The TaxLetter®

Vol. 32, No. 12 Your Guide to Tax-Saving Strategies December 2014

TAXSTRATEGY

'Tis the season … for year-end tax planning
Ways to trim your tax bill

Tax, holidays

Samantha Prasad, LL.B.

THE HOLIDAY SEASON IS OFFIcially here, and with it comes one of my holiday traditions: sharing some of my year-end tax planning tips. While my holidays are also full of family time, Christmas trees and hiding presents from nosy little ones, it's still important to take time to ensure I'm doing all I can to reduce my tax bill before the new year. Here are some tips on how you too might be able to trim your tax bill for 2014 (and not just your Christmas tree).

Claim an Allowable Business Investment Loss

While capital losses can only be used to reduce capital gains, 50 per cent of an Allowable Business Investment Loss (or "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 the sale is closed (and done at a loss), the company must have been a "small business corporation"; Canada Revenue Agency requires that 90 per cent or more of the 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 should be to a person who is "at arm's length." This means you can't sell to persons who are related to you for tax purposes, including a spouse or common-law partner, child or grandchild, sibling, or a controlled corporation, for example. There is also a factual test: it is possible that Revenue Canada could say the purchaser does not deal at arm's length with you if you were the directing mind or 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 ABIL claims are generally put under the microscope by Revenue Canada. At the very least, you should expect a review of your claim by Revenue Canada. Normally, a questionnaire is sent to you, asking for details on the investment, as well as asking you to back up the company's status as a "small business corporation." So before you decide to claim an ABIL, make sure your ducks are all in a row.

Last Minute 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 that may be relevant at year-end.

1) You can split income with low-tax-bracket family members by making loans to them (e.g., a spouse, common-

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

law partner or a child under the age of 18), provided that Revenue Canada's "prescribed rate" is charged on the loan. The rate is adjusted quarterly; currently, it is still at the low level of one per cent. Interest must be paid within 30 days after the end of each year. Otherwise, the "attribution rules" may apply, with the result that the income is taxed in your hands. Make sure that the interest payment is properly documented; e.g., via 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.

2) 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.

3) Retired couples can split Canada Pension Plan benefits. If one spouse/common-law partner has a significantly lower income, consider splitting CPP benefits in order to produce tax savings.

4) Couples that are 65 years of age 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.

5) If you have a family trust and you want to ensure that the low-tax-rate beneficiaries are taxed on the income distributed from the trust, 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 in place. To the extent that funds are actually paid, ensure that they are paid to the actual beneficiaries and deposited to their accounts. Proper trust documentation should also be in place reflecting the income being paid or payable to the particular beneficiaries.

Defer Tax on Interest

The Income 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. Accordingly, 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 incurred in the year

If you have sold assets in 2014 and realized a capital gain, in some cases, you may be able to claim a capital gains reserve to defer recognition of that capital gain for tax purposes. How so? You can claim a reserve if you sell a property but do not receive all of the proceeds right away; for example, by selling shares that have appreciated and taking back a promissory note as consideration. Under the reserve rules, you need only recognize one-fifth of the gain in the current year and each later year (cumulatively). In that way, the entire capital gain will be accounted for by the fourth year after the year of sale. ❐