THE GLOBE AND MAIL

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TAX MATTERS

# Five ways to create financial certainty in uncertain times

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED AUGUST 26, 2026

When I get up in the morning, I'm genuinely at a loss as to what I should wear. I've heard that behind every man who thinks he wears the pants in the family is a woman who tells him what pants to wear. That sounds right to me.

Being uncertain about which pants I should wear with which shirt is a type of uncertainty I can deal with. Today, Canadians are dealing with a different type of confusion. I'm talking about the financial uncertainty that comes with the breakdown in Canada-U.S. trade talks.

## The uncertainty

As you probably know, Canada's trade relationship with the United States took another tough turn last week when negotiations broke down at the eleventh hour. Canada suspended the talks, the U.S. imposed 50-per-cent tariffs on about $28-billion of Canadian goods, and now Canada has announced retaliatory tariffs to take effect Sept. 8.

As the trade war heats up, are U.S. stocks and bonds in your sights?

Where does it go from here? Only time will tell. That uncertainty matters. A business owner considering a new plant, equipment or additional employees might decide to wait. Companies that don't know what their costs or access to the U.S. market will look like six months from now have good reason to be cautious. And let's not forget about consumers who might worry about their jobs or the economy and so postpone major purchases.

The problem with uncertainty is that doing nothing can feel like the safest choice, but the end result is a weak economy. Uncertainty is expensive. Certainty has value.

## The certainty

So, let's talk about something more certain. You can create guaranteed, predictable financial benefits by focusing on saving taxes. You don't have to predict interest rates, the direction of equities or the outcome of trade negotiations. You simply have to understand the tax rules and use them to your advantage.

Over the years, I've described the five pillars of tax planning: deducting, deferring, dividing, disguising and dodging. Every tax idea you might dream up falls under one of these pillars.

Deducting means claiming legitimate deductions and credits to reduce taxable income and taxes. Things such as RRSP contributions, business expenses or deductible interest, for example, can save you thousands.

Deferring means paying tax later rather than today. Registered retirement savings plans do this, as can corporations; there's also the option to defer realizing capital gains. Money that would otherwise have gone to the taxman can remain invested and growing.

Dividing means moving income, where the rules allow, from a higher-income family member to someone in a lower tax bracket. Pension splitting and prescribed-rate loans are examples.

Disguising sounds suspicious, but it's not. It means converting income from one type to another that attracts less tax – turning fully taxable interest income into capital gains, for example.

Dodging means legitimately avoiding tax altogether. Think tax-free savings accounts, the principal-residence exemption, the lifetime capital-gains exemption and certain charitable-giving strategies. This is tax avoidance, not tax evasion. There's an important difference.

Each pillar attacks the tax bill differently, but the objective is the same: leaving more dollars in your hands to spend, invest, give away or eventually leave to your family.

## The impact

Do these five pillars really make much of a difference? Consider some examples:

- **Save and compound.** Save $10,000 of tax each year through deductions and credits and invest those savings at 6 per cent annually before taxes in a balanced portfolio. After 10 years, you'll have about $134,600 (assuming the highest tax bracket in Ontario), or after 20 years, about $318,400. Small annual savings become serious money over time.
- **Defer the bill.** Suppose you can defer $100,000 of tax for 10 years and keep that money invested at 6 per cent. It will grow by about $79,000 during that period. You may still owe the original tax eventually, but you've enjoyed the growth on the money in the meantime.
- **Divide the income.** If you're able to split income and shift $20,000 of earnings from a family member with a marginal tax rate of 50 per cent to another paying 20 per cent, the family saves $6,000 annually. Invest those savings and the benefit compounds further.
- **Change the character.** Suppose you invest $100,000 for 20 years at 5 per cent. If the return is interest and you're taxed annually at Ontario's top rate, you'll finish with about $158,300. If the return instead comes entirely as capital gains realized after 20 years, you'll have about $221,100 after tax – about 40 per cent more.

None of these strategies require you to predict what's going to happen with our economy in the future, or to guess when Canada-U.S. trade talks will start again, or how they'll play out. As year-end approaches, I'll share more ideas on how to put guaranteed, predictable money back in your pocket. A little certainty in an uncertain time is a good thing.

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