CESTNICK

TAX MATTERS

Defer a tax bill to the future to reduce the burden

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If only paying less tax was as easy as writing the Canada Revenue Agency a letter similar to the one written by the character Snoopy to the taxman: "Dear CRA, I am writing you to cancel my subscription. Please remove my name from your mailing list." Chances are pretty good that the taxman is going to ignore the request.

And so, we're left to find other ways to reduce our tax burden. I've been writing about the five pillars of tax planning: deducting, deferring, dividing, disguising and dodging. Today, I want to talk about deferring taxes.

Pushing a tax liability to a future year is the same as putting money in your pocket because you'll have use of those dollars until you have to pay the tax. Here are some ideas to consider.

Contribute to an RRSP. Making a contribution to a registered retirement savings plan is the easiest way for most Canadian residents to defer tax. You'll get a tax deduction for contributions within your contribution limit and won't face tax until you make withdrawals later. You have until March 1, 2023, to make contributions that you can deduct on your 2022 tax return. Check your Notice of Assessment for 2021 for the amount you can contribute.

Contribute to an IPP. An Individual Pension Plan is simply a registered pension plan that is set up for one executive, or perhaps a few employees. If you own a business, your company can sponsor an IPP and make deductible contributions to the plan for you and family members in the business. You won't face tax on the amounts in the IPP until benefits are paid out in retirement. Depending on your age, contributions to an IPP can be even higher than RRSP contributions.

Minimize RRIF withdrawals. If your RRSP matures and you set up a registered retirement income fund (RRIF), you'll be required to make withdrawals from the RRIF annually. The required yearly withdrawal is based on your age on Jan. 1 of that year; the younger you are, the lower the required withdrawals. If you're married, you're able to base your withdrawals on the age of the younger spouse, which will potentially allow you to leave more assets in the RRIF longer, deferring the tax to a future year.

Consider funds that return capital. Some investments make distributions in the form of your original capital returned to you. When you receive a return of capital, there's no immediate taxation. Rather, the capital returned will reduce your adjusted cost base (ACB) and you'll pay tax on a capital gain later when you sell the investment, or after your original capital has been fully returned to you.

Watch your fixed-income maturity dates. You have to report interest income on an annual basis, whether you've received it or not. But the maturity date of an investment will dictate the first year you'll have to report income. If, for example, you invest in a government bond in January, 2023, and the maturity date is in January, 2024, you won't have to report interest income until the 2024 tax year.

Consider a leave of absence or sabbatical. It's possible to have up to one-third of your salary set aside each year for a future leave or sabbatical, through a deferred-salary leave plan. You won't face tax on the portion of your salary set aside, although your leave must begin no later than six years after the deferral begins. There are other rules that apply but consider speaking to your employer about this type of plan.

Consider an estate freeze. An estate freeze allows you to "freeze" the value of certain assets you own today so that the future growth will not be taxed in your hands. That future growth typically accrues to your kids, or more likely a family trust, which you can control. A freeze can defer tax for a generation or more and doesn't require you to give up control over the frozen assets.

Incorporate your business. If your business has grown in size and profitability, you should consider incorporating. A Canadian-controlled private corporation is eligible for a reduced combined federal and provincial tax rate on the first $500,000 of active business income – about 11 per cent on average across the country. This is lower than the rate you'll pay personally. The tax will catch up to you when you pay the income to yourself out of the corporation, but you'll enjoy a deferral of tax as long as you leave the after-tax earnings in the company.

Next time, I'll write about the third pillar of tax planning: dividing to save tax.

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