TAX MATTERS

Five bad ideas about taxes to avoid

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When I was a kid, I remember my grandfather owning a 1957 Cadillac Eldorado Brougham. It was a luxury vehicle that came with its own mini-bar in the glove box. It had shot glasses with magnets on the bottom, so they wouldn't tip over when driving. Some ideas seem good at the time but are just plain bad.

Today, I want to share a few bad ideas when it comes to your taxes. Avoid them and you'll save yourself a few headaches, in addition to money.

1. Giving personal information by phone. Canadians are being defrauded every day by telephone scams in which someone impersonates a Canada Revenue Agency agent to gather personal information and steal identities and money. How do you recognize a fraudster? An official CRA agent will never ask you to make a payment to them directly or ask for payment in gift cards or bitcoins (yes, this actually happens). A scammer will try to instill a sense of urgency and make threats while the CRA generally won't. Finally, the CRA won't typically threaten police action (since owing taxes is not itself a criminal act and a formal process that allows you to obtain legal counsel must be followed).

2. Planning to get a big refund at tax time. I recall a good friend celebrating his large tax refund this past April as if he'd won the lottery. Refunds are a bad idea. It means that you've loaned the CRA money for the better part of a year, without interest. If you're expecting a refund because of certain tax credits or deductions, apply to reduce any taxes deducted from your pay. The best time to do this is in November for the following calendar year. Use Form T1213 available at cra.gc.ca to do this.

3. Selling assets to family below market value. Picture this: You decide to sell the cottage, business, home or other assets to a family member for a great price – less than fair market value. Bad idea. Why? This can create a double-tax problem. Suppose, for example, you sell the cottage to the kids for $300,000 when it's worth $500,000. You'll be deemed to have sold the place at fair market value anyway, so you'll pay tax on the $200,000 capital gain. Your kids, however, will have an adjusted cost base equal to the actual amount they paid – just $300,000. So, if the kids sell the property later for, say, $500,000, they'll also pay tax on a $200,000 capital gain – a second time! A better idea? Sell it to them for $500,000, but take $300,000 in cash and a promissory note for the remaining $200,000 and forgive that note in your will. There are no tax consequences to forgiving debt on death and the kids will avoid double-taxation.

4. Reporting losses yet again. Reporting business or rental losses on your personal tax return can save you tax because those losses can be applied against employment or other sources of income. But losses reported a few years in a row can raise a red flag on your tax return. Now, here's the deal: It's okay to report losses if the activity you're carrying on is purely commercial in nature. That is, there's no personal element to it. The onus is on you to show you're not simply carrying on a hobby or renting to your mother-in-law at a discount, for example. If there's any hint of a personal element to your activity, then you have to show you have a reasonable expectation of profit in order to be allowed losses.

5. Failing to understand principal residences. In the past, Canadians have been accustomed to simply selling any property that could qualify as a principal residence and not reporting it on a tax return. The result was that folks would sell the property tax-free. And in many cases, this was just fine. But in other cases, when people have owned more than one property at the same time, used the property primarily for business or rental or bought a property to flip it for a profit, the sale should not have necessarily been tax-free. Today, it's a bad idea to ignore the rules. Understand them or speak to a tax pro who does, because every sale of a property must now (since 2016) be reported on Schedule 3 of your tax return, and the taxman knows what to look for to ensure people are paying taxes when they should.

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