



## ***Intoxication: Why getting a tax refund may be a sign of poor financial planning***

**IN-TAX-I-CA-TION** [in-tak-si-key-shuh n] (noun) - *The short-term euphoria associated with a tax refund that fades when you realize you are getting your own money back, interest-free, over a year later.*

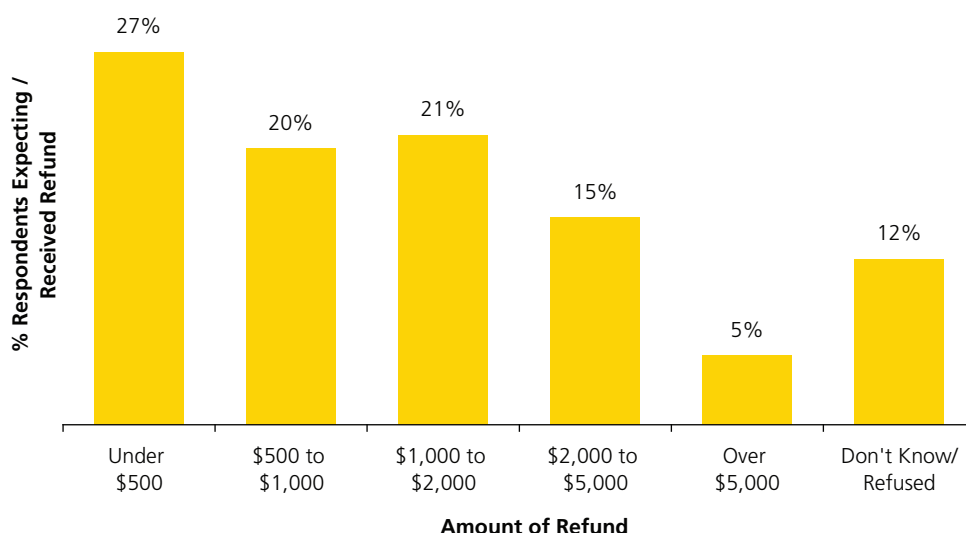
Over half of Canadians expect a tax refund for 2010 according to a new CIBC Harris/Decima poll.<sup>1</sup> The survey also found that nearly three quarters (72%) of Canadians who are receiving a refund plan to use it to pay down debts or build up their savings. While it's clear that Canadians are indeed focused on getting their financial house in order, getting a tax refund each year is actually a sign of poor tax and financial planning, as Canadians would be better off either paying down debt and/or investing their tax "refund" with every paycheque.

### **TAX REFUNDS – 2010 DATA**

With the 2010 tax filing deadline behind us, Canadians have now started to receive their refunds. How much are Canadians receiving and what are their plans for this money?

The poll showed that of Canadians who were receiving a refund for 2010, most expected to receive under \$2,000 with the average refund issued to date being \$1,506.<sup>2</sup>

**Chart 1: Refund expected from 2010 tax returns**



**Jamie Golombek**  
CA, CPA, CFP, CLU, TEP  
Managing Director

Tax & Estate Planning  
CIBC Private Wealth  
Management  
[Jamie.Golombek@cibc.com](mailto:Jamie.Golombek@cibc.com)

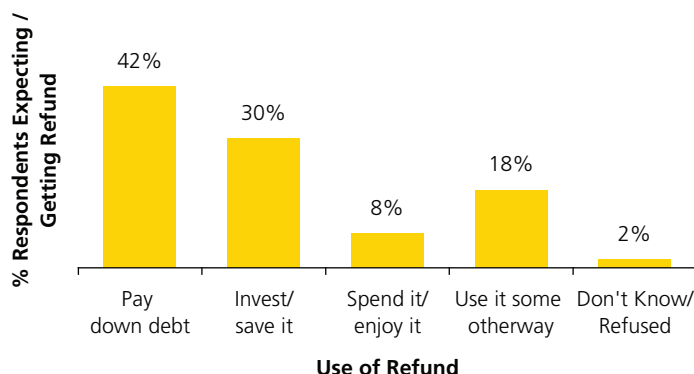
<sup>1</sup> Each week, Harris/Decima interviews just over 1,000 Canadians through teleVox, the company's national telephone omnibus survey. These data were gathered between April 20 and April 27, 2011. A sample of this size has a margin of error of 3.1%, 19 times out of 20.

<sup>2</sup> Source: CRA spokesperson, based on 20.2 million individuals who had filed by May 1, 2011. Note this is only a preliminary figure as the CRA is still receiving and processing 2010 returns.

So, what are Canadians planning to do with the refund?

While popular lore has the average Canadian splurging on that “all-inclusive” beach vacation, our poll indicates that nearly three quarters of Canadians who were expecting a refund plan to either pay down debt, invest it, or save it.

**Chart 2: What is your #1 priority for your refund?**



Given that debt repayment and investing seem to be Canadians' top priorities, let's take a look at some examples of how a tax refund might be used.

#### **Example 1 – Pay down debt**

Lisa and Harvey have a mortgage outstanding of \$140,000 at 4%, compounded semi-annually with a 25-year amortization. If they were to contribute their annual combined tax refund of \$3,600 to pay down their mortgage each year, their mortgage would be paid off in only 15.5 years and the couple would save nearly \$33,000 in interest over the amortization of the mortgage.<sup>3</sup>

#### **Example 2 – Fund a Registered Education Savings Plan (RESP)**

Jack and Jill have two kids, and Jack, who is in a 40% tax bracket, contributes \$12,500 to his RRSP annually, resulting in a tax refund of \$5,000. By contributing his tax refund to an RESP established for both of their kids, the RESP will receive the matching Canada Education Savings Grants (CESG) of 20%, or an additional \$1,000. If this is repeated for the next 12 years and the funds are invested in a balanced portfolio with a 5% return, the RESP will be worth over \$100,000.

#### **Example 3 – Fund a Registered Disability Savings Plan (RDSP)**

Jade has a son who is twenty years old, has a disability that qualifies him for the disability tax credit and has no income. Jade earns \$45,000 annually and is expecting a tax refund of \$1,500 for 2010. By directing this \$1,500 tax refund into an RDSP for her son, the RDSP will be entitled to receive \$3,500 in Canada Disability Savings Grants and \$1,000 in Canada Disability Savings Bonds for a total of \$6,000, before any growth in the plan.

If Jade continues to invest her \$1,500 tax refund annually in the RDSP, in 15 years, assuming a growth rate of 5% in a balanced portfolio, the RDSP will be worth over \$130,000.

### **REFUNDS ARE A SIGN OF POOR TAX PLANNING**

Contrary to popular belief, getting a tax refund is a sign of poor tax planning. After all, you've loaned your hard-earned money to the government, interest-free, for a year (or more!) A tax refund typically arises when the amount of tax owing on your return is less than the amount of tax withheld from your income during the year.

Employment income is the most common type of income from which tax is deducted at source. The amount of tax withheld by your employer is calculated without taking into account various deductions normally claimed, such as RRSP contributions or child-care expenses, which reduce your taxes payable.

Our survey shows that 74% of respondents realize that a refund is a sign of overpaying taxes throughout the year, yet few do anything about it from year to year.

For employees, there are two ways in which your taxes at source can be reduced. The first is by making sure that the credits your employer uses to calculate your payroll deductions are up to date (the “TD1 Return”) and the second is to apply annually for a reduction of tax source (the “T1213 Form.”)

### **TD1 – PERSONAL TAX CREDIT RETURN**

The “TD1 Personal Tax Credit Return”<sup>4</sup> sets out the personal tax credits you intend to claim when filing your tax return, and helps determine how much tax is deducted each pay period. If your entitlement to personal

<sup>3</sup> Assumes monthly mortgage payments; extra payment made annually each May of the following year.

<sup>4</sup> Quebec employees must also complete the Quebec form, “Quebec Source Deductions Return” (TP-1015.3-V)

tax credits such as the spouse or partner amount, the child amount or tuition has changed from the time you were hired, you should re-submit the form so that taxes withheld at source can be adjusted for tax credits beyond the basic personal exemption. Note that you must submit both the federal and provincial TD1 forms, which can be found on the CRA website.<sup>5</sup>

Commission employees who are able to claim expenses may complete the "TD1X, Statement of Commission Income and Expenses for Payroll Tax Deductions"<sup>6</sup> so that their expenses can be taken into consideration in the calculation of the income taxes deducted from their commission income. These forms (both federal and provincial) should be reviewed and, where appropriate, refiled annually to reduce taxes withheld at source.

## FORM T1213 -- "REQUEST TO REDUCE TAX DEDUCTIONS AT SOURCE"

By taking advantage of the "undue hardship provision" under the Income Tax Act. By doing so, it's possible to get your tax refund throughout the year, on every paycheque, instead of waiting until your return is filed the following spring. To apply, you simply complete Canada Revenue Agency's one-page form, T1213 "Request to Reduce Tax Deductions at Source" (see the last page of this report for a copy of the form).<sup>7</sup> On this form, you indicate the various deductions or credits that, if not taken into account, would otherwise result in a tax refund for the year.

This form is then sent to your local CRA tax services office for approval. Once approved, the CRA will send you a letter of authority, which must be given to your employer, allowing them to reduce tax at source.

Let's review an example of how the monthly reduction of tax at source can boost your savings by directly investing

in a Tax Free Savings Account (TFSA).

### Example 4 – Savings in a TFSA (monthly)

Kevin will earn \$69,000 in 2011 and plans to contribute \$9,000 to his RRSP. Based on 2011 Ontario tax rates, he would be eligible for a reduced tax withholding of about \$240 per month.

If this \$240 monthly savings is automatically redirected from Kevin's paycheque into a regular investment program in his Tax Free Saving Account (TFSA), he won't miss the money on a monthly basis because his net pay will remain constant. He therefore may be less tempted to spend any refund received the following spring. Over a working career of 30 years, at a 5% annual compounded growth rate in a balanced portfolio, Kevin's TFSA could grow to nearly \$200,000, representing over \$113,000 in tax-free growth on the monthly contributions.

As you can see, there are a number of ways to either use your tax refund to your advantage or, even better, ensure that next year, your tax refund is eliminated altogether and the taxes saved are used throughout the entire year to your benefit rather than accumulating interest-free in hands of the CRA.

Jamie.Golombek@cibc.com

*Jamie Golombek, CA, CPA, CFP, CLU, TEP is the Managing Director, Tax & Estate Planning with CIBC Private Wealth Management in Toronto.*

<sup>5</sup> See: <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/hwpyrllwrks/stps/hrng/td1/menu-eng.html?slnk>

<sup>6</sup> Quebec employees must also complete the Quebec form, "Statement of Commissions and Expenses for Source Deduction Purposes" (TP-1015.R.13.1-V)

<sup>7</sup> Quebec residents must also complete Ministère du Revenu du Québec Form TP-1016-V.

#### Disclaimer:

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## REQUEST TO REDUCE TAX DEDUCTIONS AT SOURCE FOR YEAR(S) \_\_\_\_\_

- Use this form to ask for reduced tax deductions at source for any deductions or non-refundable tax credits that are not part of the Form TD1, *Personal Tax Credits Return*.
- All your income tax returns that are due have to be filed and amounts paid in full before you send us this form.
- You usually have to file this request every year. However, if you have deductible support payments that are the same or greater for more than one year, you can make this request for two years.
- Send the completed form with all supporting documents to the Taxpayer Services Division of your tax services office. You can find the address on our Web site at [www.cra.gc.ca/tso](http://www.cra.gc.ca/tso) or by calling us at **1-800-959-8281**.
- We will write to you in four to eight weeks to let you know if we have approved your request.

Identification			
First name	Last name		Social insurance number 
Address			
City	Province or territory	Postal code       -	Residence Telephone Business
Employer Name		Contact person	Telephone and fax numbers
Address			
Request to reduce tax on			
<input type="checkbox"/> Salary <input type="checkbox"/> Lump sum – if lump sum, give payment amount and details (for example, a bonus or vacation pay) \$ _____			
Deductions from income and non-refundable tax credits			
<b>Registered retirement savings plan (RRSP) contributions</b> .....			\$ _____
• Give details or a copy of the payment arrangement contract. • Do not include contributions deducted from your pay by your employer.			
<b>Child care expenses</b> .....			\$ _____
• Give details on a separate sheet.			
<b>Support payments</b> .....			\$ _____
• Attach a copy of your court order or written agreement and Form T1158, <i>Registration of Family Support Payments</i> (if not previously filed); • Recipient's name and social insurance number: _____			
<b>Employment expenses</b> .....			\$ _____
• Attach a completed Form T2200, <i>Declaration of Conditions of Employment</i> , and Form T777, <i>Statement of Employment Expenses</i> .			
<b>Carrying charges and interest expenses on investment loans</b> .....			\$ _____
• Attach a copy of statements from the lender confirming the purpose and amount of the loan(s) and the interest payments to be made in the year.			
<b>Other (for example, charitable donations or rental losses)</b> .....			\$ _____
• Attach all supporting documents. Use a separate sheet to give details if necessary. Specify: _____			
<b>Total amounts to be deducted from income</b>			\$ _____
<b>Subtract income not subject to tax deductions at source</b> (interest, net rental or self-employed income)			—
<b>Net amount requested for tax waiver</b>			\$ _____
Certification			
I request authorization for my employer to reduce my tax deductions at source based on the information given. I certify that the information given is, to the best of my knowledge, correct and complete.			
_____		_____	
Signature		Date	