Tax planning…don't wait until it's too late!

Managing Your Money

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I'm talking about 2024…because unfortunately, it's already too late for 2023. While 2023 tax preparation may still be underway, any tax planning opportunities for 2023 ended December 31, 2023 – except the RRSP contribution which ended February 29, 2024.

Generally, tax planning can be far more successful if started early in the year, or even several years ahead, hence why NOW is a great time to start. I'll assume most readers are already doing "basic" tax planning, so in this article I'll focus on "intermediate" tax planning strategies. These should always be discussed with your accountant or financial professional to ensure they make sense for your particular situation.

Capital Gains Deferral: As investment positions increase during the year, many investors like to take the opportunity to trim positions as a way of rebalancing their portfolio. If there is a large capital gain on the position, this may discourage them from doing this prudent, risk-reducing rebalancing. Using a Capital Gains Deferral strategy, investors can exchange shares of an individual investment position for a diversified fund position without triggering the capital gain, ultimately reducing risk and deferring the tax consequence. Not all firms are set up to implement this strategy; speak with your advisor to see if it makes sense for you.

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Deductible Debt: As interest rates have climbed, this strategy has become even more attractive. Most debts, unless used in a business context, are not tax deductible. However, a debt that is used for the purpose of investment is tax deductible. Swapping non-deductible debt for deductible debt can turn non-deductible interest into deductible interest! Whether this makes sense for you will depend on your tax rate, where you have accessible funds, and how they are currently invested, or not invested. There are tax rules around using this strategy to ensure that your interest will be deductible so talk to your tax or financial professional to determine if it could work for you.

Income Splitting: As much as you love them, you can't just gift money as you wish to your spouse or children to invest. The government sees this as a way of avoiding taxes on the income or gains by putting it in the hands of lower-income family members. However, there are several approved ways of income splitting with a spouse or minor children that can reduce taxes. Aside from the basic ones like pension splitting, there are strategies such as Prescribed Rate Loans, and investment of second-generation income, also known as "income on income", which allow the shifting of assets to a lower-income spouse or child without the dreaded attribution rules kicking in. Fair warning: know the rules so that this strategy doesn't backfire on you.

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Incorporation: Many professionals and self-employed workers consider the option of incorporation to lower their taxes. This can be a great strategy with many benefits IF certain things hold true. Corporate tax rates in Canada are lower than personal tax rates. They are also more complex, so it's not always a straightforward decision of whether or not you should incorporate. For example, incorporation for tax purposes only makes sense if a large portion of income is going to remain in the corporation. If most of the income is pulled out of the corporation to live on, it will be taxable at regular personal tax rates, and this defeats the whole purpose of doing it. Run the numbers with your tax or financial professional before jumping in, especially if the main goal is tax savings.

There are also added costs to consider. Business owners, professionals, and self-employed workers who are considering incorporation should be aware of the legal and accounting charges involved with setting up a corporation: shareholder agreements, articles of incorporation, annual financial statements and reports, and filing tax returns are just some of the costs involved.

I'll take this opportunity to mention two "basic" tax strategies because I very often see them being missed. These are not going to save you bundles, but like they say, "every little bit counts!"

The first is for retirees who don't need all their RRIF income but are forced to take it out and pay taxes on

it anyway. You can use a younger spouse's age to calculate the payment amounts which lessens the amount you are forced to take out, and in turn, lessens the taxes. You would be surprised how many industry professionals aren't even aware of this rule.

The second is for those, often retirees, who move money from a non-registered account to their TFSA for their annual TFSA contribution. If you have any capital losses in your non-registered portfolio, instead of simply waiting for the investment to "bounce back up", it's an opportunity to trigger the loss and buy a similar investment (not the same one or your tax loss will be denied) in your TFSA. This way, when the investment "bounces back up", the gain will be sheltered from taxes.

There are lots of big and little tax strategies that I see getting missed. Investments and taxes are complex and are continuously changing and updating. While the specific details and rules of the above-mentioned strategies are out of the scope of this article, it's good to know that they exist.

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As we move through different stages of our lives, new strategies may apply while old ones are dropped. Tax planning and tax preparation are two very different things – but both are very important. Tax planning requires strategic knowledge and regular review. Some tax planning strategies, particularly intermediate and advanced strategies, may not be appropriate because they involve more complexities or increased risk tolerance. Ask your financial professionals which tax strategies could apply to you!

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