



Novel Coronavirus (COVID-19)

Tax

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Tax Planning Considerations for Uncertain Times

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Amidst these unprecedented and uncertain times, the question that often arises is what should one do regarding their own taxes? It is during times like these that tax planning becomes so much more important and critical. In this article, we will discuss some common tax planning techniques that should be considered.

For some historical context, in 1949, to pay for post-war expenditures, the government of Canada and its provinces levied a personal marginal tax rate of 84% for all income over \$400,000. Currently, the highest combined federal-provincial marginal tax rate on ordinary income is 53.53% in Ontario. The government of Canada has so far pledged \$82 billion to fight COVID-19, which the Parliamentary Budget Officer projects would create a \$112.7 billion deficit in 2021. Based on history, it might be reasonable to expect that the government will increase marginal tax rates to recoup its expenditures and balance the budget.

Planning Tips That You Should Consider During Covid-19

Estate Freezes

Inter-generational transfers are generally taxable under Canadian law. However, an estate freeze is a common tax planning strategy that allows a taxpayer to “lock in” the current value of businesses and capital properties so that future growth or appreciation is shifted to the next generation or to other family members. It is also a great strategy to minimize any capital gains on the death of the taxpayer. As the COVID-19 pandemic has significantly affected many businesses and the value of capital properties (such as marketable securities and real estate), the value that a taxpayer may be able to “lock-in” should be relatively low. However, a qualified valuator should be consulted in this regard. Freezing the value of the property while it is low reduces the owner’s capital gains, and can increase the gain that is transferred to family members tax-free.

Capital Gains Strip

The current corporate and personal income tax rate structure has created a significant incentive for shareholders to extract value from closely held corporations in the form of capital gains, as opposed to dividends. In general, taxpayers who expect to withdraw surplus income from their corporations in the short term might benefit from implementing a surplus strip.

A number of techniques have been developed, and aggressively implemented, to convert dividends into capital gains. The **infamous 2017 consultation paper** would have introduced an anti-avoidance rule to restrict the effectiveness of these transactions; however, the Liberal Government aborted this measure in the face of significant public backlash. Nevertheless, officials at the Department of Finance have publicly stated that they remain concerned with surplus stripping, and there is talk that a more targeted form of the rule might be introduced. Now, the deficits associated with COVID-19 expenditures might provide an even greater impetus to enact legislation to curtail this strategy.

Trigger Capital Gains (if any)

For those lucky ones who still hold assets with accrued capital gains, in light of COVID-19, there is a reasonable expectation that the capital gain inclusion rate will be increased from its current 50% (with perhaps some form of *de minimis* grandfathering). From a tax planning perspective, it may be an opportune time to trigger a capital gain before any changes to the *Income Tax Act* to avoid exposure to the higher capital gains inclusion rate.

Utilizing Losses

As a reminder, any net capital losses realized may be applied against capital gains and may be carried back 3 years and forward indefinitely. Similarly, non-capital losses may be carried back 3 years and forward 20 years and may be applied to other sources of income. The *Income Tax Act* contains complex rules that restrict when losses may be realized and utilized. As such, we urge you to contact a member of our Tax Department to discuss your particular circumstances.

Loss Consolidation

No formal mechanism exists to transfer losses between corporations under Canadian law. However, Canadian courts and the administrative policy of the Canada Revenue Agency sanction the use of several forms of transactions to consolidate or transfer losses among related or affiliated groups of Canadian corporations. Selecting the appropriate method will depend on the particular facts and circumstances of each case. As a result, we recommend that you contact a **member of our Tax Department** to discuss which loss utilization technique is appropriate in your circumstances.

For more information about dealing with COVID-19, please visit our COVID-19 Resource Center.

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