Fidelity INVESTMENTS

Year-end tax tips – 2020

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

As busy as you may be in the lead-up to the December holidays, you would be well served to set aside some time to deal with your taxes. While you don't have to crunch every number until April, if you want to minimize your 2020 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 2020 calendar year to be considered a 2020 disposition. Assuming a normal two-day settlement, a transaction must be initiated by December 29 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 purchase the same or identical investments within 30 days before or repurchase 30 days after the original sale.

Consider timing capital gains

Another way to potentially minimize taxes is to defer realizing capital gains to 2021. If a gain is realized in 2020, then tax on that gain would be due by April 30, 2021. If you wait until January to sell, then you won't have to pay tax on that gain until April 30, 2022. Keep in mind that if you think you'll have a lower marginal tax rate in 2021, 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 for a maximum of three years. So 2020 losses would first be applied to 2020 capital gains before being carried back to offset gains in 2017 through 2019. 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 instalments, you'll have received a payment schedule from the Canada Revenue Agency earlier in the year. The schedule is based on your previous year's income. With December 15 being the deadline for your final quarterly tax instalment payment, it's important to make sure you're not overpaying.

For example, if your income is heavily dependent on investments, but income from those assets has decreased in 2020, then you may owe less tax this year. That decrease in investment income won't be reflected on your instalment schedule. To avoid possibly overpaying, carefully estimate your 2020 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 is worth making the estimate to avoid overpaying. Although a tax refund is always enjoyed, a large refund doesn't constitute good tax planning given the loss of cash flow from December 15 until you receive your refund.

COVID-19 pandemic relief payments

There were, and continue to be, many measures introduced to help Canadians facing financial hardship due to the COVID-19 pandemic. Some of these measures for individuals include the Canada Emergency Response Benefit (CERB), Canada Recovery Benefit (CRB), Canada Recovery Sickness Benefit (CRSB), Canada Recovery Caregiving Benefit (CRCB), Canada Emergency Student Benefit (CESB), etc. Most of these payments are taxable, but no tax (or reduced tax) was deducted at source from the payments. This may mean that you will have taxes owing with your 2020 tax return due in April 2021.

Pay expenses before year-end

A number of expenses must be paid before December 31 if you want to deduct them on your 2020 tax return. Some of these include interest, investment counsel fees, child care expenses, accounting fees and professional dues. Similarly, expenses that can be claimed as tax credits for 2020 must be paid by the end of the year, including charitable donations, political contributions, tuition fees and medical expenses. Depending on anticipated income in 2021, you may want to consider paying these expenses by December 31 to benefit from the tax deduction or credit in 2020, rather than waiting until next year.

Deduction for employee workspace-in-home expenses

Many people have been working from home during the pandemic. If you are in this situation, you may want to consider the deduction for workspace-in-home expenses. The workspace must be either

- the place where you mainly (more than 50% of the time) do your work; or
- used exclusively for earning employment income, and used on a regular and continual basis for meeting customers or other persons in the course of performing your job.

This deduction is available for employees if your contract of employment required you to pay the expenses, and the expenses were not reimbursable by your employer. To certify this, you and your employer should complete form T2200, Declaration of Conditions of Employment (note that at time of writing, there are hopes that this certification process will be simplified). Given the circumstances of the pandemic, the hope is that the CRA will release guidance to clarify what expenses can qualify and if a modified administration process will be available.

Common examples of deductible expenses include office supplies, long-distance phone calls, heating bills and a portion of your rent related to the home office. However, the cost of items such as furniture and computer equipment cannot be deducted (nor can a portion be claimed as deductible depreciation). Deductible employment expenses are a deduction on your personal income tax return.

As with all tax deductions, it is important to keep track of your expenses, meaning you must keep a paper trail of the receipts in the event that you are audited and need to prove the deduction.

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 2020 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 2020 dates.

Consider RRSP strategies

Most Canadians know they can offset 2020 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, 2021.) 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 turned 71 in 2020, and generated employment income this year, it is possible to make an RRSP contribution for 2021 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 2021 and over-contributing in December 2020. 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.

RRIF minimum annual withdrawals

In the year a RRIF (registered retirement income fund) is set up, there is no withdrawal necessary, but after the year of set-up there is a minimum amount that must be withdrawn. The minimum withdrawal amount is calculated by multiplying the market value of your RRIF holdings at the beginning of the year by a "prescribed factor" that increases with age.

Under the COVID-19 pandemic relief measures, the amount of the mandatory 2020 withdrawal from a RRIF was reduced by 25% for all RRIF holders. To calculate your 2020 reduced minimum withdrawal, start with the unadjusted minimum withdrawal amount and then multiply by 75%.

This measure provides additional flexibility, but ensure that you still make the reduced minimum withdrawal by year-end. Note that if you have already withdrawn more than the reduced 2020 minimum, you are not permitted to re-contribute the excess amount back to the RRIF.

Consider carefully whether to take advantage of this temporary relief; it may make sense to take *more* than the normal minimum, especially if your income is lower than normal in 2020.

Get the RESP grant

Registered education savings plans (RESPs) 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. As with 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 twelve-year anniversary of the tax-free savings account (TFSA). In 2020, the additional TFSA contribution room was $6,000. If you have never contributed before and turned 18 in 2009 (or earlier), the cumulative TFSA contribution limit is $69,500. 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 2021 contribution in January!

Private company tax changes

Several changes were made to the taxation of Canadian controlled private corporations (CCPCs). There are "income sprinkling" rules that restrict shifting income from a high-tax-rate business owner to a low-tax-rate family member. There are also "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 2021!

Peter Bowen
VP, Tax and Retirement Research

Peter leads the Tax and Retirement Research team at Fidelity Canada, informing investors and advisors across the country on the changing retirement and tax landscape in Canada.

Michelle Munro
Director, Tax and Retirement Research

Michelle is a leading member of the Tax and Retirement Research team at Fidelity Canada. In addition to presenting to investors and advisors on tax and retirement trends, she has a special interest in women and wealth.

For more information, contact your Fidelity representative or visit *fidelity.ca*

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