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

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My son was finishing a research paper on the issue of procrastination. “Dad, do you want to see my pie chart about procrastination?” he asked. “Sure,” I replied. So, he showed me a page with an empty circle printed on it. “Uh, Michael, this pie chart isn’t finished,” I observed. “I know, Dad. It’s not due until tomorrow morning.” I got the joke.

When it comes to the art of the last minute, there are several things investors can do before year-end to save tax this year or otherwise improve a portfolio. Last week, I shared several ideas, and today I want to share nine more.

Rebalance your portfolio. If you have a carefully designed strategic asset allocation (that is, a plan for how much you should hold in cash, fixed income, equities and other investments), you generally shouldn’t make changes to that allocation merely because there have been declines in the markets this year. Rather, it’s an opportunity to rebalance your portfolio to bring it back in line with your strategic asset allocation.

Revisit your asset location. If you’re going to hold interest-bearing investments in your portfolio you should hold them in a registered plan, to the extent possible, where the interest income will be sheltered from tax (interest is more highly taxed than dividends or capital gains). The capital gains and losses from equities, or dividends from Canadian stocks, have favourable tax treatment and are therefore well-suited to be earned outside your registered plans. This is not to say that equities should be avoided inside your registered plans if you’ve already maxed-out the amount of interest-bearing investments you should be holding.

Review beneficiary designations. Year-end is a good time to review who you’ve named as beneficiaries of your registered plans. This is especially important if you’ve gone through a change in marital status this year.

Accelerate your TFSA withdrawals. If you're thinking of making a withdrawal from your TFSA, consider doing this before year-end. The reason? Amounts withdrawn will be added to your TFSA contribution room in the following calendar year. So, a withdrawal in 2022 can be recontributed to your TFSA as early as Jan. 1, 2023, but a withdrawal in early 2023 will require you to wait until 2024 before you can recontribute that amount.

Time the purchase of investments. You may want to delay the purchase of certain mutual funds until early in the new year if those funds are expected to make a taxable distribution before year-end. If you own units in the fund before the distribution date, you could end up paying tax on income that was not earned by you, but was earned before you became an investor in the fund. Likewise, if you're thinking of selling a fund, consider selling before the fund declares its taxable distribution in December.

Defer your investment dispositions. If you're planning to sell an investment for a profit in a non-registered account, you should consider waiting until January so any taxes owing on the capital gain will not be due until you file your 2023 tax return in the spring of 2024. If, on the other hand, you can avoid taxes on the capital gain because you have offsetting capital losses to utilize this year, then selling before year-end may not cost you taxes and would be fine.

Donate securities to charity. If you have investments that have appreciated in value, you can eliminate the tax on the capital gain and receive a donation tax credit to boot if you donate these publicly traded securities to charity. It generally makes more sense to donate appreciated securities than cash to charity because of the tax benefits.

Complete a debt swap. You can set yourself up for interest deductions in 2023 if you ensure the money you've borrowed is used for an income-producing purpose. A debt swap may accomplish this. If, for example, you have debts that don't give rise to deductible interest (credit card debt is a common example) and you have cash or liquid investments, consider using some of the cash, or proceeds on the sale of some investments, to pay down the debt, then reborrow to replace that cash or the investments. The newly borrowed funds will now be used to earn income and will give rise to deductible interest.

Consider an investment holding company. Depending on your province of residence, you might benefit from a deferral of tax when earning investment income inside a corporation. This idea might make the most sense if you're also thinking of completing an estate freeze or undertaking other planning for which a corporation is a good idea. If it makes sense for you, set yourself up for 2023 by transferring assets to a corporation before year-end. Speak to a tax pro about it.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca