Tips for year-end tax planning

Consider Covid-19 benefits, tax-loss selling and more

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This year may require special consideration when it comes to tax planning given that many Canadians received Covid-19-related income support.

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"Individuals who are affected by Covid-19 may have received a number of specific benefits on which they may have to pay tax — and they may not have thought about it," said Jamie Golombek, managing director of tax and estate planning with CIBC Financial Planning and Advice, in an interview.

Golombek suggested clients consider their total tax liability on Covid-19 benefits received in 2020 and set aside money now to cover that cost.

In particular, some clients may be concerned about tax liability for the Canada Emergency Response Benefit (CERB). The benefit could total up to $14,000 for a taxpayer depending on eligibility, and the amount wasn't subject to tax at source.

Overall, CERB paid out more than $81.6 billion to nearly nine million Canadians from March to October. While most CERB recipients had incomes that fell within the lowest income tax bracket, some were high earners, according to Canada Revenue Agency (CRA) data.

"Depending on your tax bracket, you could actually owe a lot of money on that CERB at the end of the year" if you received the full amount, Golombek said.

Any taxed owed would depend on your client's marginal tax rate and total income for 2020.

That rate "could be as high as 54% for someone in Nova Scotia who was at the top tax bracket, who earned a substantial amount of income before being laid off, and then started collecting the CERB," Golombek said. "These are issues to think about."

While the newer Covid-19 benefits — the Canada Recovery Benefit, sickness benefit and caregiving benefit — are subject to 10% withholding tax, "that may not be enough, depending on your tax rate for 2020," he said.

Another year-end tax tip is to consider tax-loss selling.

"2020 was a difficult year if you owned energy stocks," Golombek said. "If you've got some losers … maybe you want to sell those before the end of the year, take that capital loss and apply it against other gains you had this year."

Alternatively, net capital losses can be carried back three calendar years or carried forward indefinitely.

For a loss to be immediately available for 2020 or one of the prior three years, the settlement must take place in 2020, Golombek said in a report detailing year-end tax tips. The trade date must be no later than Dec. 29, 2020, to complete settlement by Dec. 31.

Clients planning to repurchase a stock sold at a loss should also be aware of the superficial loss rules that apply when a security is sold at a loss and bought back within 30 days before or after the sale date.

The rules apply if the property is repurchased within 30 days and still held on the 30th day by the client or an affiliated person, Golombek said in the report.

"If you buy it back within 30 days — either you or your spouse, your corporation, or even an RRSP or a TFSA buys it back — that loss is superficial and therefore you cannot take advantage of it right away," he said when interviewed.

The capital loss would be added to the adjusted cost base of the repurchased stock, and any benefit of the capital loss would be obtained only when the repurchased stock is ultimately sold, the report said.

Clients who turned 71 in 2020 have only until year-end to make final contributions to their RRSPs before converting them to RRIFs or annuities.

"If you have any unused RRSP contribution room, you'll want to make sure you use that before Dec. 31," Golombek said. "You don't have that normal 60 days" at the beginning of the new year.

These clients may also want to consider an overcontribution in December to their RRSPs before conversion if they've earned income this year that will create contribution room for next year. The client would be subject to a penalty tax of 1% on the overcontribution (above the $2,000 permitted contribution limit) for December 2020, and new RRSP room would open up on Jan. 1, 2021.

"The penalty tax will cease in January 2021," Golombek said in the report. "You can then choose to deduct the overcontributed amount on your 2021 (or a future year's) return."

Another tip is to pay certain expenses by year-end, such as student loans. For qualifying student loans, students can claim a non-refundable tax credit in 2020 for the amount of interest paid by Dec. 31.

"While only the student can claim the student loan interest credit, the interest on the loan itself can be paid either by the student or by someone related to the student, such as a (grand)parent," the report said.

Charitable gifts should also be paid by year-end to receive a tax credit for 2020.

Clients with medical expenses may claim a tax credit when total eligible medical expenses exceed the lesser of 3% of net income or $2,397 in 2020.

Clients may want to look for unclaimed medical expenses prior to 2020 as well, Golombek said in the report. That's because the medical expense credit may be claimed for eligible medical expenses paid during any 12-month period ending within the calendar year (and is extended to 24 months when a person dies in the year).

Golombek also highlighted the opportunity to receive the one-time, non-taxable Covid-19 payment of $600 for those with a disability. The CRA extended the deadline to apply for the disability tax credit (in order to receive the payment) to Dec. 31, 2020.

For more tax-planning ideas, read Golombek's report of 2020 year-end tax tips.

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