TAX AND ESTATE STRATEGIES

GOING FOR THE BIG TAX REFUND? HERE'S A BETTER ALTERNATIVE **JAN. 29, 2015**

A good friend of mine, Allan, is a professional photographer living in British Columbia. A few years back he was hired by a newspaper to take some aerial pictures of a serious forest fire that threatened to destroy some neighbourhoods. So Allan arrived at the airport where he was told that he'd be flying in the Cessna plane sitting on the tarmac. Allan made his way to the plane, hopped in and greeted the pilot who was already there.

"Let's get going," Allan said. The pilot proceeded to the runway and they took off. After a few minutes, Allan asked the pilot: "Can you fly closer to the fire – in fact, make a couple of low-level passes if you can." The pilot looked nervously at Allan. "Why do you want to do that?" the pilot asked. "Because I have to get some pictures of the fire," Allan replied. The pilot stared at him with a worried look and said, "So, you're telling me that you're not the instructor?"

Oops. Allan had assumed he was in the right plane, and the pilot had assumed Allan was the instructor. As it turns out, they landed safely a few minutes later. The point is that making the wrong assumptions can lead to bad results. When it comes to tax planning, many Canadians assume that a tax refund each spring is a positive thing. In fact, many people will rush to make registered retirement savings plan (RRSP) contributions over the next month so that they can enjoy a healthy tax refund when they file their tax returns in April.

I'm not going to suggest that contributing to your RRSP is a bad idea – it's actually a good idea – but getting a big tax refund at tax time shouldn't be your objective – it's actually a bad result. The ideal scenario is one where you keep more of your hard-earned money throughout the year and receive no refund at all at tax time. This way, you'll have more money to work with earlier.

The Concept

The idea is that you should be better off financially if you have use of your own money throughout the year rather than waiting to get your money back from the government, without interest, when you receive a tax refund after filing your return.

As an example, suppose you expect to receive a $2,400 tax refund in April, and this happens every year for 30 years. If you were to invest that $2,400 each year in your tax-free savings account (TFSA), and earned a 7-per-cent return, you'd have $226,706 at the end of 30 years.

Compare this with the scenario where you manage to receive an extra $200 a month in take-home income (which is $2,400 each year) rather getting the $2,400 back all at once at tax time. In this case, investing that $200 monthly in the TFSA and earning the same 7-per-cent annually will result in a portfolio worth $243,994 at the end of 30 years. That is, your portfolio will be 7.6-per-cent bigger in the second scenario. So, how can you make this happen?

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The Plan

If you're an employee subject to withholding taxes from your pay, it's not difficult to arrange to reduce the tax deducted from each pay, if you have certain expenses or amounts you expect to claim at tax time. All you have to do is complete Form T1213, Request to Reduce Tax Deductions at Source. You'll generally have to file this form each year. I like to file the form in November for the upcoming calendar year, but it's still early in 2015 and you may be able to enjoy greater take-home pay for the better part of this year.

You'll list on the form various amounts you expect to claim for tax purposes, such as RRSP contributions, child-care expenses, support payments, employment expenses, carrying charges or interest costs, charitable donations, or other amounts such as rental losses. You'll then send the form to CRA. Once the taxman approves it, you'll receive a letter to this effect, which you then provide to your employer who will adjust the amount deducted from each pay for the balance of 2015.

Now, what will you do with those extra dollars each payday? Consider making contributions to your RRSP throughout the year. Or contribute to a registered education savings plan, invest in your TFSA, make additional payments on your mortgage, pay down other debt, or use the extra cash to pay for life insurance.

Contact your Financial Advisor to learn more about Tax and Estate strategies.

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