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## How To Reduce Your Tax Refund

AT FIRST GLANCE, THE IDEA OF WORKING TO REDUCE YOUR tax refund would strike most taxpayers as, at the very least, exceedingly poor tax planning advice. Most Canadian taxpayers view getting a refund from filing their annual tax returns as receiving “free” money from the federal government. In fact, except in very narrow circumstances, the reality is the opposite – it’s the taxpayer who has provided the federal government with the interest-free use of the taxpayer’s money.

To understand why that is so, it’s necessary to understand how and when the tax authorities collect taxes from individual taxpayers. Canada’s tax system is a self-assessing one, in which individual taxpayers file an annual return at a prescribed time, usually by the end of April in the following year, reporting their income from all sources and calculating the amount of federal and provincial tax which they must pay on that income. Of course, very few taxpayers would be able to pay their entire tax bill for the year at one time and the tax authorities are equally disinclined to wait until past the end of the tax year to receive income taxes owed by Canadians. So, for most Canadians (certainly for the vast majority who receive their income from employment), income tax, along with other statutory deductions like Canada Pension Plan and Employment Insurance contributions, are paid periodically throughout the year by means of deductions taken from their paycheques with those deductions then remitted to the Canada Revenue Agency on the taxpayer’s behalf by his or her employer.

Of course, each taxpayer’s situation is unique, and so the employer has to have some guidance as to how much to deduct and remit on behalf of each individual taxpayer. That guidance is provided by the employee/taxpayer in the form of a TD1 form which is completed and signed by

every employee, sometimes at the start of each tax year but certainly at the time employment commences. The TD1 form (which is available on the CRA Web site at <http://www.cra-arc.gc.ca/E/pbg/tf/td1/td1-09e.pdf>) lists the most common statutory credits and deductions claimed by taxpayers, including the basic personal credit, the spousal credit amount, the child amount and the age amount. Adding all amounts claimed together gives the Total Claim Amount, which the employer then uses to determine, based on tables issued by the Canada Revenue Agency, the amount of income tax which should be deducted (or withheld) from each of the employee’s paycheques and remitted on his or her behalf to the federal government.

While this system makes fundamental sense, it can go awry when too much tax is withheld from the employee’s paycheque, and then returned to him or her at the end of the tax year in the form of a tax refund. Generally, this happens when the employee does not correctly indicate all personal tax credit amounts available to him or her on the TD1, or where the employee has deductions or credits which cannot be claimed on that form. In either case, the amount withheld from the employee’s paycheque throughout the year will be greater than the amount of tax he or she actually owes – thereby providing the tax authorities with an interest-free loan of what is ultimately the taxpayer’s money.

Where the taxpayer simply isn’t claiming on the TD1 all of the amounts to which he or she is entitled, the solution is a simple one. Only the basic personal tax credit which all Canadian resident taxpayers are entitled is automatically taken into account in determining a taxpayer’s deductions at source – all others must be specified by the taxpayer. So, if you are entitled to claim a particular tax credit amount, like

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the spousal amount, or the child amount or the age amount, you should do so on the TD1. Assuming that your employment income is, as is the case for most Canadians, your only significant source of income, claiming all amounts to which you are entitled on the TD1 will mean that your source deductions will accurately reflect your tax liabilities for the year. At the end of the year, you will have paid the taxes for which you are responsible, without under or overpaying.

Where the taxpayer has available deductions which cannot be recorded on the TD1, it makes things a little more complicated, but it's still possible to have source deductions adjusted to accurately reflect tax liability. The way to do so is to file a Form T1213 – Request to Reduce Tax Deductions at Source (available on the CRA Web site at <http://www.cra-arc.gc.ca/E/pbg/tf/t1213/t1213-04e.pdf>) with the Canada Revenue Agency. Once that form is filed with the CRA, the Agency will authorize the employer to reduce the amount of tax being withheld at source to more accurately reflect the taxpayer's actual tax owing for the year. In most cases, taxpayers who file a Form 1213 do so because they are incurring expenditures which, while deductible for tax purposes, don't show up on the TD1. Most commonly, those are expenditures like deductible support payments or contributions to a registered retirement savings plan (RRSP).

Many taxpayers like getting a tax refund because they see it as a kind of forced savings plan, and it's true that if your money is being held throughout the year by the tax authorities, you can't spend it. And it's also true that a reduction in the amount of source deductions, while it can amount to a significant sum over the course of a year, is likely to be a relatively small amount per paycheque. Even the most financially self-disciplined among us find it difficult not to spend what seems like a fairly insignificant amount of money when it's made available to us, especially when it seems like "free" money. The solution on both counts is to have the "excess" amount represented by reduced deductions at source transferred into a savings account or, even better, an RRSP account as soon as it appears in the taxpayer's bank account. Even \$20 a week will amount, not including interest, to just over \$1000 per year. And, if that \$1,000 is transferred into an RRSP, then the taxpayer will have a \$1,000 deduction to claim on his or her tax return for the year.

By this time of the year, most Canadians have a fairly accurate idea of what their total income will be for the year and so are able to do at least a rough calculation of how much income tax they must pay. While tax rates do, of course, vary by province and territory, a rough idea of one's tax liability for the year can be determined by adding together 25% of the first \$40,000 in income plus 33% of the next \$40,000 in income. (A listing of the actual tax rates imposed by the federal government and by each province and territory for 2009 can be found on the CRA Web site at <http://www.cra-arc.gc.ca/tx/ndvdl/fq/txrts-eng.html>). If the amount of tax being withheld at source on a yearly basis exceeds that estimated amount, and there is no significant source of income other than one's regular paycheque, taxes are probably being over-withheld, and consideration should be given to having those source deductions adjusted. If you're having trouble determining just how much tax has been withheld from your paycheque over the course of the year (the information should be available on your pay stub or equivalent statement of salary and deductions), your company's human resources department, or the bookkeeper who prepares the payroll, should be able to help.

As with all things bureaucratic, having one's source deductions reduced by filing a T1213 takes some time – the CRA's estimate is four to eight weeks. While it's not too late to make that change for the 2009 tax year, it will require immediate action. However, even where no change is made for 2009, taxpayers should be looking ahead to 2010. Even where the employer already has a TD1 on file for the employee, it's easy to provide the employer with a new one for 2010. And where the employee has deductions (or will have deductions in 2010) that can't be recorded on the TD1, this would be a good time to prepare and file a T1213 for 2010. Doing either, or both, as the case may be, will ensure that source deductions made during 2010 accurately reflect the employee's circumstances and his or her actual tax liability for the year.

*The information presented is only of a general nature, may omit many details and special rules, is current only as of its published date, and accordingly cannot be regarded as legal or tax advice. Please contact our office for more information on this subject and how it pertains to your specific tax or financial situation.*