Tax planning in a unique year

CERB, combined with lower deductions, is a recipe for potential tax owing

- By: Curtis Davis; October 30, 2020

Many Canadians experienced income changes this year, so tax return figures may look very different than in previous years. In some cases, clients who typically receive refunds may owe tax.

On the surface, it may not seem like a big tax issue when someone's income declines. Logically, taxes should decline, too. However, the situation may be more complicated.

For those who received Canada Emergency Response Benefit (CERB) payments, no income tax was withheld at source. In addition, tax deductions such as those for retirement savings contributions (especially payroll deductions to employer-sponsored plans) may be less than in previous years. With childcare facilities closed, work travel halted and medical services like dentistry on hold, the corresponding tax deductions or credits may be lower. This combination could be the perfect storm for a higher tax bill.

Adjusting for 16 weeks of CERB

Consider Hannah, a fictitious sales representative in Saskatchewan. She's a self-directed investor (with almost $300,000 in investment assets) but she wants to partner with an advisor because she's worried about her 2020 tax return. When her employment was affected by Covid-19, she received CERB for 16 weeks in the middle of the year. Since her return to work this fall, all sales calls are virtual, so Hannah no longer travels. Without Covid-19, her 2020 tax situation would have looked like this:

Employment income	$80,000
Taxable investment income[1]	$3,320
RRSP contribution (payroll deduction)	($8,000)
Car expenses	($5,000)
Deduction for enhanced CPP contribution	($166)
Taxable income	$70,154

Refund (including climate action incentive)[2]	$1,499

[1] Includes $250 of taxable capital gains, $2,070 of grossed-up eligible dividends and $1,000 of interest income

[2] Difference between income tax withheld by her employer and taxes payable ($15,359 – $13,860) Normally, Hannah would be in a refund position.

Normally, Hannah would be in a refund position. Let's project what her situation may look like because of Covid-19:

Employment income	$55,385
Taxable investment income[1]	$3,320
CERB	$8,000
RRSP contribution (payroll deduction)	($5,538)
Car expenses	($2,000)
Deduction for enhanced CPP contribution	($156)
Taxable income	$59,011
Projected taxes owing (net of climate action incentive)[2]	($2,132)

[1]Includes $250 of taxable capital gains, $2,070 of grossed-up eligible dividends and $1,000 of interest income

[2] Difference between income tax withheld by her employer and taxes payable ($8,093 – $10,225)

Despite her taxable income being lower than normal, the combination of lower deductions and no tax withheld on CERB has Hannah in a potential balance owing situation. What can you do?

First you review her tax information — including her notice of assessment — for any amounts carried forward from previous years that could reduce taxes this year, and you find RRSP carry-forward room of $35,000. Hannah also mentions that she realized a $4,000 capital gain in 2019 on her non-registered account. Finally, when reviewing her investment statements, you notice two investments in her non-registered portfolio have combined unrealized capital losses of $3,000.

While there may be multiple solutions for Hannah, let's explore one. An additional RRSP contribution of $6,462 would reduce Hannah's taxes payable to $0. Since the current market value of the investments in the loss position is $10,000, you suggest using that amount to fund the RRSP contribution. To do this, Hannah must realize the losses in her taxable portfolio. You also suggest she carry the net capital loss back to 2019 to reduce her taxable capital gain. This results in the following:

- a total RRSP contribution of $15,538 and no taxable capital gain, resulting in a projected refund of $1,250 for 2020
- additional tax savings of $413 from the capital loss carryback

Hannah's projected combined tax refund of $1,663 is greater than the $1,499 she would have received in a normal year, and it's much better than owing $2,132. You have a happy new client.

For next year, remember that Hannah's earned income was lower than expected in 2020, decreasing her new 2021 RRSP contribution room relative to the previous year. This may require a review of her contributions from her payroll to ensure the amounts are still suitable.

For other clients continuing to receive pandemic benefits, remember that the new Canada Recovery Benefit and others are subject to 10% tax at source.

Tax-saving strategies

While no two client scenarios are the same, here are some ideas for tax savings in 2020:

Carry-forward amounts — Review CRA's My Account and the notice of assessment, where carry-forward amounts are tracked. These include items like tuition/education amounts, moving expenses, charitable donations and student loan interest. Where available, these amounts can be used to reduce the current year's taxes.

RRSP contributions — Using current year or carry-forward RRSP amounts could be a simple way to create a deduction, lowering 2020 income and taxes payable.

Charitable donations — A charitable donation could provide additional tax savings and directly lower taxes.

Capital losses — These can reduce net capital gains, saving tax.

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