losses, be aware that your losses could be denied if you sell investments at a loss but you, or someone affiliated with you (your spouse, for example), reacquires the same securities in the period that starts 30 days before and ends 30 days after your sale. But the loss doesn't disappear forever. The denied loss is added to the adjusted cost base of the newly acquired securities, which will reduce a capital gain or increase a capital loss later when the investment is ultimately sold.

3. Transfer capital losses to your spouse. If you have investments that have dropped in value, but you don't have capital gains to use up the losses, you can transfer unrealized capital losses to your spouse if he or she can use them. How? Step 1: Sell your losers on the open market. Step 2: Your spouse should reacquire the same investment within 30 days. This will cause your loss to be denied under the superficial loss rule. Your spouse will have an adjusted cost base in the newly acquired investment that is bumped up by the loss denied to you. Step 3: Your spouse can then sell the investment and will realize a capital loss that they can use. Your spouse will have to wait until after the 30th day following Step 1 before they sell.

4. Consider an estate freeze. An estate freeze involves taking certain assets and "freezing" them at today's value. The future growth of the assets typically accrues to your kids, or a family trust that you control. A freeze can cap your tax bill upon death, among other benefits. The best time to freeze is when assets are lower in value, so that more future growth is placed in the hands of the kids or a trust. A freeze doesn't mean having to give up control over, or use of, the assets or future growth. Speak to a tax pro about it.

5. Play dead when you see the bear. When you see a bear, how do you react? There's an old saying that when you see a bear market, just play dead. I'm talking about staying calm and not making any sudden moves. If you have a long-term investment horizon you can count on the markets growing over time. Selling low and buying high again later is precisely a recipe for wealth erosion.

6. Take advantage of dollar cost averaging. If you have cash available, is now the time to be putting it all in equities? Well, if you had a crystal ball, you'd find your answer. Author and hedge fund manager Ray Dalio wrote: "He who lives by the crystal ball will eat shattered glass." Rather than trying to guess when we've hit market bottom, consider the approach of systematically purchasing equities over time, which allows you to average your cost amount over that period.

7. Use cash to pay down debt. When you pay down debt, you'll enjoy a guaranteed rate of return equal to your after-tax interest cost on the debt. Who wouldn't want a guaranteed return today when markets are in decline? And the higher your interest costs, the higher your guaranteed return. If you have cash on the sidelines, look to get rid of some of your debt.

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