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Your guide to tax season: year-end tax planning

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Thanks, Hemal. That was great.

All right, we're going to focus on your end planning. And you may notice, if you pay special attention, there may be a couple of points that I raise that should focus on early next year, but they're interrelated to some of your intended concepts.

Another notion I want to throw out there is, as excited as I get about tax planning and Hemal as well, one comment I would make is don't always let the tax wag the dog. There are other factors to take into account as well. Tax is very important element, but it's not the only element.

Before we get into some of your own planning, I just want to go through a couple of concepts to make sure you're familiar with them. I want to discuss tax deductions and tax credits. A lot of people don't really understand them very well or the nuances. I just go over them really quickly.

A tax deduction, like an interest expense on RRSP contribution, saves you taxes and the amount of tax it saves depends on your marginal tax rate. So if I make a \$1,000 RRSP contribution and my marginal tax rate is 40%, I will save \$400 in taxes. If my marginal tax rate is 20%, I'll save \$200 in taxes.

Deductions are distinguished from credits and there are two types of credits: refundable and nonrefundable. Credits reduce the tax payable, and you multiply the amount of the credits by a tax rate. Normally it's the lowest marginal tax rate. You may have heard that the federal government has reduced the lowest tax bracket, for 2025, it's 14.5% and for 2026, it's 14%. Lowering the lowest tax bracket reduces the taxes payable on that tax bracket but on the contrary, it also reduces the amount of tax credits you get.

So there's the basic personal exemption. There's charitable donations. There are also two different types of tax credits you can get. Nonrefundable credits mean that if you're total nonrefundable credits exceed the amount of taxes you owe, you will not benefit from that excess. Whereas refundable tax credits, if the total amount of refundable credits exceeds amount of taxes owned, you can actually get a refund from that.

Generally speaking, there are more nonrefundable credits than refundable because they're more beneficial to individuals like you and me than to the government. But there are both.

Another thing to think about when you're looking at tax planning for next year, or when you're preparing a 2025 tax return is to pay special attention to any carry forward amounts like tuition, moving expenses, charitable donations, and student loan interest. There may be balances you've been able to carry forward that you may want to use for your 2025 return, depending on your personal situation.

So with that, we'll move to the to the next slide. Probably the most common year-end question I deal with involves tax-loss selling. In those situations, we're dealing with investments or other assets. Capital assets could be real estate as well.

Where they're in a loss position and individuals are thinking about selling. Or it could be corporations as well. People are thinking about selling, realizing that capital loss, and using it to offset any capital gains.

There are some very specific rules when it comes to this. It can be a very effective tax planning strategy, but there are the rules you have to be very careful with.

First, I'm going to assume that if it's a sale of an investment, you're not considered a day trader. If you considered a day trader, then it's considered a business and any losses are not considered capital losses, they're considered business losses. Similarly, any gains are considered income. So I'm assuming, these are people not in the business of selling.

Again, a capital gain or capital loss occurs on a disposition. The first rule, when it comes to the capital losses: any capital loss you realize in 2025 must first be used to offset any other capital gains in 2025. Only if you have excess capital losses in 2025 can you carry them back up to three years or carry them forward indefinitely to offset other capital gains.

A couple other key points to keep in mind when implementing this strategy for investments: they use the settlement date, not the date you gave the instructions. Settlement dates decreased over the years and are now down to one day. What that means is you have to make sure if you're selling an investment like

mutual fund, stock or target fund that you sell it by December 30, 2025, so the instructions are in by date. The settlement date will then be December 31st and will qualify as a 2025 capital loss. Very important.

Another important point and people often get tripped up on, is if you have foreign investments, taking into account the foreign exchange rate. The foreign exchange rate might be significantly different when you bought it versus when you sold. You might think you're triggering a capital loss, but depending on how the currencies have fluctuated, you may actually trigger a capital gain or vice versa. Normally, you use the foreign exchange rate on the date of the transaction to calculate your potential capital gain or capital loss.

Another important point is to consider the superficial loss rules. These rules deny your capital loss if you meet certain criteria and add the capital loss to the cost base of the new asset. We'll get to that in more detail later. But one neat strategy is that, while superficial loss rules are usually bad, you can use them to your benefit if you want to transfer capital losses to a spouse or common law partner. Perhaps you don't have capital gains, but they do, or they're in a much higher tax bracket where the capital loss could be better utilized.

We won't necessarily get into it that during my slides but if you want to ask about it, I can go through a specific example later on during the Q&A period with Alex.

For those of you who have capital gains, generally speaking, all things being equal, I would say consider, deferring, realizing any capital gains until the new year to give you one more year before having to pay tax. But if you are in a low tax bracket, or you don't think a tax break is going to change and for investment reasons you have to sell, then if you're in a lower tax bracket this year then you might be in future years, or you have other capital losses to offset a capital gain, then it may make sense to realize the capital gain now.

Another thing is with certain capital gains, for example, the sale of real estate, if you take a back a mortgage, when you sell property to a child or someone else, and you defer payments for at least five years, you can spread that capital gain over five years. You only have to take 20% of the capital gain into income every year for five years. This is called a capital gains reserve, and it can be a very effective tax planning strategy if you meet certain criteria.

So you can go to the next slide. How do you carry back capital losses? This assumes you have excess capital losses over the capital gains this year. Let's say you want to carry them back to 2024, 2023 or 2022. What you would do is, when you file the 2025 tax return, there's a form called a T1A Request for Loss Carryback, and you would attach it to your tax return, your T1.

An important note to make: when you realize a capital loss and claim it in the year that you realize it, it is reported on one line, that's line 12,700. Whereas if you take out an excess capital loss and carry it back or carry it forward, this is reported on a different line, line 25,300. I'll explain to you the significance about that in one slide.

Sometimes people ask me, "John, why have these excess capital losses? Should I take them back or should I carry them forward?" Again, it depends on your personal situation. If you expect your tax rate to be the same in past years versus current and future years, then I would say take it back as far as possible, up to three years. If you had capital gains three years ago, take it back three years because next year that last year will fall off the table.

But if you expect to be in a higher tax bracket in future years and you're pretty confident you'll have capital gains in those years to use against these losses, then you may want to carry them forward. But there's a little riskier, depending on how certain you are about those future gains and your tax bracket. So it's kind of the "one in the hand or two in the bush" analogy.

I also mentioned that capital losses are reported on different lines in your tax return depending on when they were realized. If capital losses are realized in the year of your tax return, so in 2025, they're reported on line, 12,700. But if you use capital losses from other years, either carried them back or carried forward, they're reported on line 25,300. This is very important because it may not impact you, but it may impact other family members. The capital loss reported on line 25,300 doesn't reduce income tested benefits like the OAS clawback, EI repayments, or eligibility for non refundable tax credits like the Canada Child Benefit, GST/HST credit, or the age amount. So keep that in mind.

Now, realizing capital losses in your corporation, some very important points about this. Two key points. First, if you have an operating corporation with an active income, you want to preserve what's called your small business deduction. Generally speaking, your first \$500,000 of active income is taxed at a much lower rate, sometimes, 10%, 11%, 12%, or 13%. Anything over that is taxed at a higher rate, usually mid to high 20%.

If you have too much investment income in your corporation, and the government says that \$50,000 is considered too much then every dollar of investment income over \$50,000 reduces or grinds down that small business limit of 500,000 by \$5. For example, if you have \$60,000 of investment income, that exceeds \$50,000 by \$10,000. Multiply \$10,000 by five, that's \$50,000. So now your small business limit reduced from \$500,000 to \$450,000. Only the first \$450,000 of active income is taxed at the lower rate. If you have a \$150,000 of investment income, your small business limit is

completely ground down and none of your active income is taxed at a low rate, it's all taxed at a higher rate.

Capital losses can reduce that amount of investment income, but only if realized in that year by the corporation. If the corporation carries forward or carries back capital losses, it will not help with that calculation when it comes to preserving your small business limit. So just keep that in mind.

Another thing: there's a reason you might want to realize capital losses if you're worried about the small business deduction. But before you do, be very careful. When you realize a capital loss, 50% of the loss reduces your Capital Dividend Account (CDA). The Capital Dividend Account is very powerful because it's a notional account. Allows corporation to pay tax free capital dividend to a shareholder. For example, if I realize a \$200,000 capital gain in my corporation, my CDA goes up by \$100,000. The next day, I could pay that out that \$100,000 tax free to myself as a shareholder. But if, before paying out that capital dividend, I realize a \$200,000 capital loss, my CDA goes down by \$100,000, half the loss, so back to zero.

Sequence of events is critical. If I pay out the CDA first, then realize the capital loss, my CDA will go negative (-\$100,000), but that's okay because I allowed myself the privilege of paying out a \$100,000 tax free dividend that I wouldn't have been able to do if I had realized the capital loss first.

So timing is very important. Before we move on, make sure you talk to your corporate accountant to make confirm whether you should pay out any capital dividend account balance beforehand.

Now, let's talk about superficial loss rules. I mentioned earlier that one of the challenges when it comes to tax loss selling is if your capital loss is considered a superficial loss. So what is a superficial loss? There are a couple conditions you have to meet.

You and an affiliated person buy the same or identical property during a period that spans 30 days before you sell something for a loss, and 30 days after you sell something for a loss, a total of 61 days. So, 30 days prior to the sale, the day of the sale and 30 days after the sale. If within that 61 day window you sell something for a capital loss and you or someone affiliated that owns an identical property, the capital loss will be denied and added to the adjusted cost base of the property bought within that window.

Now, what is an affiliated person? It means you or your spouse, including a common law partner. It also includes, your corporation or a corporation controlled by you or your spouse, and trusts where you or your spouse are a majority beneficiary or a subscriber. This includes, RRSPs owned by you and your spouse. But it does not include parents, children, grandchildren or cousins.

So if I sell something for a loss and then buy it back in my RRSP within 30 days, that tax loss is lost forever. Or if I transferred in-kind, the same applies. So you want to be careful about that.

Next, What is considered an identical property? Most of us would think an identical property is something that's the same in every aspect.

But CRA uses a looser interpretation: something that's the same in all material respects, and where a buyer would not have preference of one versus another. This is not taxpayer friendly.

So I'll give you a couple examples.

Stocks in two different companies, like Manulife for Sunlife, the same industry. That's okay, the superficial loss rule won't apply.

Different classes of stock in the same company, one voting and one non voting, again not identical.

ETFs based on the same index, like the TSX 300, even if they're from different institutions, CRA considers them identical.

Different series of the same fund, like series A and series F, that's identical.

Retail version versus pool version of the same fund, that's identical too.

So you want to be careful. The definition of identical properties is not as intuitive as some people think.

Here's an example: if today is November 13 and I sell a property for a capital loss, CRA will check whether I bought the exact same property 30 days before and 30 days after November 13. If on December 13 I still own that property, and all criteria are met, the capital loss will be denied and added to the cost base of the property bought within 61 day window. To avoid this, don't buy back the same property or wait at least 30 days.

Now, a couple of other quick year end planning tips as we move away from the tax loss selling. RRSP contribution to your spouse's RRSP and still claim the deduction on your 2025 return.

If you're turning 71 this year, RRSPs cannot continue beyond December 31 of the year you turn 71. You must convert it to an annuity, RRIF or cash. Most people convert to a RRIF. A couple key points: if you have unused RRSP contribution room, you can make a contribution before year end. You don't have to claim the deduction all out once, you can spread it out over future years. For example, if I have \$50,000 of unused room, I can contribute \$50,000 and then claim my deduction of \$5,000 a year for ten years, or \$10,000 a year for five

years. Or, if I don't have RRSP room now but will generate earned income next year, I can make a contribution in December to take advantage of future room. Be mindful of over contributions penalties: CRA charges 1% per month on amounts over \$2,000 buffer. So if contribute \$5,000 in excess of the \$2,000 limit, that's \$3,000 subject to penalty.

Another neat little strategy is, if you're going to make or you know someone's going to make a withdrawal from the homebuyers plan or lifelong learning plan, generally speaking, if you wait until the new year to make that withdrawal, then it defers your repayment schedule by one year because the repayment schedule starts two years after the withdrawal.

However, with the homebuyers plan, there is a one year exception here. The government did introduce a proposal that if you make a withdrawal before the end of this year, 2025, they give you a three year extension on commencing those repayments. So when it comes to home buyers, you may actually want to think about making the withdrawal before year end. But normally, you want to wait a year if you can.

If you can go to the next slide. Similar idea for RESP and RDSP contributions. The sooner you make the contribution, once you have the room, the better. You get the money invested and growing tax deferred more quickly. But there a couple of key changes, age 15 and age 49 for RESPs and RDSPs specifically. Those are the maximum ages. If you haven't already made a contribution to benefit from the government grants, and the government grants can be very generous, make sure you contribute if it makes sense to take advantage of any grants.

Consider making a first home savings account contribution before year end. It doesn't work like the first 60 days of the new year. You have until December 31st and you can only take for \$8,000 of room anyway. So if you're interested in the first home savings account, I would say make a contribution before year end.

When you set up a RRIF, if you have the choice of using your age or your spouse's age for minimum, all things being equal, I generally recommend the younger spouse's age for the minimum because it reduces your RRIF minimum and allows you to keep more of your wealth growing tax deferred. For most people, that's a benefit.

TFSAs again, trying to maximize your contributions to your TFSA. Do it as soon as possible if you have a contribution room. Be careful if you make a withdrawal. If you make withdrawal, you don't get the contribution room from the withdrawal back until next year. So that's very important. If you're going to make withdrawal next year, let's say in January, I would say make the withdrawal now. For example, if it's \$10,000, you'll get \$10,000 of room back in 2026 versus if you make the withdrawal in 2026, you

don't get the room back until 2027. So you get the room back a year quicker.

If you're looking at making charitable donations, the donation receipt is issued based on the time you make the donation. So if you're thinking about doing one, do it before year end so you can claim it on your 2025 tax return.

You can go to one more slide. Just some other expenses to think about. You have to pay the expenses to claim them on your 2025 return, things like investment counseling fees, administrative or management fees, or paying interest expenses, for example, student loans, child care expenses. Make sure you make those payments. You can actually make childcare expense payments or babysitting payments to a child over 18 for a child under the age of 16, just make sure there's a receipt.

If you're thinking about making gifts to adult kids or minors for income splitting purposes, the sooner you do that, the better. If you think about a prescribed rate loan, the prescribed rate is 3% in Q4, so that's another income splitting tool.

If you want to take advantage of pension income splitting, and you're over age 65, withdrawals from your RRIF can qualify for pension income splitting. So if you want to take advantage of pension splitting for 2025 and you're over age 65, think about increasing your RRIF withdrawal. Just remember you can split 50%, but you have to report the other 50%.

Be careful about year end deposits into mutual funds because all of them have year end distributions. So you may get stuck with a taxable distribution at year end. You might just want to think about the timing of those distributions, as well as purchasing other interest bearing investments because they may produce an income slip for 2026. Whereas if you buy that interest bearing investment in 2026, they won't produce a slip until 2027.

So just some things to think about to monitor and manage your tax return.

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That's all the time we have. Thank you for joining us. I'd like to thank Hemal and John for their great insight, and I hope everyone found the discussion informative and valuable.

Have a good rest of the day and we'll speak to you again soon.

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