THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Take advantage of tough economic times to save taxes

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You've probably heard the saying: When life gives you lemons, you might as well make lemonade. From an economic perspective, most Canadians are being handed enough lemons to stock a well-run lemonade stand for quite a while. Inflation continues to run rampant, hitting 7.7 per cent in May, and so the Bank of Canada responded by increasing its benchmark interest rate by a full percentage point on Wednesday, to 2.5 per cent. This has further sparked concerns that a recession may be just around the corner. So, what are we to do about this?

I'm going to suggest that we make lemonade out of these lemons. Even better, let's make pink lemonade. That is, let's be even more creative as we navigate our way through these turbulent times characterized by higher prices, increasing interest rates and reduced investment values. Here are some ideas to consider.

Carrying-back losses

With the S&P/TSX Composite Index and S&P 500 down 13.6 per cent and 20.5 per cent year-to-date, respectively, and real estate prices also in decline, you may have investments in your portfolio that have accrued losses. This is in stark contrast to the past couple of years when many people paid tax on capital gains in 2020 and 2021. If you're in this boat, you should consider selling some of your losers today and carrying those capital losses back up to three years, to 2019, 2020 and 2021, to recover taxes paid in those years. You can do this by realizing capital losses today and filing Form T1A with your 2022 tax return when prepare your return next spring.

Transferring losses

But what if you don't have any capital gains to offset capital losses? It's also possible to transfer unrealized capital losses to your spouse if they are able to use them. This can be done in three steps: 1) Sell your losers on the open market; 2) your spouse should then buy back the same investments within the 30 days following your sale; and 3) your spouse can then sell those investments after the 30th day, counting from the date of your sale in Step 1.

This idea takes advantage of the superficial loss rules which will deny the capital loss in your hands that results from your sale in step one because your spouse – who is affiliated with you under our tax law – purchases the same investments in Step 2. But the loss doesn't disappear forever. Instead, it's added to the cost amount of your spouse's purchase so that your spouse will have a higher adjusted cost base. This results in a smaller capital gain or larger capital loss later when he or she eventually sells the investments in Step 3. It's important that your spouse not sell in Step 3 too soon. He or she will have to wait until after that 30th day following your sale in Step 1. Otherwise, the capital loss will not be denied in your hands, and you'll have to claim the loss rather than your spouse. See my article from Oct. 22, 2020 for an example of how this idea works.

Spousal loans

Next, it's possible to save tax as a family by putting some personal investments in the name of your lower-income spouse so that he or she can pay the tax on any investment income rather than you. You can do this by lending money to your spouse to invest. You'll need to charge the taxman's prescribed rate of interest on the loan to make this work. While that rate was just 1 per cent prior to this month, it's currently 2 per cent (until Sept. 30), which is still a low rate. A loan set up before the end of September will lock in this 2-per-cent rate indefinitely. We know already that the prescribed rate on Oct. 1, 2022, will be going up to 3 per cent. So, now is the time to act.

Estate freeze

An estate freeze is a manoeuvre that allows you to effectively "freeze" the value of certain assets today so that the tax owing upon your death is less than it might otherwise be. This is most often accomplished by transferring those assets to a holding company in exchange for special shares in the company that are frozen in value. The future growth of the assets accrues to the common shares of the holding company, which are most often held in a family trust, out of your hands. A freeze doesn't mean giving up control or use of the future growth of your assets. The best time to freeze is when asset prices are depressed since this will reduce the ultimate tax bill on your death. So, now may be a very good time to consider a freeze, or a refreeze if you've already done this in the past.

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