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TAXSTRATEGY

Tax Planning

Tips For Saving

Samantha Prasad LL.B.

In the tax world, December is usually a time for last-minute transactions and other tax-planning reorganizations to carry out before the clock strikes midnight on December 31. But I have to remind myself to take time out for the holidays and remember the season of gifting is upon us. So, what other gift can I give you other than a few last minute year-end tax tips?

Claim an Allowable Business Investment Loss (ABIL)

In last month's article, I chatted about losses and touched upon the unicorn of losses known as ABILS. I thought I would give you a bit more information for those of you that might be interested. As a reminder, 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 not be to a person who is not "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 CanRev 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).

Keep in mind that if the investment was made by way of a loan to a company that you control (or considered "related" to under the Income Tax Act), then that loan should be interest-bearing; otherwise the ABIL will not be an option.

And if you're wondering why I'm focusing on the technicalities, it's because ABIL claims are generally put under the microscope by CanRev. At the very least, you should expect a review of your claim by CanRev – a standard questionnaire is normally 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 in a row.

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

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 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 - the rate is adjusted quarterly (currently it is still at the low 1 per cent rate for the last quarter of 2021). 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., 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. Consider splitting CPP if one spouse/common-law partner has a significantly lower income to produce tax savings.

☛ Couples that are 65 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.

☛ 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 account. Proper trust documentation should also be in place reflecting the income being paid or payable to the particular beneficiaries.

☛ If you have a private corporation in which your family members are also shareholders (whether directly to through a family trust), pay them a dividend before December 31, 2021 to take advantage of their graduated tax rates. But be beware of the "tax on split income" rules that came into place a few years ago, which have severely limited the ability to pay tax-friendly dividends to family members in many instances if the family members are not active in the business (i.e. in the context of their involvement or contribution (whether financially, labour related or exposing them to risk) to the company). If you are unsure, speak to your tax advisor, or consider putting the family members on payroll and paying salary (but ensure that the salary is reasonable).

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.

Trigger losses before year end

If you are holding onto investments that are in a loss position, and you expect to have a capital gain for 2021 from other investments, consider whether now is the time to dump your "loser stock"; this can trigger a capital loss to offset any other capital gains in your portfolio. Even if you don't have current capital gains for 2021, your capital loss can be carried back three years to offset any previous capital gains.

Be kind and donate

If you expect to have other income for 2021, consider donating to a registered charity. Not only will you be spreading the wealth among those in need, you will also create a tax credit to offset against your other income. ❑