2018 year-end tax tips

Peter Bowen and Michelle Munro's top tax tips for Canadian investors

As busy as everyone is in the lead-up to the December holidays, people need to set aside some time to deal with their taxes. While you don't have to crunch every number until April, if you want to minimize your 2018 tax bill, you should consider taking care of a few things before the new year. Of course, tax is complicated, and every individual's circumstances are different, so it's important to talk to your financial and tax advisors to see whether the ideas here will work for you.

Balance capital gains and losses

December is a good time to rebalance portfolios to smooth out the effects of capital gains and losses. If you have realized capital gains this year, you could offset the associated tax liability by selling securities with accrued losses before the end of the year. Keep in mind that a trade must be settled in the 2018 calendar year to be considered a 2018 disposition. Assuming a normal two-day settlement, a transaction must be initiated by December 27 for it to settle this year.

There are two things to keep in mind. The investment merits should trump any tax considerations, so talk to your advisor about which investments to sell. Also, be aware of the superficial loss rule, which denies a loss if you repurchase investments within 30 days before or after the original sale.

Consider timing capital gains

Another way to potentially minimize taxes is to defer unrealized capital gains to 2019. If a gain is realized in 2018, then tax on that gain would be due by April 30, 2019. If you wait until January to sell, then you won't have to pay tax on that gain until April 30, 2020. Keep in mind that if you think you'll have a lower marginal tax rate in 2019, the tax on the deferred capital gain will also be lower. If you'll be in a higher tax bracket next year, then your capital gains tax will be higher as well. In the latter case, you could consider *accelerating* capital gains.

Take advantage of the capital loss carry-back and carry-forward rules

One advantage of capital losses is that they can be used to offset capital gains in other years. However, the current year's capital losses must first be applied to this year's capital gains before being carried back a maximum of three years. So 2018 losses would first be applied to 2018 capital gains before being carried back to offset gains in 2015 through 2017. As well, unused capital losses can be carried forward and applied to capital gains in any future year.

Pay the right amount

If you pay installments, you'll have received a payment schedule from the Canada Revenue Agency earlier in the year. The schedule is based on your prior year's income, but it's this year's income that counts. With December 15 the deadline for your final quarterly tax installment payment, it's important to make sure you're not overpaying.

For example, if your income is heavily dependent on investments, but money made off those assets falls in 2018, then you'd owe less tax this year. That wouldn't be reflected on your installment schedule. To avoid possibly overpaying, carefully estimate your 2018 income, and then make a final payment based on that calculation. The only caveat is that if your estimate is incorrect, and you underpay income taxes for the year, you may be charged interest and penalties. Nevertheless, it's worth doing the estimate to avoid overpaying. Although a tax refund is always enjoyed, a large refund hardly constitutes good tax planning.

Pay expenses before year-end

A number of expenses must be paid before December 31 if you want to deduct them on your 2018 tax return. These include interest, investment counsel fees, child care expenses, safety deposit box fees, accounting fees and professional dues. Similarly, expenses that can be claimed as tax credits for 2018 must be paid by the end of the year. These include charitable donations, political contributions, tuition fees and medical expenses. Depending on anticipated income in 2019, you may want to consider paying these expenses by December 31 to benefit from the tax deduction or credit in 2018, rather than waiting until next year.

Donate securities instead of cash

If you want to make a charitable donation, you might consider donating publicly listed securities or mutual funds instead of cash. With this strategy, you can claim the full value of the gift as a donation without the realized capital gain being subject to tax. To claim the donation credit on your 2018 return, you must make donations by December 31. Because the administrative process for donating securities in-kind can take a while, it's best to do this well in advance of the year-end, to ensure donation receipts have 2018 dates.

Consider RRSP strategies

Most Canadians know they can offset 2018 taxes by making a registered retirement savings plan contribution (RRSP) up to 60 days after the year ends. (The next RRSP deadline is March 1, 2019.) However, if you are 71 years old at the end of the year, you have to make a final RRSP contribution no later than December 31. Similarly, your RRSP must be matured by the end of the calendar year.

If you are turning 71 in 2018, and generated employment income this year, it is possible to make an RRSP contribution for 2019 before maturing the RRSP, even though 71-year-olds can't hold RRSPs after December 31.

How? By estimating how much room you would have in 2019 and over-contributing in December 2018. You will be subject to a penalty of 1% for the one month when you over-contributed (in excess of the $2,000 allowable over-contribution), but the tax savings generated by making the contribution should more than offset the penalty.

Those turning 71 can also take advantage of unused contribution room by contributing to a spousal RRSP, so long as the partner is 71 or younger.

Get the RESP grant

Registered education savings plans (RESP) can help parents and other family members save for a child's post-secondary education in a tax-deferred account. The real benefit, though, is that an RESP contribution of up to $2,500 per child per year receives a Canada Education Savings Grant from the federal government of 20% of the contribution (up to $500). If you haven't contributed in previous years, the annual grant can be as much as $1,000 on a $5,000 contribution. Consider contributing on or before December 31 to maximize the income deferral and benefit from the grant.

RDSP for Canadians with disabilities

The registered disability savings plan (RDSP) is a program introduced by the federal government to help families save for the long-term financial security of individuals with disabilities. Similar to an RESP, contributions made to an RDSP are not tax deductible, but earnings are allowed to grow tax-free. The government also pays grant money into an RDSP, with the amount based on the contribution and the beneficiary's family's net income. Consider contributing on or before December 31 to maximize the income deferral and benefit from the grant.

Make use of TFSAs

January 1 will mark the ten-year anniversary of the tax-free savings account (TFSA). In 2018, contribution room increased once again, by $5,500, bringing the cumulative contribution limit to $57,500. Now is an excellent time to talk to your advisor about how to make the most of this contribution room – and be ready to make your 2019 contribution in January!

Private company tax changes

Several changes were made to the taxation of Canadian controlled private corporations (CCPCs). There are new "income sprinkling" rules that restrict shifting income from a high-tax-rate business owner to a low-tax-rate family member. There are also new "passive income" rules that reduce the small business deduction (SBD) when passive investment income exceeds $50,000. These rules are complex, and private company business owners should discuss them with their tax advisor.

In closing

As you can see, Canadians have a host of year-end tax planning issues to deal with. It's worth doing as much as you can now so you can take advantage of every tax-saving possibility. Your financial advisor can help you identify and take advantage of these potential tax savings. Do things right and you may even receive a little post-holiday "gift" from the taxman in 2019!

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