The TaxLetter®

Vol. 29, No. 11 Your Guide to Tax-Saving Strategies November 2011

TAXPLANNING

Want to get in good shape for the year end? Plan early and…

Trim your tax bill

Samantha Prasad LL.B.

It has become something of a tradition for me to write about year-end tax tips right about now.

I know it might be a little too soon for most of you to think about tax planning just yet, but it's never too early to focus your mind towards the December 31 deadline.

Good intentions are never as effective as actual implementation. So read on and see how you might be able to trim your 2011 tax bill.

Allowable Business Investment Losses (ABILs)

While capital losses can only be used to reduce capital gains, 50 per cent of an ABIL can be used to reduce all types of income. Therefore, if you're a shareholder or creditor of an unsuccessful private corporation, consider selling your shares or debt by year end.

To claim an ABIL, the investment must be in a private Canadian corporation. The general rule is that, at the time of the loss sale, the company must have been a "small business corporation" – CanRev requires that 90 per cent or more (in value) of the company's assets must be used principally in an active business carried on primarily in Canada. One final restriction: the loss reverts to an ordinary capital loss to the extent that you have claimed the capital gains exemption in a previous year.

To claim an ABIL, the sale must be to a person who is "at arm's length" to you. This excludes persons who are related to you for tax purposes, including a spouse, child/grandchild, sibling, or a controlled corporation.

There is also a factual test: it's possible that CanRev could say the purchaser does not deal at arm's length if you were the directing mind, or if you acted in concert with the purchaser. Accordingly, if a large loss is involved, care must be taken. (Alternatively, the loss may be available in situations where the company has gone out of business.)

And if you're wondering why I'm focusing on the technicalities, it's because sizeable ABIL claims are put under the microscope by CanRev. At the very least, you should expect them to review your claim. You will probably get a letter from the federal government asking you to back up the company's status as a "small business corporation," and the cost of your investment. So before you decide to claim an ABIL, make sure your ducks are in a row.

Income Splitting

Income splitting with low-bracket family members is always a good way to trim your tax bill. The following are some income splitting strategies which may be relevant at year-end:

✓ You can split income with low-bracket family members by making a loan to them (e.g., a spouse, common-law partner or a child under the age of 18) provided that CanRev's "prescribed rate" is charged on the loan (meaning the rate is adjusted quarterly – currently it is one per cent, so it's a great time to use

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

this strategy).

Interest must be paid within 30 days after the end of each year, otherwise, the "attribution rules" may apply and therefore that income will be taxed in your hands instead of your low-income family members. Don't forget to make sure that the interest payment is properly documented, e.g., by a cheque deposited to your account.

Occasionally you might want to purposely trigger the attribution rules. For example, if the investment is generating losses, the attribution rules may allow you to claim them on your return. In this case, a strategy may be to purposely miss the interest-payment deadline.However, if this is done even once, the "prescribed rate loan" exemption will no longer apply to investments made from that loan on a go-forward basis.

✓ The higher-bracket spouse should pay all household expenses (including the lower-bracket spouse's income tax), permitting the lower-bracket spouse to invest his or her income. The income earned on the investments will be taxed on the lower-bracket spouse's tax return – i.e., at a lower tax rate.

✓ Retired couples can split CPP benefits upon reaching age 60. Consider splitting CPP if one spouse/common-law partner has a significantly lower income to produce tax savings.

✓ Couples that are 65 or older can also pool their retirement pension income. In order to do so, both the recipient of the eligible pension income and the spouse must agree to the allocation in their tax returns for the year in question.

✓ If you have a family trust and you want to ensure that the low-tax rate beneficiaries are taxed on the income, it is necessary that the income be either paid or payable by the end of the calendar year.

If actual payments are not made, then promissory notes or other evidence that there is a legal obligation to pay should be put in place. If the funds are actually paid, make sure that they are paid to the actual beneficiaries, and deposited to their account.

Proper trust documentation such as trustee resolutions should also be in place reflecting that the income is being paid or payable to the particular beneficiaries.

Defer Tax on Interest

The Tax Act allows a deferral of tax on an interest-bearing investment for one year after its purchase, unless the interest is paid or credited to a taxpayer's account in the meantime.

For investments on which interest payments are deferred (e.g., payments that occur once or twice a year), it may make sense to make the purchase early in the new year, rather than late in the current year, since this means that at least a portion of the interest payments will be "kicked over" to the next year.

Claim reserves for capital gains

If you have sold assets in 2011 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.

How, you might ask? 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), so that 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 the fact that you received 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 – chances are that you might have unused capital losses what with the up and down of the market over the last few years.

So this year end, remember that an early start will help keep your tax bill trim! ❐