# Vern Krishna: Tax planning is about timing your transactions wisely

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The last six years have been spectacular for stock markets. The Dow Jones Industrial Index hit a record high of 15,570 in October 2013, a gain of 84% from the bottom of 8,451 in 2008.

Patient investors have been rewarded, but are likely sitting on both accrued capital gains and losses from earlier years. Now is the time to plan for 2013.

Income tax is a tax on transactions and not on income. Tax planning is about timing transactions to minimize taxes. Tax planning is about arranging one's affairs to take full advantage of all exemptions, deductions, and concessions permitted under the Income Tax Act.

Here are some tips.

**Charitable donations**

Individuals can save taxes and benefit legitimate charities by donating appreciated shares. Donations eliminate the accrued capital gain on the securities and also allow the taxpayer to claim a tax credit of about 50%, which is the best of all worlds. For example, if an individual purchased shares for $20,000 and sold them for $120,000, the taxable capital gain of $50,000 would might attract tax of about $25,000. By donating the shares in kind, the taxpayer would save the capital gains tax and also get a charitable credit of about $60,000, for total savings of $85,000.

**Managing capital losses**

Tax sheltering means protecting income gains from taxation by offsetting losses or deductions. Individuals should houseclean their stock portfolio by December 23 to trigger sufficient capital losses to offset against any capital gains realized in the year or to carry back losses to offset gains in the three previous years. Similarly, investors should close out their option contracts with accrued capital losses in order to shelter their capital gains. You can carry forward your unused capital losses and apply them in the future. They are like money in the bank.

If you are sufficiently optimistic and believe that your losers will rise again to become stars in the future, you can "bed and breakfast" them: Sell the shares, wait for 30 days and buy them back. Meanwhile, you can use your losses and end up owning the stock.

**Use your allowable business investment losses**

Investors who lost money in private corporations should evaluate whether they can write off their losses as allowable business investment losses (ABILs) — a special type of capital loss. A business investment loss is a capital loss that arises when one disposes of shares or debt of a "small business corporation" to an unrelated person. The advantage of ABILs is that they are deductible against any source of income — for example, business or rental income.

A business investment loss arises when one sells or transfers the shares or debt of a corporation that qualified as a small business corporation at any time within the preceding twelve months. Hence, shareholders in financially troubled corporations or individuals who have lent money to such a corporation can use these losses if they dispose of their interests before the year-end.

**Claim the capital gains exemption**

The $750,000 capital gains exemption ($800,000 after 2014) is one of the richest exemptions in the Income Tax Act. The exemption is available in respect of shares of a qualified small business corporation (QSBC) – that is, a Canadian-controlled private corporation that carries on an active business primarily in Canada. The exemption is available when the taxpayer disposes of his shares of such a corporation if the individual held the shares for at least 24 months. An individual can trigger the gain by selling the QSBC shares at their fair market value to his spouse, to a third party or to a corporation that one controls. There are several technical rules that apply.

**Defer mutual fund purchases**

Defer purchasing mutual funds in taxable accounts. Mutual funds generally clean up their portfolios in December to window dress their yearend performance reports and promote sales in the New Year. For tax purposes, a mutual fund is a conduit for its unit holders, who must include their share in income and pay tax thereon, regardless whether the fund actually pays out or reinvests the income in additional units.

An individual who buys fund units in December can end up paying tax on undistributed income that the fund allocates to him or her in 2013. That is like joining a party as it is winding down — you are saddled with the clean up. Wait until January before buying in taxable accounts.

Timing of transactions is essential to legitimate tax planning. The Income Tax Act allows tax sheltering for gains and investments, through exemptions, deductions, and concessions, but the rules are technical and the timelines are strict. We can use the gains of the past year in particular to reduce our tax bills, but do so before the end of the year.