Alert: 2 Tax Tips for Before 2021

Description

Many of you are probably especially busy this holiday season, perhaps buying gifts and delivering them to the doors of family and friends, aiming for limited contact amid the pandemic.

However, please allow me to alert you of these two tax tips that you should consider doing before the end of the year.

Withdraw money from your TFSA

Now is a good time to withdraw money from your Tax-Free Savings Account (TFSA). I know this is shocking coming from me, as I normally write about compounding your wealth tax-free inside the wonderful tool for the long haul.

Here’s the idea. If you know you’ll be withdrawing money from your TFSA in early 2021, it’s better to withdraw it now. For example, some Canadians have chosen to sell their condos in major cities and buy houses in suburbs where it’s less crowded. The TFSA is a handy tax-free option to help make that large lump sum down payment.

Another example — tax season will descend upon us in a few months. Those who owe taxes might be strapped for cash, especially after the pandemic. Withdrawing money from the TFSA now could be a smart move.

The idea is to withdraw money from your TFSA before the year ends. If you find that you don’t need this extra cash in 2021, you can simply re-contribute it to your TFSA immediately.

If you find you need cash from your TFSA in 2021 and withdraw then, you’ll have to wait until 2022 to contribute that amount back into the TFSA if you don’t have enough TFSA room, and you’ll lose a year of compounding for the withdrawn amount.

Perform tax-loss selling … or not

Some investors prefer to perform tax-loss selling in December. The idea is to review their portfolio performance for the year, book losses in taxable accounts to offset capital gains, thereby reducing your income taxes.

Remember that the losses can offset capital gains from up to three years ago or be carried forward indefinitely. So, if your income is lower this year, you could book losses to offset capital gains from last year to reduce your tax bill.

Don't sell your stocks just because they are in the red. Many stock investments turn green within three to five years when the underlying businesses or the macro environment improve.

Also, don't sell just for tax purposes. Consider from a portfolio management perspective instead. For example, you might want to shift your stock portfolio to emphasize income over growth as you approach retirement. Then you might look into booking losses in your growth portfolio to rotate more capital into value stocks with bigger dividends over time.

Chances are, you'll lose less money by performing your annual review for tax-loss selling earlier in the year, because most investors would consider doing it late in the year (when most others are selling).

In any case, if you do decide that tax-loss selling makes sense now, the last day for doing so for this year is on December 29.

The Foolish takeaway

If you think you might withdraw from your TFSA in early 2021, you should do so now. This way, if you don't need the money, you can re-contribute the amount in 2021 with no penalties. And if you need the money, then you'll have withdrawn it already.

If you decide tax-loss selling is the way to go, make sure you perform the selling by December 29 to make it count for this year.

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