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TAX LETTER

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SOME END-OF-YEAR TAX CONSIDERATIONS

With the end of the year fast approaching, the window for taking steps to claim certain deductions, and for planning to minimize your 2023 tax liability, is closing.

There are several things that can be done before January 1 to help control your ultimate tax payment, or maximize your tax refund, in April 2024. Below are some of the more common planning considerations which are relevant at this time of year.

Tax loss harvesting

If you have realized capital gains in 2023, one common way to mitigate the associated tax liability is tax loss harvesting. Essentially, this consists of selling investments with accrued losses to offset the taxable gains.

For example, if you sold a capital asset in 2023 and realized a gain of $10,000, one half of that gain would be included in your income and subject to tax. If you also had, say, portfolio investments sitting with an accrued loss of $10,000, you could sell those investments in 2023 and realize that loss.

Capital losses are automatically set off against capital gains in the same year, so the “taxable capital gain” of $10,000 would be wiped out by the “allowable capital loss” of $10,000. Thus, no tax liability would arise in respect of the gain.

The concept is fairly simple, but there are a few important timing points to be aware of.

First, any loss needs to happen in 2023, meaning that the underlying shares need to be actually sold in 2023. For publicly traded shares in Canada, “settlement” of a trade is normally 2 business days after the trade, and December 30-31 are on the weekend this year. Therefore, you likely have to complete the sale by December 27, 2023. (Certain securities can settle in 1 business day; check with your broker.)

(If you don’t complete the sale until 2024, you still may be able to carry back half of the loss (a “net capital loss”) to 2023 to offset against the taxable capital gain, but only when you file your 2024 return in spring 2025.)

Secondly, the "superficial loss rules" in the Income Tax Act, prevent you from realizing a loss on the sale of an asset, if you, or someone "affiliated" with you (most commonly your spouse or a company you or your spouse control) buys the same or identical property in the period beginning 30 days before the sale and ending 30 days after the sale.

If this is the case, and that person still holds the property 30 days after the sale, the capital loss will be denied. Instead, the cost of the acquired identical property will be increased, meaning that the loss will only be taken into account when the acquired property is sold in the future.

Capital losses are first offset against capital gains arising in the same year. Any excess losses can be carried forward to future years or can be carried back to any of the previous three tax years, but still only against capital gains. Therefore, you may be able to obtain a refund for some tax already paid. They cannot be used against other kinds of income.

Also, if you have capital gains and your spouse has assets sitting at a loss (or vice versa), it is possible in certain circumstances to transfer the assets with an accrued loss to the other spouse to sell and offset their gain. This takes some planning and you should consult with your advisor before taking such action.

Tax loss harvesting can be done by a company also. However, before doing so, it is worthwhile checking whether there is any balance in the company's capital dividend account (which can be paid out to shareholders tax-free) as any losses created would reduce this tax-free balance. It may be best to pay out capital dividends before triggering losses.

At this time of year, it may be worth speaking to your financial advisor to get an idea of the capital gains you have triggered in 2023, as well as an indication of any potential assets which may be suitable to sell to create a capital loss to offset those gains.

Timing of income and expenses

Towards the end of the year, it is often possible to delay certain events until the next year, or to bring those events forward. Depending on your anticipated tax liability for 2023, doing one of these may be beneficial.

For example, if you are due to sell a capital asset, it may be beneficial to delay the sale until the new year if this is practicable. By doing so, any capital gain would arise in 2024, and tax wouldn't be due until April 2025, giving you a whole extra year of the benefit of the money used to eventually pay the tax.

Similarly, it may be beneficial to incur certain expenses before the year-end, if these expenses can be deducted from your 2023 income. Doing so can reduce your 2023 tax liability.

Outlays such as medical expenses, charitable donations, political contributions, student loan interest, childcare expenses and professional dues are all eligible for either a tax credit or an outright deduction, subject to various rules.

Charitable donations

Any donations made to registered charities by December 31, 2023 should be eligible for a charitable donations tax credit, which will reduce your 2023 tax liability.

The federal credit is equal to 15% of the first $200 donated for the year, plus 29% of all donations above this level (33% if you are in the highest tax bracket). There are similar provincial credits available too. A helpful credit calculator can be found here.

The value of donations in respect of which you can claim a credit is limited to 75% of your "net income" for the year. (Net income is a defined amount, calculated after certain deductions, but before others that are allowed in computing "taxable income".) Any donations not claimed can be carried forward and claimed in any of the following 5 years.

Charitable donations made by a couple can be claimed by either spouse, and tax return software will usually automatically calculate the most beneficial allocation between spouses to maximize the benefit received.

As well as donating money, you can also donate shares to charity. This is actually a very tax-efficient method of donating if the shares are publicly-traded shares with accrued gains. The main reason for this is that, although you are disposing of the shares, you do not have to pay tax on the gains.

You also maximize your tax credit through a direct share donation because you are donating the entire value of the shares. If you instead sold the shares and donated the after-tax proceeds, the amount donated (and the credit) would be less due to having to pay tax on the gain.

The value of the donation eligible for the tax credit is the market value of the shares at the time of the donation.

For both cash and share donations, the charity must be a "qualifying donee" in order for any donation to qualify for the tax credit, and you must ensure that you receive a donation receipt, and that you keep this for at least six years, in case the CRA ask to see proof of the donation.

The CRA provides a searchable database of qualifying donees here.

RRSP/TFSA considerations

A Registered Retirement Savings Plan (RRSP) is one of the most tax-efficient investment products available. Not only can you claim a tax deduction for amounts contributed, but any gains arising on investments held within an RRSP are not taxed until they are withdrawn (which can be staggered to take advantage of available tax brackets each year).

Generally, your available contribution room for 2023 is 18% of your "earned income" (a defined term) for 2022, to a maximum of $30,780 (adjusted for inflation each year), plus all unused contribution room from earlier years.

If you have a registered pension plan or a deferred profit sharing plan, be careful as these usually reduce your RRSP contribution room. You can check your available contribution room on CRA's My Account for Individuals, or on your 2022 Notice of Assessment.

One advantage of RRSP contributions, in terms of year-end planning, is that contributions made by February 29, 2024 can be used to reduce your tax for 2023. Therefore, it is possible to calculate your tax liability early in 2024 and make RRSP contributions accordingly. Note that the deadline is usually March 1, but since 2024 is a leap year, it is February 29!

If part of your income falls into a high tax bracket this year, it may be possible to make strategic RRSP contributions to prevent tax from applying at high-taxed rate, while saving some contribution room for future year high tax bracket income.

For example, if an Ontario resident's taxable income was $110,000 for 2023, an RRSP contribution of $1,000 would save them $434 in tax, whereas if their taxable income was $100,000, the same contribution would only save them $339 in tax, as their final $1,000 of income is taxed at a lower rate.

One exception to the February 29, 2024 contribution deadline is if you turn 71 in 2023. In this case, you can only contribute up to December 31, and you must close your RRSP by the end of the year (usually by using the balance to purchase an annuity or transferring it into a Registered Retirement Income Fund, which is like an RRSP but takes no new contributions and requires a certain amount to be paid out and taxed every year.)

One other major advantage of contributing to an RRSP is that spouses can use this to split their income. For example, a high earning individual can establish a second RRSP in their spouse's name and make contributions to it (provided the contributing spouse has contribution room).

Although the individual contributes to the spousal RRSP, it is their spouse who is entitled to the funds when withdrawn. Therefore, this allows both spouses to benefit from the use of their marginal tax brackets when withdrawing funds later in life. Note however that any withdrawals in the same year spousal contributions are made, or within the next two calendar years, will be attributed back and taxed in the hands of the contributing spouse (to the extent of those contributions).

Tax-Free Savings Accounts (TFSA) are not as beneficial from a tax-planning perspective as there is no deduction available for contributions. However, a TFSA is still a highly tax-efficient tool because investment earnings in a TFSA are not taxed at all (even when withdrawn).

Similar to RRSPs, it is possible for spouses to use TFSAs to split their income. Specifically, an individual can gift money to their spouse to contribute to their TFSA without any income or gains in the TFSA attributing back to the contributor. However, care must be taken when the spouse eventually withdraws from their TFSA – if they reinvest the withdrawn funds, income or gains on THOSE investments may be attributed back to the contributing spouse.

The maximum amount you can contribute to a TFSA in 2023 is $6,500 plus any unused contribution room from previous years. If you were born before 1992 and have never contributed to a TFSA, you have $88,000 of contribution room in 2023. There are strict penalties for over-contributions (1% per month of the over-contribution), so care must be taken to correctly calculate your contribution room.

You can generally withdraw amounts in your TFSA at any time without paying tax. If you withdraw an amount from your TFSA, you get that contribution room back, but not until the following January 1st, so be very cautious about withdrawing and recontributing funds.

Salary vs dividends from company

If you have a corporation, the end of the year is a good time to meet with your professional advisor to determine how best to pay yourself from the company.

For example, the company can pay you a salary or bonus (which is deductible to the company and creates RRSP contribution room), dividends (which are taxed at a lower rate than salary but are not deductible to the company and don't create RRSP contribution room) or a mixture of both, depending upon your circumstances.

Some important considerations in this regard include: Has the company realized any capital gains in the year (half of which can be paid out to you tax-free as a capital dividend)? Do you already max out your RRSP contribution room by paying the maximum amount each year? Does the company's income exceed the small business deduction limit of $500,000?

Income splitting with family

If you have family members who either provide services to your company, or are shareholders of the company, consider whether the company can pay amounts out to them by the end of the year to take advantage of any of their lower tax brackets which would otherwise not be used in the year.

This type of planning has been made extraordinarily difficult in recent years due to the introduction of the TOSI (tax on split income) rules, but may still be possible with correct professional advice.

For example, if a spouse or child has done some work for the company during the year, consider what the fair market value of that work is.

Provided that any salary paid for that work is reasonable given the person's contribution, it should be possible to pay out that salary without any negative implications.

Similarly, if family members are shareholders of the company, the company may consider paying dividends to those shareholders. As with paying a salary to family members, any dividend must be reasonable based on the shareholder's contribution to the business; but you need to carefully analyse the TOSI rule in such a case.

Professional advice should always be sought before making payments to family members, either personally or from a company.

Upcoming business transfer?

Unique to the 2023 year-end, if you are thinking about passing all or part of a business to the next generation in the near future, consider whether it may be worth accelerating this business transition.

Current rules allow you, in certain circumstances, to transfer shares to an adult child and claim the benefit of your lifetime capital gains exemption (LCGE) without giving up outright control of the business. This could mean close to $1 million of value of any shares transferred being tax-free in your hands.

This is still available after 2023, but the rules are changing in 2024, significantly restricting the availability of the LCGE when passing on a business to a child.

Time is quickly running out to transfer shares under the current rules. The planning required is complex and time-consuming. Consult with your advisor as soon as possible if you think this planning may be possible for you.

More details on this planning, and the upcoming changes, were discussed in the July 2023 Tax Letter.

UNDERUSED HOUSING TAX PENALTIES NOW APPLICABLE

From November 1, 2023, penalties for late filing of Underused Housing Tax (UHT) returns come into effect. These penalties apply from the UHT return due in 2023 onwards.

As discussed in our April 2023's Tax Letter, the UHT regime was introduced last year to try to combat the underuse of residential property, particularly property owned by non-residents.

The regime imposes an annual tax of **1% of the relevant property's value.** There is also an annual reporting requirement, unless one or more exemptions are met. In some circumstances, there may be an obligation to file a return but no obligation to pay tax. **Filing is required for residential property owned by a corporation, partnership or trust even if no non-resident is involved, with severe penalties for non-filing!**

Liability is determined based on the ownership of the property at December 31 each year, with the filing and tax payment deadline being April 30 of the following year.

As 2023 is the first year of the new tax, the CRA extended the filing and tax deadline to October 31, 2023 to give people time to become aware of the regime and understand it. **However, there will be no further extensions.**

Generally, Canadian citizens and Permanent Residents are exempt from both the filing and tax requirements, provided that the property is registered in their name as an individual (and not, for example, as a trustee of a trust). However, property held by corporations, trusts and partnerships, as well as property held by non-residents, may be caught. The CRA provides a self-assessment tool to check potential liability here.

Some individuals and entities caught may have only a filing requirement, as there are various tax payment exemptions which may apply. However, penalties still apply for late filing, even if there is no tax liability.

And the penalties are significant. For individuals, the minimum penalty for late filing is $5,000. For corporations, the minimum penalty is $10,000. Penalties may be higher depending on the value of the property and the length of time that the return remains unfiled after the filing deadline. Interest may also be due on any unpaid tax liability.

To potentially compound the penalty impact, a return is required for **each property owned** and a return is required by **each owner** if a property is owned by more than one person.

Relief from penalties and interest may be available under the taxpayer relief regime (see our October 2023 Tax Letter for an explanation of this).

If you suspect that a property owned by you (or a company, partnership or trust that you are connected with) may be caught by the UHT rules, seek professional advice immediately.

EXTENSION OF DEADLINES FOR CEBA LOAN REPAYMENT

The Government recently extended the deadlines for repayment of outstanding Canada Emergency Business Account loans. These loans were made available to businesses to help them to continue operating during the COVID-19 pandemic.

The maximum loan available was $60,000 and the loans were partially forgivable (up to 1/3 of the loan amount advanced) provided that the non-forgivable portion was repaid by a certain deadline. The original deadline was December 31, 2022; this has now been extended to January 18, **2024**. The deadline is extended further, to April 30, 2024, if the business applies for refinancing in order to repay the non-forgivable portion by that date.

If the non-forgivable portion is not paid by the deadline, **the forgivable element is lost**, and the full amount still outstanding is automatically converted to a 3-year term loan, with interest charged at a rate of 5%. Therefore, the deadline for full repayment of the loan is now **December 31, 2026.**

There is expected to be a high demand for refinancing between now and March 2024 in order for businesses to ensure they benefit from the forgivable amount (which could be as much as $20,000). Therefore, anyone wishing to pursue this option should contact their original CEBA lender as soon as possible to start their application.

Various business organizations continue to call for further extensions to the above deadlines, so anyone affected should keep up to date with news reports on the matter.

CHANGE TO CORPORATE PAPER FILING LIMIT

Although the majority of businesses file tax information slips (such as T4s and T4As) electronically, there are still many, particularly small businesses, which file them on paper. From January 1, 2024, the number of businesses that can continue to file on paper has been narrowed.

Currently, businesses filing 50 or fewer information returns per year are allowed to file them on paper. All other businesses must file electronically.

From January 1, 2024 only businesses that file **5 or fewer slips** will still be permitted to file on paper. This means that only the smallest of businesses will still be able to do so.

Penalties for paper filing more returns than is permitted are relatively minor. For example, a corporation that qualifies to paper-file under the current rules but will not qualify under the new rules will suffer a **$125 penalty** if they continue to paper-file after 2023. However, particularly for the small businesses affected by this change, even minor penalties can be a significant unwanted expense.

The full CRA communication, with further details on how to file electronically, can be found here.

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.

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