CESTNICK

TAX MATTERS

Dodge the taxman with tax-free sources of income

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I've been writing about the five pillars of tax planning over the last few weeks. This week I want to talk about the fifth pillar: "Dodging" to save tax. Don't worry – it's not illegal. I'm talking about structuring your affairs so that certain types of income won't be taxable to you at all.

As I was thinking about this concept of "dodging," I couldn't help but recall the movie Dodgeball where a character said "Remember the five Ds of dodgeball: Dodge, duck, dip, dive and dodge." As uncanny as it might seem, the five Ds in tax planning are pretty similar concepts: Deduct, defer, divide, disguise and dodge. Now, let's look at ways to "dodge" taxes.

Use a tax-free FHSA. First-time homebuyers will be able to open a Tax-Free First Home Savings Account (FHSA) starting this year. Talk to your financial institution about when they'll be available – it should be very soon. The FHSA allows a first-time homebuyer (someone who, along with their current spouse, hasn't owned a home in the year the FHSA is opened, or in the preceding four years) the ability to contribute $8,000 annually to an FHSA, up to a limit of $40,000 in a lifetime. The contributions are deductible, and you won't face tax on any growth or income in the plan, or on withdrawals as long as the money is put toward a home purchase. It's a great deal. See my article from Aug. 25, 2022, for more tips.

Negotiate non-taxable benefits. Although benefits provided by your employer are generally treated as taxable, certain ones could be tax-free. These benefits can include some education costs, costs of counselling, certain membership fees to social or athletic clubs, relocation expenses, a portion of cellphone service costs, employer-provided daycare, gifts and awards ($500 or less per year), parking costs (in some cases), and loans from your employer, or interest subsidies (i.e. your employer could arrange for a mortgage or financing for you and could make payments to the lender for part of your interest costs). For these last two benefits, there will be no taxable benefit as long as the interest cost you pay personally remains at or above the prescribed rate under our tax law (currently 4 per cent).

Ask for a tax-free death benefit. It's possible for your employer to pay up to $10,000 in tax-free cash to your surviving beneficiary at the time of your

demise. As long as the payment is made after your death in recognition of your service as an employee, then the payments can be tax-free.

Invest in a tax-exempt life insurance policy. Our tax law will allow you to accumulate investments inside a life insurance policy, similar to a tax-free savings account. For each dollar you pay in premiums on the policy, a portion goes to cover the mortality charge – that is, the cost of insuring your life – but part of the premium can go into a growing pool of investments. You won't face tax on the income earned in the policy, and the accumulating funds will be paid out tax-free upon your death. The policies that allow this type of accumulation are "whole life" or "universal life" insurance policies. Term insurance policies (the cheapest insurance available) won't allow for accumulating investments inside the policy.

Use a second will to avoid probate fees. Probate fees are levied by many provinces and territories and are, by any other name, a tax. These fees apply when you pass away and are generally calculated as a percentage of your assets that pass through your will. You may be able to avoid probate on certain assets that don't require probate by using a second, separate, will to deal with those assets, and using a primary will to deal with everything else you own. Private company shares are an example of an asset that can have a high value and could be passed to your heirs by a separate will that doesn't have to go through probate. Speak to a lawyer in your province or territory about this type of planning.

Extract funds from your corporation tax-free. If you own a corporation there may be ways to withdraw amounts from it without paying tax. Consider taking a repayment of shareholder loans owed to you by your company, borrowing from the corporation in certain situations, paying yourself capital dividends, or withdrawing paid-up capital from your company (speak to a tax pro about these ideas.) These moves are all potentially tax-free. You might also consider having your company pay you rent for office space in your home that's used for corporate business. You'll have to report these rents as income, but you may have enough expenses to fully offset this income, making it effectively a tax-free withdrawal from your company.

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