The TaxLetter®

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YEAR-END TAXTIPS

Here are some quick and easy deductions to help…

Trim your bill

Samantha Prasad LL.B.

The holidays are officially here, and in the seasonal spirit of giving, I've prepared some quick and easy deductions to help cut your tax bill.

In addition to well-known tax-saving tips, I'll also serve up a few lesser-known year-end strategies that will benefit higher-net-worth investors, business-people, and executives.

Claim Interest on Disappearing Investments

If you have borrowed money for an investment (or even a business) that you may have sold for a loss, you're not likely to be too happy about the fact that you are still paying interest. Well, it's just possible that this interest may still be deductible.

Samantha Prasad, LL.B., is a tax partner with the Toronto-based law firm Minden Gross LLP, a member of Meritas Law Firms Worldwide, and a Contributing Editor of The TaxLetter, published by MPL Communications.
sprasad@mindengross.com

There are two (unhappy) exceptions to this, however:

- In the event you have managed to salvage some proceeds and the money is put to personal use rather than re-invested, the portion of your continuing interest charges relating to the personal-use investment won't be deductible.
- If the investment you made was in real estate – but it's important to note that you will lose the deductibility only if the real estate is "directly held." In other words, the interest charges should continue to be deductible if (for example) the real estate was held in a partnership or a company.

A case can also be made for continuing interest deductions for real estate if you have managed to salvage some proceeds from the investment and then re-invested in the same type of property.

Investment carrying charges

Most investment-related carrying and financial service charges are deductible if they are related to earning income (i.e., investment counsel and safety-deposit box charges).

Check your bank statements for investment or business-related service charges, such as certification or overdraft charges, or fees for new chequebooks for your investments.

Also, make sure you've picked up all expenses on your brokerage statements, e.g., interest on margin accounts or late payments on stock purchases.

Although brokerage fees themselves are not immediately deductible, they reduce your capital gains exposure when you sell.

Another possibility: interest which becomes payable in 2013 on an investment or business loan. This holds true even if you can't make the actual payments, but regularly deduct interest in the year it becomes payable.

Get your GST/HST Back

If you're allowed to deduct employment expenses (like an automobile or home office), you can claim a rebate to recover the GST/HST included in the price of goods and services on which you have claimed a deduction.

A similar rebate applies if you earn income from a partnership registered for GST/HST. In both cases, you can recover the GST/HST you pay on expenses you deduct personally by filing Form GST 370, Employee and Partner Goods and Services Tax Rebate, with your T1 return.

Objection expenses

You can also deduct legal fees paid for advice to object to (or appeal) an assessment under the Income Tax Act, the Unemployment Insurance Act, the Canada Pension Plan or the Quebec Pension Plan, plus any related accounting fees (net of any award or reimbursements for such expenses).

Taxable benefits on interest-subsidized loan

If a taxable benefit has been added to your T4 as a result of an interest-subsidized loan from your employer, you may be able to claim an offsetting deduction if the funds were used for income-earning purposes. For example, if you are a member of an employee share-purchase plan.

Tax return preparation fees

If you pay to have your tax return prepared and part of the fee relates to accounting charges for detailing your investment or business income, this portion of the fee should be deductible. Ask your accountant to send you a separate bill for these charges to back up the deduction.

Capital Gain Reserves

If you have sold assets in 2013 and realized a capital gain, you may be able (in some cases) to claim a capital gains reserve to defer recognition of that capital gain for tax purposes.

You can claim a reserve if you sell a property but do not receive all of the proceeds right away. An example of this would be selling appreciated shares and taking back a promissory note as consideration.

Under the reserve rules, you need only recognize one-fifth of the gain in the current and each later year (cumulatively). The result: the entire capital gain will be accounted for by the fourth year after the year of sale.

If you are not able to claim a reserve due to receiving all of the proceeds immediately on the sale, look to see if you have a capital loss carryforward balance from previous years that can offset your capital gain.

Have your kids report capital gains

Since you may be footing the bill for school, it only seems right that your kids should foot the bill for capital gains.

If an investment is owned by your kids, the gain can be reported on their tax return. This could dramatically slash, or even eliminate, the tax bite. How so? With the basic personal credits, a child or grandchild with no other income can make over $22,000 a year in capital gains – per child, that is – free of federal tax.

And even if the gain exceeds this amount, your kid is in the lowest tax bracket where the tax rate is only about half of what a high-income earner would pay.

(Note: in most cases, the funding parent must normally pay tax on interest and dividends generated by the investment until the year the child turns 18 due to the attribution rules; however, if the investment does not generate much income, then this becomes less of an issue.)

People will sometimes hold an investment for their kids, perhaps as a gift for them, but it is registered in the name of the adult. This isn't necessarily a showstopper. For one thing, if the account is registered in your name "in trust," this may show that it is really for your kids.

Another possibility is to visit a tax advisor to discuss the possibility of documenting the fact that the investment is for your kids – for example, by filling out a legal declaration of trust.

File a Tax Return

Many new businesses experience start-up losses in the first few years of their existence.

Still, you should file a return for each year. That's because your business's loss can be used to reduce income from other sources in the current year, or it can be carried back three years and forward twenty years. And that income can be from any source – be it the business itself, from employment or even from investment income.

But to claim the loss, you must file a tax return for the year.

The year-end for an individual who is a sole proprietor or an active partner in a partnership created since 1995 is December 31. Self-employed taxpayers and their spouses (if not separated) have until June 15 to file a return, although any taxes owing must be paid by April 30.

Lower Your Tax Instalments

If you pay taxes on an instalment basis, you've probably received several notices from CanRev informing you how much those instalments should be. But if your income has gone down in the last few years, think twice before you send in your cheque.

CanRev's instalment calculations are based partly on your income tax position from two years ago, and partly on last year's.

Instead of using CanRev's method, you are legally entitled to base your instalments on last year's tax position, or even on the current year's estimated position, if it is lower.

But be careful with the latter: penalties may apply if you underestimate your taxes and your instalments turn out to be lower than what the other two options required.

If your income has gone down in the last couple of years, using one of the other two options can mean that you could reduce your quarterly instalments without suffering interest penalties. But if you under-install, CanRev will start to charge you interest; the current rate is five per cent.

However, this rate is compounded daily – and worse still, it's non-deductible. So this is an expensive way to enhance your cash position. For seriously delinquent instalments, there is a 50 per cent interest surcharge slapped on.

If, during the year, it becomes apparent that you have paid more instalments than necessary, you might consider deliberately not following the instalment schedule by paying deficient or late instalments. This, in fact, is quite "legal."

By the way, if you've over-installed or have paid early, CanRev gives you what's known as an "offset" or "contra-interest" credit.

Basically, the rule works as if you had deposited the instalment in a bank account and earned interest (at CanRev's prescribed rates – currently three per cent for individuals and one per cent for businesses).

This credit can then be applied against interest penalties on deficient or late instalments.

The flip side of this, of course, is that you can reduce interest charges on a late or deficient tax instalment by overpaying other instalments, or paying them before their due date. ❒