CHAPTER 3

Planning Your Tax Strategy

We Owe How Much in Taxes?

Now that his daughter, Mandy, is two, Melvin Eckert has decided to restart his full-time business. Since Mandy's birth, Melvin has stayed home to care for her while his wife, Nina, continued her career as a human resources supervisor for a health care products company. Her salary and employee benefits provide the family with adequate financial resources. However, Melvin misses his career activities.

Before Mandy's birth, Melvin worked as an independent distributor and technical consultant for companies that made computer software used by small businesses. He represented several software companies and earned a commission based on sales. He also earned fees for helping companies set up computer networks.

When Melvin resumes his full-time career activities, he will need a car, business clothes, equipment, and supplies. The family will have child care expenses for Mandy. In addition, with two working parents, the Eckerts will likely eat meals away from home more often.

While most business-related expenses are deductible from Melvin's income, the net earnings from his business will be subject to tax, with the marginal federal tax rate (including surtaxes) rising to as high as 26 percent. Additionally, since his business is in Quebec, his net income will also be subject to a marginal provincial tax rate as high as 25 percent. If Melvin's business nets him an income of $63,000 or more, his total marginal tax rate will be 49 percent. In addition to this, he will be required to pay $2,660.00 as a Quebec Pension Plan contribution, representing an additional payment of more than 4.2 percent on the $63,000.

"By the time we pay our extra household expenses, business expenses, and taxes, and put something away for retirement, we may be left with as little as 30 to 40 cents for every dollar I earn," Melvin commented to Nina. "Is it worth it?"

"That depends," replied Nina. "If you enjoy your work, that has to count for something."

"Well," responded Melvin, "I'm sure the government will enjoy my work, since they'll get a big chunk of the money."

Questions

1. What financial and personal factors can affect a person's decision to work?
2. What are the tax benefits and drawbacks associated with owning your own business?
3. How might the Eckerts evaluate the financial and personal benefits of Melvin's working?

Learning Objectives

Obj. 1 Describe the importance of taxes for personal financial planning.

Obj. 2 Calculate taxable income and the amount owed for federal income tax.

Obj. 3 Prepare a federal income tax return.

Obj. 4 Identify tax assistance sources.

Obj. 5 Select appropriate tax strategies for different financial and personal situations.

TAXES AND FINANCIAL PLANNING

Obj. 1
Describe the importance of taxes for personal financial planning.

Taxes are an everyday financial fact of life. You pay some taxes every time you get a paycheque or make a purchase. However, most people concern themselves with taxes only in April. With about one-third of each dollar you earn going for taxes, an effective tax strategy is vital for successful financial planning. Familiarity with the tax rules and regulations can help you reduce your tax liability.

Every year, the Fraser Institute determines how long on average a person will need to work before all income taxes are paid for that year. In 2000, "Tax Freedom Day" arrived on July 14, more than six months into the year. That means that, on the average, every dollar you earned in the first half of 2000 was not for you, but for the government.

This financial obligation includes the many types of taxes discussed later in this section. To help you cope with these taxes, common goals related to tax planning include

- Knowing the current tax laws and regulations that affect you.
- Maintaining complete and appropriate tax records.
- Making purchase and investment decisions that can reduce your tax liability.

You should gear tax planning efforts toward paying your fair share of taxes while taking advantage of tax benefits appropriate to your personal and financial situation.

The principal purpose of taxes is to finance government activities. As citizens, we expect government to provide services such as police and fire protection, schools, road maintenance, parks and libraries, and safety inspection of food, drugs, and other products. Most people pay taxes in four major categories: taxes on purchases, taxes on property, taxes on wealth, and taxes on earnings.

? Did You Know

Consider the Fraser Institute's announcement that July 14 would be Tax Freedom Day for 2000. In 1961, 39 years earlier, Tax Freedom Day arrived a full 72 days sooner, on May 3. That means that, on the average, the extent to which Canadians are taxed on income has risen more than 58 percent since 1961.

Taxes on Purchases

You probably pay sales tax on many of your purchases. These federal and provincial taxes are added to the purchase price of products. Many provinces exempt

excise tax A tax imposed on specific goods and services, such as gasoline, cigarettes, alcoholic beverages, tires, and air travel.

food and drugs from sales tax to reduce the economic burden of this tax on the poor. An **excise tax** is imposed by the federal and provincial governments on specific goods and services, such as gasoline, cigarettes, alcoholic beverages, tires, air travel, and telephone service.

Taxes on Property

Real estate property tax is a major source of revenue for local governments. This tax is based on the value of land and buildings. The increasing amount of real estate property taxes is a major concern of homeowners. Retired people with fixed incomes may encounter financial difficulties when local property taxes increase rapidly.

Some areas also impose personal property taxes. Provincial and municipal governments may assess taxes on the value of automobiles, boats, furniture, and farm equipment.

Taxes on Wealth

Currently, the federal and provincial governments do not impose estate or inheritance taxes. However, federal tax liabilities may arise when proceeds of an estate are transferred to beneficiaries (other than a spouse). An estate's executor(s) files a final "terminal" income tax return as of the date of death, which includes a deemed disposition of all assets owned by the individual as of that date.

In addition, the deceased is deemed to have disposed of all capital property upon death, which may trigger capital gains or losses. Thus, money and property passed on to heirs (other than a spouse) is subject to tax.

Taxes on Earnings

Income taxes are used by the federal government to support a number of social benefit programs, such as the Canada Pension Plan and Employment Insurance. Income tax is a major financial planning factor for most people. Most workers are subject to federal and provincial income taxes.

Throughout the year, your employer will withhold income tax amounts from your paycheque, and you may be required to make income tax installments if you earn income from other sources, such as a business. Both types of payments are only estimates of your income taxes payable. You may need to pay an additional amount when you file your income tax return, or you may get a tax refund. The following sections will assist you in preparing your federal income tax return and planning your future tax strategies.

Concept Check 3-1

1. How should you consider taxes in your financial planning?
2. What types of taxes do people frequently overlook when making financial decisions?

INCOME TAX FUNDAMENTALS

Each year, millions of Canadians are required to pay their share of income taxes to the federal government. The process involves computing taxable income, determining the amount of income tax owed, and comparing this amount with the income tax payments withheld or made during the year.

Obj. 2
Calculate taxable income and the amount owed for federal income tax.

taxable income The net amount of income, after allowable deductions, on which income tax is computed.

employment income Money received for personal effort, such as wages, salary, commission, fees, tips, or bonuses.

investment income Money received in the form of dividends, interest, capital gains, or rent from investments. Also called *portfolio income.*

passive income Income resulting from business activities in which one does not actively participate.

exclusion An amount not included in total income.

tax-deferred income Income that will be taxed at a later date.

tax shelter An investment that provides immediate tax benefits and a reasonable expectation of a future profit.

net income Total income reduced by certain adjustments, such as contributions to an RRSP or RPP.

deductions Expenses that can be deducted from total income, such as certain medical expenses, child care expenses, union dues, attendant fees, investment counselling fees, and certain employment-related expenses.

Step 1: Determining Total Income

Taxable income is the net amount of income, after allowable deductions and expenses are deducted, on which income tax is computed. Exhibit 3–1 presents the components of taxable income and the process used to compute it.

Types of Income

Most, but not all, income is subject to taxation. Your total income can consist of three main components:

1. **Employment income** is money received for personal effort. Employment income is usually in the form of salary, commission, fees, tips, or bonuses.
2. **Investment income,** sometimes referred to as *portfolio income*, is money received in the form of dividends, interest, capital gains, or rent from investments.
3. **Passive income** results from business activities in which you do not actively participate, such as a limited partnership.

Total income is unaffected by exclusions. An **exclusion** (also referred to as tax-exempt income) is an amount received but not included in total income for tax purposes. For example, the first $10,000 of a death benefit paid in recognition of a deceased employee's service by a company to the spouse of the deceased is exempt from tax.

Tax-deferred income is income that will be taxed at a later date. Common examples of tax-deferred income are the returns on investments held in Registered Retirement Savings Plans (RRSPs), Registered Pension Plans (RPPs), and Individual Pension Plans (IPPs). In addition, capital gains can be considered tax-deferred income since taxes are normally paid once a gain is realized on a sale. While these earnings are credited to the account now, you do not pay taxes on them until you withdraw them.

Certain adjustments to income, such as tax-deferred retirement plans, are a type of tax shelter. **Tax shelters** are investments that provide immediate tax benefits and a reasonable expectation of a future profit. In recent years, tax court rulings and changes in the tax code have disallowed various types of tax shelters that were considered excessive.

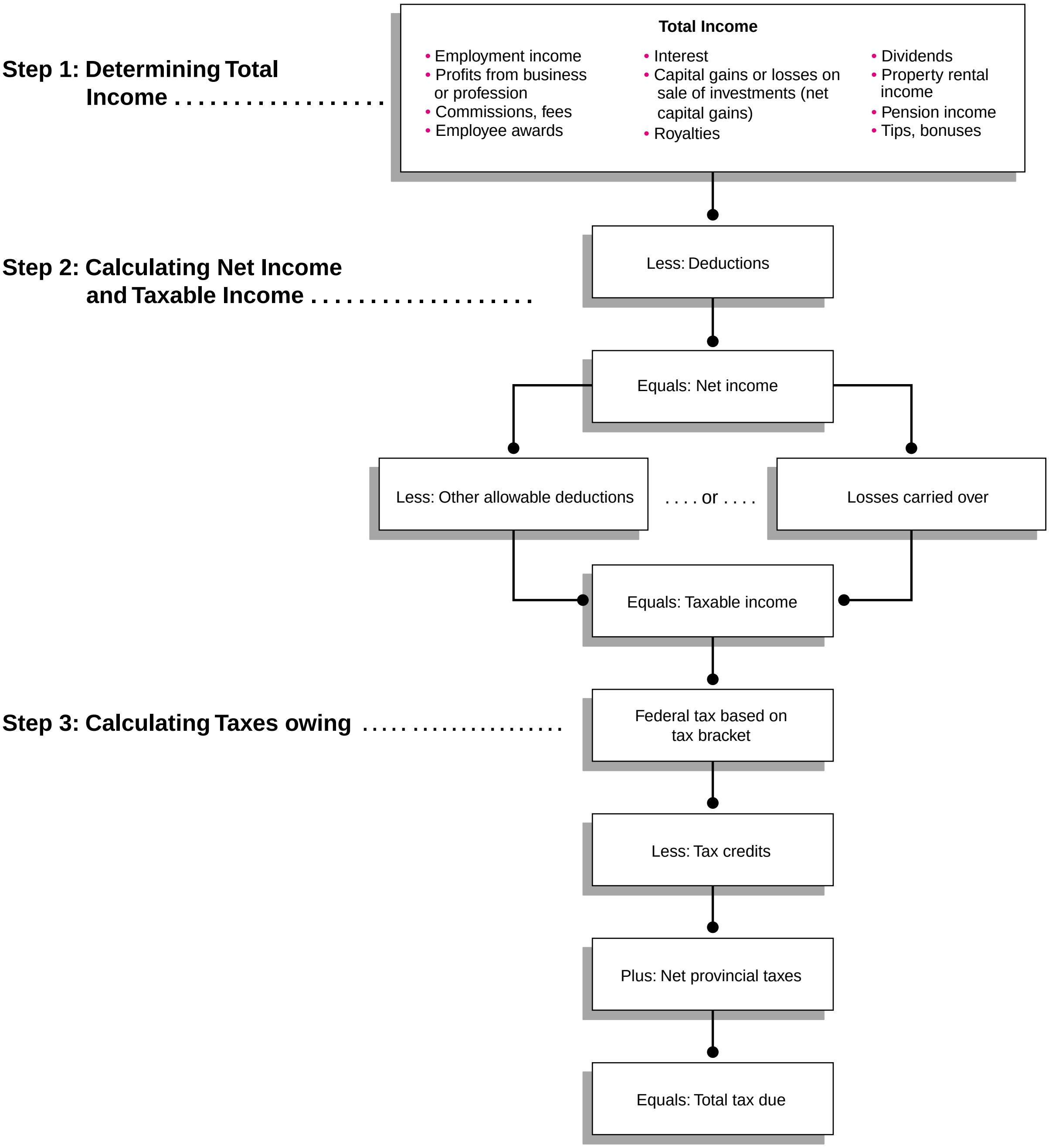
Step 2: Calculating Net Income and Taxable Income

Net income is total income after certain reductions have been made and is used as the basis for computing various income tax credits, such as medical expenses.

Deductions are expenses that a taxpayer is allowed to deduct from total income. Common deductions include the following:

- *Contributions* to registered deferred income plans such as pension funds and registered saving plans.
- *Union and professional dues* are generally deductible. Union dues are normally withheld at source and reported on the T4 and Québec Relevé 1 you receive from your employer. Dues required to maintain a legally recognized professional status are deductible even if you do not need to maintain that status for your current job.
- *Moving expenses* are largely deductible if you move to start working at a new location or to start a business. The move must be to a home that is 40 km closer to your new work location than your old home. The 40-km distance is measured according to the shortest normal route of travel, not as a straight line between points. The deduction is not allowable if you are moving either to or from Canada.
- *Child care expenses* can be deducted, usually by the spouse with the lesser income in a two-parent family, subject to various limitations. This is also true for common-law couples that meet certain criteria. Single parents can deduct child

EXHIBIT 3-1 Computing Taxable Income and Your Tax Liability



care expenses from their own income. These expenses include babysitting, day nursery service, day camps, boarding schools, and camps. The criteria for eligibility are that these services free the parents to work, to carry on business, to attend school full time or part time, or to conduct grant-funded research.

- *Expenses to pay for an attendant for disabled people* may be either deducted as such or may be claimed as a medical expense credit. The deduction is limited to two-thirds of your earned income, which is essentially the sum of your salary and business income.
- *Other deductions* might include interest paid on loans, the proceeds of which are used to earn investment income, legal fees if paid for specific purposes such as disputed support or severance payments, a deduction for residents of northern Canada, and deductions for allowable business expenses, capital gains, interest charges, and others.

Your deductions are subtracted from total income to obtain your net income. Finally, other allowable deductions such as the capital gains deduction (see below) and losses carried forward from other years are deducted from net income to arrive at taxable income. The accompanying Financial Planning for Life's Situations box can help you determine which items to include in your taxable income when you calculate your federal income tax.

You are required to maintain sufficient records to support tax deductions. Financial advisers recommend a home filing system (see Exhibit 3–2a) for storing receipts and other tax documents. Travel expenses can be documented in a daily log with records of mileage, tolls, parking fees, and away-from-home costs.

Generally, you should keep tax records for three years from the date you receive your notice of assessment. However, you may be required to provide backup documentation for up to six years from filing. Certain records, such as housing documents, should be kept indefinitely.

Capital Gains Exemption Capital gains arising from the sale of an individual's principal residence are exempt from taxes. A $100,000 capital gains exemption on all kinds of property was available before February 22, 1994. However, current regulations entitle the individual to a $500,000 lifetime "capital gains exemption" on qualified small business corporation shares and farm property. Note that under the *Income Tax Act*, and on all forms from the Canada Customs and Revenue Agency (CCRA; formerly Revenue Canada), this exemption is referred to as a capital gains *deduction* because the realized capital gains are included in determining total income, but are then offset as a deduction to arrive at taxable income. After deducting the amounts for exemptions you obtain your taxable income, which is the amount used to determine taxes owed.

Step 3: Calculating Taxes Owing

Your taxable income is the basis for computing the amount of your income tax owing. Tax rates and the benefits of tax credits are the final phase of the tax computation process.

Tax Rates Using your taxable income, the appropriate federal, provincial and combined marginal rates can be determined. In 2000, five provinces introduced a "tax on income" system to replace the "tax on tax" calculation. Generally, the taxable income remains the same as that used in the calculation of federal tax except in the province of Quebec where a separate Quebec tax return must be filed (more on page 71). Ontario figures are presented to illustrate these marginal rates. Note, these rates take into account the Economic Statement tabled by the federal government on October 18, 2000, which intends to gradually reduce marginal income tax rates over the next five years.

Financial Planning for Life's Situations

Is It Taxable Income? Is It Deductible?

Certain financial benefits individuals receive are not subject to federal income tax. Indicate whether each of the following items would or would not be included in taxable income when you compute your federal income tax.

Is it taxable income . . . ?	**Yes**	**No**
1. Lottery winnings	______	______
2. Child support received	______	______
3. Workers' compensation benefits	______	______
4. Life insurance death benefits	______	______
5. Provincial bond interest earnings	______	______
6. Bartering income	______	______

Note: These taxable income items and deductions are based on the 2000 tax year and may change due to changes in the *Income Tax Act.*

Indicate whether each of the following items would or would not be deductible when you compute your federal income tax.

Is it deductible . . . ?	**Yes**	**No**
7. Life insurance premiums	______	______
8. Cosmetic surgery for improved looks	______	______
9. Fees for traffic violation tickets	______	______
10. Mileage for driving to volunteer work	______	______
11. A notary's fee for preparing a will	______	______
12. Income tax preparation fee	______	______

Answers: 3, 5, 6, 8—yes; 1, 2, 4, 7, 9, 10, 11, 12—no.

EXHIBIT 3-2a A Tax Recordkeeping System

Tax Returns and Tax Filing Information

- Current tax returns and instruction booklets
- Reference books on current tax laws and tax-saving techniques
- Social insurance numbers of household members
- Copies of federal tax returns from previous years

Income Records

- T4 slips reporting salary and taxes withheld at source
- T4 slips reporting pension income
- T5 slips reporting interest, dividends, and capital gains and losses from savings and investments
- Other slips for Employment Insurance benefits, royalty income, retirement, and other support payments

Expense Records

- Receipts for medical, dependant care, charitable donations, and employment-related expenses
- Business, investment, and rental-property expense documents

EXHIBIT 3-2b Personal Tax Credits

PERSONAL TAX CREDITS (FEDERAL)

Under the definition provided by the Income Tax Act, personal tax credits are equal to the prescribed amount multiplied by the basic rate for the year. The basic rate is 17%.

	2000
Basic personal amount	$7,231.00
Amount with respect to age	$3,531.00
Spousal amount or equivalent-to-spouse amount	$6,140.00
reduced by net income in excess of	$614.00
Amount for infirm dependants	$2,386.00
reduced by net income in excess of	$4,845.00
Attendant care amount	$2,386.00
reduced by net income in excess of	$11,661.00
Contributions to QPP/CPP	
employee (3.9% of contributory earnings)	$1,329.90
self-employed worker (7.8% of contributory earnings)	$2,659.80
Employment Insurance (2.4% of insurable earnings)	$936.00
Pension income amount	$1,000.00
Disability amount	$4,293.00
Supplement for disabled children	$2,941.00
Tuition fees (if more than $100)	Amount paid
Amount for full-time education	$200.00/month
Amount for part-time education	$60.00/month
Interest on student loan	Amount paid
Charitable donations, gifts to government and cultural or ecological gifts	Amount paid or carried forward
Medical expenses	Amount paid

SOURCE: www.taxprep.com

2000 Income Tax Rates for Ontario residents

Income Tax bracket ($)	Fed. Marginal Rate (%)	Ont. Marginal Rate (%)	Combined Rate (%)
30,003 or less	17.00	6.37	23.37
30,004–51,999	25.00	9.62	34.62
52,000–60,008[1]	25.00	9.62	36.54
60,009–61,999	29.00	11.16	42.39
62,000–74,999[1]	29.00	11.16	46.41
75,000 or more[2]	30.45	11.16	47.86

[1] Ontario's marginal rate reflects the basic personal amount as well as the 20% surtax on provincial tax in excess of $3,561 (approximately $52,000 of taxable income) and the 36% surtax on provincial tax in excess of $4,468 (approximately $62,000 of taxable income), but does not take into account the provincial tax reduction.

[2] The federal marginal rate reflects the 5% surtax on federal tax in excess of $15,000 (approximately $75,000 of taxable income).

marginal tax rate The rate of tax paid on the last (and next) dollar of taxable income.

Your **marginal tax rate** is the rate you pay on the last dollar earned. For example, suppose you earned taxable income of $35,000 per year in Ontario. The first $30,003 will be taxed at 17 percent, while the remainder of your income will be taxed at 25 percent. The next dollar you earn will be taxed by the federal government at a rate of 25 percent (or a combined federal and provincial marginal tax rate of 34.62 percent).

average tax rate Total tax due divided by total income.

In contrast, the **average tax rate** is based on the total tax due divided by total income. Except for taxpayers in the 17 percent tax bracket, this rate is less than a person's marginal tax rate. For example, a person with total income of $40,000 and total tax bill of $8,783 (see Exhibit 3–6 which computes the total federal and provincial tax) would have an *average tax rate* of 21.95%. The following table shows provincial tax rates, surtaxes, and the maximum combined marginal tax rate for all provinces and territories.

Prov./ Terr.	Taxable Income	Provincial Rate	Max. Combined Rate
NF		62% of BFT Surtax: 6% of PT > $250; 10% of PT > $7,050	51.31
PE		57.5% of BFT Surtax: 10% of PT > $5,200	48.79
NS	0–$29,590 $29,591–$59,180 Over $59,180	9.77% 14.95% 16.67% Surtax: 10% of PT > $10,000	48.79
NB	0–29,590 $29,591–$59,180 Over $59,180	9.94% 15.21% 16.98% Surtax: 8% of PT > $13,500	48.77
QC	0–26,000 $26,001–$52,000 Over $52,000	19.00% 22.50% 25.00%	50.70
ON	0–$30,004 $30,005–$60,009 Over $60,009	6.37% 9.62% 11.16% Surtax: 20% of PT > $3,561; 36% of PT > $4,468	47.86

Prov./ Terr.	Taxable Income	Provincial Rate	Max. Combined Rate
MB	0–$29,590 $29,591–$59,180 Over $59,180	8.00% 12.22% 13.63% Surtax: 2% of NI > $30,000; reduced by credits. Add't tax: 2% of NI.	48.08
SK		48% of BFT Surtax: 10% of PT. Add'l tax: 1.5% of NI.	49.73
AB		44% of BFT Add'l tax: 0.5% of NI.	43.71
BC	0–$30,004 $30,005–$60,009 Over $60,009	8.40% 12.40% 14.35% Surtax: 30% of PT > $5,300; 15% of PT > $8,660	51.26
YT		49% of BFT Surtax: 5% of TT > $6,000	45.37
NT/NU		45% of BFT	43.50
Non-residents of Canada		48% of BFT	44.37

Note: BFT = Basic Federal Tax; PT = Provincial Tax; TT = Territorial Tax; NI = Net Income

SOURCE: www.taxprep.com

Taxpayers who benefit from the special treatment given to certain income and receive special deductions may be subject to an additional tax. The *alternative mini-*

Financial Planning Calculations

Tax Credits versus Tax Deductions

Many people confuse *tax credits* with *tax deductions.* Is one better than the other? A tax *credit,* such as tuition fees or medical expenses, results in a dollar-for-dollar reduction in the amount of taxes owed. A tax *deduction,* such as an RRSP contribution, reduces the taxable income on which your taxes are based.

Here is how a $100 tax credit compares with a $100 tax deduction:

$100 Tax Credit

↓

Reduces your taxes by $100.

All tax credits reduce taxes payable with the limitation that taxes payable cannot be reduced below zero. Aside from political donations and the dividend tax credit (which require additional procedural calculations), the amount claimed is multiplied by 17 percent to arrive at the tax credit. For example, if $588 is spent on tuition, then about $100 can be claimed as a direct reduction of taxes ($588 × .17).

On the other hand, a deduction of $588 may or may not reduce your taxes by $100 because the tax savings arising from the deduction will depend on your marginal tax rate. Note that tax savings are simply equal to the deduction multiplied by the marginal tax rate. Thus, it should be apparent that a tax credit of one dollar is worth more than a deduction worth one dollar. However, making a comparison of whether spending on a deductible item is better than spending on an item that generates tax credits requires a careful specification of several variables, including your marginal federal rate, the province you reside in, the rules attributed to the tax credit in question, and so on. Careful financial planning will help you use both tax credits and tax deductions to your maximum advantage.

$100 Tax Deduction

↓

Reduces your taxable income by $100. The amount of your tax reduction depends on your tax bracket. Your federal taxes will be reduced by $17 if you are in the 17 percent tax bracket and by $24 if you are in the 24 percent tax bracket.

mum tax (AMT) is designed to ensure that those who receive tax breaks also pay their fair share of taxes. Further discussion of the AMT is beyond the scope of this book; you may obtain information from the Canada Customs and Revenue Agency.

tax credit An amount subtracted directly from the amount of taxes owing.

Tax Credits

The tax owing may be reduced by a **tax credit**, an amount subtracted from the amount of taxes owed. Personal credits such as the basic, spousal, dependants, age, and disability credits will reduce your payable income tax directly according to how each may apply to your situation. Some of the other credits that might also be claimed are for charitable or political donations, caregiver and medical expenses, tuition fees, interest on student loans, and dividend tax credits (See Exhibit 3-2b).

In addition, every individual gets a federal tax credit of $1,229 (the basic personal amount), which offsets the federal tax on your first $7,231 of taxable income. People with a severe and prolonged mental or physical disability receive an additional federal tax credit of $4,233.

Note that while most of the amounts claimed are multiplied by 17 percent to arrive at the tax credit, certain tax credits, such as political donations and the dividend tax credit, require additional calculations (see Chapter 10 for examples of how the dividend tax credit is computed).

Making Tax Payments

Source Withholding

Source withholding occurs as your employer and others are required to withhold tax at source and remit it to the CCRA as well as the Québec

EXHIBIT 3-3

T4 Form

SOURCE: Canada Customs and Revenue Agency, 2000.

Employer's name — Nom de l'employeur

Canada Customs and Revenue Agency — Agence des douanes et du revenu du Canada

Year / Année

T4

STATEMENT OF REMUNERATION PAID
ÉTAT DE LA RÉMUNÉRATION PAYÉE

VOID / ANNULÉ

14 Employment income – line 101 / Revenus d'emploi – ligne 101

22 Income tax deducted – line 437 / Impôt sur le revenu retenu – ligne 437

54 Business Number / Numéro d'entreprise

10 Province of employment / Province d'emploi

16 Employee's CPP contributions – line 308 / Cotisations de l'employé au RPC – ligne 308

24 EI insurable earnings / Gains assurables d'AE

12 Social insurance number / Numéro d'assurance sociale

Exempt – Exemption 28 CPP - QPP / RPC - RRQ; EI / AE

29 Employment Code / Code d'emploi

17 Employee's QPP contributions – line 308 / Cotisations de l'employé au RRQ – ligne 308

26 CPP/QPP pensionable earnings / Gains donnant droit à pension - RPC/RRQ

Employee's name and address – Nom et adresse de l'employé

Last name (in capital letters) – Nom de famille (en lettres majuscules) · First name – Prénom · Initials – Initiales

18 Employee's EI premiums – line 312 / Cotisations de l'employé à l'AE – ligne 312

44 Union dues – line 212 / Cotisations syndicales – ligne 212

20 RPP contributions – line 207 / Cotisations à un RPA – ligne 207

46 Charitable donations – Schedule 9 / Dons de bienfaisance – Annexe 9

52 Pension adjustment – line 206 / Facteur d'équivalence – ligne 206

50 RPP or DPSP registration number / Nº d'agrément d'un RPA ou d'un RPDB

Other information (see the back) / Autres renseignements (voir au verso)

Box – Case · Amount – Montant · Box – Case · Amount – Montant

Box – Case · Amount – Montant · Box – Case · Amount – Montant · Box – Case · Amount – Montant · Box – Case · Amount – Montant

T4 (00)

Ministère du Revenu if you live in Quebec. These withholdings will be applied toward all forms of taxable income. Generally, there is no withholding of tax on interest, dividends, rent, or royalties paid to Canadian residents.

Tax withheld from a payment to you is considered to have been paid by you to the tax authorities, even if your employer never remits it. It is also considered to have been paid *to* you in the sense that it forms part of your total income.

After the end of the year, you will receive a T4 form (see Exhibit 3–3), which reports your annual earnings and the amounts that have been deducted for income tax, social benefits, and other taxes. A copy of the T4 form is filed with your tax return to document your earnings and the amount you have paid in taxes. The difference between the amount withheld and the tax owed is either the additional amount you must pay or the refund you will receive.

Many taxpayers view an annual tax refund as a "windfall," extra money they can count on each year. However, these taxpayers are forgetting the opportunity cost of withholding excessive amounts. Others view their extra tax withholding as "forced savings." However, a payroll deduction plan for savings could serve the same purpose and would enable them to earn the interest instead of giving the government an interest-free loan.

Reductions of Source Withholdings It is possible to reduce source withholdings if you prove that you are paying more withholding tax than necessary. In any situation where you expect to receive a refund after filing your return, you can request to have your source withholdings reduced. This type of situation can arise due to personal tax credits, RRSP contributions, charitable donations, medical expenses, and alimony and support payments. The CCRA form used to request this is the TD-1, the Personal Tax Credit Return.

Installment Payments Your tax payments must be paid in installments if the difference between your payable taxes (including provincial tax) and the amount you have already had withheld at source is more than $2,000 in both the current year and either of the two preceding years. In Quebec, where the federal government does not collect the provincial tax, the threshold is $1,200 of provincial tax instead of $2,000. The payments, which must be made quarterly, are due on the 15th day of March, June, September, and December.

? Did You Know

In 1997, 14.4 million Canadians paid income taxes, with an average income of $36,900 and an average tax bill from Ottawa of $5,100. (Source: Canada Customs and Revenue Agency)

Deadlines and Penalties

Most people are required to file their federal and Quebec tax returns by April 30 each year. If you or your spouse (or common-law spouse) has business income, then you have until June 15 to file your return. Note, however, that even though the return is not due until June 15, you will be required to pay any balance of tax owing by April 30. In cases where you have no tax to pay for the year, and neither the CCRA nor the Québec Ministère du Revenu has requested it, you have no obligation to file a return. Despite this, it is often still to your advantage to do so as it may affect your allowable RRSP contribution and other factors in future returns. Note, both parents must file a return to qualify for family support payments, GST and QST refunds.

Your return must be postmarked or transmitted electronically by the due date. Failure to do this will incur an automatic 5-percent penalty on any balance owing. In addition, 1 percent of the unpaid balance will be added for each full month that your return is late, to a maximum of 12 months. If you repeatedly fail to file your returns on time, you may incur even higher penalties.

You should file your return on time even if you are unable to pay the balance owing since doing so will allow you to avoid the 5-percent automatic penalty. (Remember, though, that interest will continue to accrue on your unpaid balance.)

Concept Check 3-2

1. How does tax-exempt income differ from tax-deferred income?
2. What information is needed to compute taxable income?
3. What is the difference between your marginal tax rate and your average tax rate?
4. How does a tax credit affect the amount owed for federal income tax?

FILING YOUR FEDERAL INCOME TAX RETURN

Obj. 3
Prepare a federal income tax return.

As you stare at those piles of papers, you know it's time to do your taxes! Submitting your federal income tax return requires several decisions and actions. First, you must determine whether you are required to file a return. Next, you need to decide which basic form best serves your needs and whether you are required to submit additional schedules or supplementary forms. Finally, you must prepare your return. Note, students should file nil returns to get GST and QST refunds, and if applicable, other housing refunds.

Who Must File?

All residents and citizens of Canada must file a tax return for any year in which they have a balance of taxes owing. In addition, the federal government will tax Canadian citizens who are non-residents of Canada on certain income from Canadian sources.

If you are a resident of Quebec on December 31 of a given taxation year, you will be able to choose between either the general tax filing system or the simplified system. While the former allows a series of Quebec deductions as well as non-refundable tax credits, the simplified system allows you to claim a single lump-sum amount of $2,350. Obviously, you will want to choose the system that gives you the greater tax savings, so you should estimate your payable taxes under both systems to establish the one that is more advantageous for your situation.

Completing the Federal Income Tax Return

There are basically five sections that follow the identification section of your federal tax return form, and the amount of additional material to fill out and attach with your return will depend on what you enter in them. The general sections (shown in Exhibit 3–4) are as follows:

1. The **Income** section is where you list and detail your total income for the year. Here you add up all sources of income including employment income, net business income, net property income, taxable capital gains in excess of deductible capital losses, and other income such as retirement or Employment Insurance benefits and support payments received.
2. The **Deductions** section allows you to compile the total of contributions to registered deferred income plans, professional and union dues, moving expenses, and child care and support payments, as well as other deductions such as carrying charges and exploration and development expenses.
3. The first two sections allow you to calculate your net income. Following this, the **Other Deductions** section allows you to further claim a capital gains deduction (offsetting your taxable capital gains) as well as any losses carried over from other years. Subtracting the results of this section from the results of subtracting section two from section one will give you your taxable income.
4. You can further reduce your taxes payable by making claims in the **Tax Credits** section. In this section you can claim all pertinent personal credits such as the basic, spousal, dependant, age, and disability credits. You may also claim such credits as those for retirement income, charitable donations, caregiver and medical expenses, tuition fees, interest payments on student loans, and others. Claiming these credits will allow you to calculate your basic tax (and surtax).
5. From the basic tax and surtax, you may claim further credits in the **Other Tax Credits** section of your return. These claims include tax credits for political donations, labour-sponsored funds, a refundable Quebec abatement, medical expense supplements, and other credits. These credits will be subtracted from your basic tax and will thus allow you to calculate your payable tax. In instances where you end up with a negative number, that will be the amount which you paid in excess and which the government will refund on acceptance of your return.

The complete federal income tax return (in this case, combined with the provincial return for Ontario) is shown in Exhibit 3–5.

Filing Quebec Tax Returns

Quebec is the only province that does not “piggyback” on the federal system of personal taxation, and as a result its residents must file both a federal tax return and a separate Quebec tax return. While the Quebec *Taxation Act* has a number of similarities with the federal *Income Tax Act*, there are still a number of differences. If you must file a return in the province of Quebec, it is imperative that you contact the Québec Ministère du Revenu for further information. Quebec tax forms and guides are available in both French and English from the provincial government’s Web site at

EXHIBIT 3–4

Five General Sections of Your Federal Tax Return Form

SOURCE: www.taxprep.com

CALCULATION OF FEDERAL PERSONAL TAX

INCOME
- —Employment income
- —Net business income
- —Net income from property such as interest, real estate rental, and taxable dividends
- —Taxable capital gains exceeding deductible capital losses
- —Other income such as: Employment Insurance benefits, retirement benefits and support payments[1]

DEDUCTIONS
- —Contributions to registered deferred income plans such as: pension funds, retirement savings plans
- —Professional and union dues
- —Moving expenses
- —Child care expenses
- —Support payments made[1]
- —Other deductions such as: carrying charges, exploration and development expenses

NET INCOME

OTHER DEDUCTIONS
- —Capital gains deduction
- —Losses carried over from other years

TAXABLE INCOME

INCOME TAX

TAX CREDITS
- —Personal credits
  - —Basic
  - —Spouse
  - —Certain dependants
  - —Age
  - —Disability
- —Other credits
  - —Retirement income
  - —Charitable donations
  - —Caregivers
  - —Medical expenses
  - —Tuition fees, education amount
  - —Interest on a student loan
  - —CPP/QPP and Employment Insurance contributions
  - —Transfer of credits from one spouse to the other
  - —Dividend tax credit

BASIC TAX AND SURTAX

OTHER TAX CREDITS
- —Political contributions
- —Labour-sponsored funds
- —Refundable Quebec abatement
- —Refundable medical expense supplement
- —Other credits

TAX PAYABLE

1 Child support payments made under a court order or written agreement made on or after April 30, 1997 are not taxable nor deductible.

www.gouv.qc.ca. See Exhibit 3–6 for an example of the effect of combining federal and provincial taxes.

Concept Check 3–3

1. Who must file a tax return?
2. What are the five sections of the federal tax return?
3. How is the tax system in Quebec unique?

EXHIBIT 3-5

Federal Income Tax Return

SOURCE: Canada Customs and Revenue Agency, 2000

Canada Customs and Revenue Agency / Agence des douanes et du revenu du Canada

T1 GENERAL 2000

Income Tax and Benefit Return

Identification

ON 7

Attach your personal label here. Correct any wrong information.
If you are not attaching a label, print your name and address below.

First name and initial

Last name

Address | Apt. or Unit No.

City

Province or territory | Postal code

Enter your province or territory of residence on December 31, 2000:

If you were self-employed in 2000, enter the province or territory of self-employment:

If you became or ceased to be a resident of Canada **in 2000**, give the date of:
entry (Month, Day) or departure (Month, Day)

Enter your social insurance number if it is not on the label, or if you are not attaching a label:

Enter your date of birth: Year Month Day

Your language of correspondence: / Votre langue de correspondance : English ☐ Français ☐

If this return is for a deceased person, enter the date of death: Year Month Day

Marital status on December 31, 2000 (check the box that applies):
(see the "Marital status" section in the guide for details)

1 ☐ Married 2 ☐ Living common law 3 ☐ Widowed
4 ☐ Divorced 5 ☐ Separated 6 ☐ Single

If box 1 or 2 applies, enter your spouse's social insurance number if it is not on the label, or if you are not attaching a label:

Enter the first name of your spouse:

Check this box if your spouse was self-employed in 2000: 1 ☐

Do not use this area

Elections Canada **(see the guide for details)**

Do you authorize the Canada Customs and Revenue Agency to provide your name, address, and date of birth to Elections Canada to update your information on the **National Register of Electors**? .... Yes ☐ 1 No ☐ 2
Your authorization is needed each year. This information can be used for electoral purposes only.

Goods and services tax / Harmonized sales tax (GST/HST) credit application

Are you applying for the GST/HST credit? (see the guide for details) .... Yes ☐ 1 No ☐ 2

If *yes*, enter the number of children under age 19 on December 31, 2000 (if applicable) ....

If *yes*, enter your spouse's net income from line 236 of your spouse's return (if applicable) ....

Foreign income

As a Canadian resident, you have to report your income from all sources both inside and outside Canada.

Please answer the following question

Did you own or hold foreign property at any time in 2000 with a total cost of more than CAN$100,000?
(read the "Foreign income" section in the guide for details) .... 266 Yes ☐ 1 No ☐ 2
If *yes*, attach a completed Form T1135.

If you had certain dealings with a non-resident trust or corporation in 2000, see the "Foreign income" section in the guide.

Do not use this area	172					171				

TAX ASSISTANCE AND THE AUDIT PROCESS

In the process of completing your federal income tax return, you may seek additional information or assistance. After filing your return, you may be identified for a tax audit. If this happens, several policies and procedures protect your rights.

Tax Information Sources

Obj. 4
Identify tax assistance sources.

As with other aspects of personal financial planning, many resources are available to assist you with your taxes. Both the Canada Customs and Revenue Agency and the Québec Ministère du Revenu offer comprehensive guides to help you plan and com-

EXHIBIT 3–5

(continued)

2

Total income

Employment income (box 14 on all T4 slips)				101
Commissions included on line 101 (box 42 on all T4 slips)		102		
Other employment income (see line 104 in the guide)				104+
Old Age Security pension (box 18 on the T4A(OAS) slip)				113+
Canada or Quebec Pension Plan benefits (box 20 on the T4A(P) slip)				114+
Disability benefits included on line 114 (box 16 on the T4A(P) slip)		152		
Other pensions or superannuation (see line 115 in the guide)				115+
Employment Insurance benefits (box 14 on the T4E slip)				119+
Taxable amount of dividends from taxable Canadian corporations (see line 120 in the guide)				120+
Interest and other investment income (attach a completed Schedule 4)				121+
Net partnership income: limited or non-active partners only (attach a completed Schedule 4)				122+
Rental income	Gross	160	Net	126+
Taxable capital gains (attach a completed Schedule 3)				127+
Support payments received	Total	156	Taxable amount	128+
RRSP income (from all T4RSP slips)				129+
Other income (see line 130 in the guide)	Specify:			130+
Self-employment income (see lines 135 to 143 in the guide)				
Business income	Gross	162	Net	135+
Professional income	Gross	164	Net	137+
Commission income	Gross	166	Net	139+
Farming income	Gross	168	Net	141+
Fishing income	Gross	170	Net	143+
Workers' compensation benefits (box 10 on the T5007 slip)		144		
Social assistance payments (see line 145 in the guide)		145+		
Net federal supplements (box 21 on the T4A(OAS) slip)		146+		
Add lines 144, 145, and 146		=	▶	147 +
Add lines 101, 104 to 143, and 147 This is your **total income.**				150= ▶

Net income

Pension adjustment (box 52 on all T4 slips and box 34 on all T4A slips)		206		
Registered pension plan deduction (box 20 on all T4 slips and box 32 on all T4A slips)				207
RRSP deduction (see Schedule 7; attach receipts)				208+
Saskatchewan Pension Plan deduction (see line 209 in the guide)				209+
Annual union, professional, or like dues (box 44 on all T4 slips, or from receipts)				212+
Child care expenses (attach a completed Form T778)				214+
Attendant care expenses (see line 215 in the guide)				215+
Business investment loss (see line 217 in the guide) Gross (before) 227	Gross (after)	228	Allowable deduction	217+
Moving expenses (see line 219 in the guide)				219+
Support payments made	Total	230	Allowable deduction	220+
Carrying charges and interest expenses (attach a completed Schedule 4)				221+
Exploration and development expenses (attach a completed Schedule 4)				224+
Other employment expenses (see line 229 in the guide)				229+
Cleric's residence deduction (see line 231 in the guide)				231+
Other deductions (see line 232 in the guide)	Specify:			232+
Add lines 207 to 224, 229, 231, and 232.				233 = ▶ –
Line 150 minus line 233 (if negative, enter "0"). This is your **net income before adjustments.**				234 =
Social benefits repayment (if you reported income on line 113, 119, or 146, see line 235 in the guide)				235–
Line 234 minus line 235 (if negative, enter "0") This is your **net income.**				236 =

plete your tax return. Libraries and bookstores offer books and other publications that are updated yearly and that will help you create a strategy to effectively and legally minimize your total taxes paid. In addition, most daily newspapers frequently contain articles related to personal taxes and their various effects. See Exhibit 3–7 for an example of a tax-planning system.

The fastest way to find information on the various rules and regulations for both the CCRA and the Québec Ministère du Revenu is by searching online at their respective Internet sites. The CCRA is available at www.ccra-adrc.gc.ca, while the Québec Ministère du Revenu site can be found at www.revenu.gouv.qc.ca. Both can also be

EXHIBIT 3-5

(continued)

3

Before you mail your return, make sure you have attached here all completed schedules, required information slips, receipts, and corresponding statements.

Taxable income

Enter your **net income** from line 236		236
Employee home relocation loan deduction (box 37 on all T4 slips)	**248**	
Stock option and shares deductions (boxes 39, 41, 98, and 99 on all T4 slips)	**249**+	
Other payments deduction (if you reported income on line 147, see line 250 in the guide)	**250**+	
Limited partnership losses of other years	**251**+	
Non-capital losses of other years	**252**+	
Net capital losses of other years	**253**+	
Capital gains deduction (see line 254 in the guide)	**254**+	
Northern residents deductions (attach a completed Form T2222)	**255**+	
Additional deductions (see line 256 in the guide) Specify:	**256**+	
Add lines 248 to 256.	257 =	▶ –
Line 236 minus line 257 (if negative, enter "0") This is your **taxable income.**		**260** =

Non-refundable tax credits

Basic personal amount (see line 300 in the guide)	**claim $7,231.00**	**300**	
Age amount (if you were born in 1935 or earlier, see line 301 in the guide)		**301**+	
Spousal amount (see line 303 in the guide)			
Base amount	6,754 00		
Minus: Your spouse's net income	–		
Spousal amount (if negative, enter "0") **(maximum claim $6,140)**	=	▶ **303**+	
Equivalent-to-spouse amount (see line 305 in the guide)	**(maximum claim $6,140)**	**305**+	
Amount for infirm dependants age 18 or older (see line 306 in the guide)		**306**+	
Canada or Quebec Pension Plan contributions			
Contributions through employment from box 16 and box 17 on all T4 slips (maximum $1,329.90)		**308**+	•
Contributions payable on self-employment and other earnings (attach a completed Schedule 8)		**310**+	•
Employment Insurance premiums from box 18 on all T4 slips (see line 312 in the guide)		**312**+	•
Pension income amount (maximum $1,000; see line 314 in the guide)		**314**+	
Caregiver amount (see line 315 in the guide)		**315**+	
Disability amount (see line 316 in the guide)		**316**+	
Disability amount transferred from a dependant other than your spouse		**318**+	
Interest paid on your student loans (see line 319 in the guide)		**319**+	
Tuition and education amounts (attach a completed Schedule 11)		**323**+	
Tuition and education amounts transferred from a child (see line 324 in the guide)		**324**+	
Amounts transferred from your spouse (attach a completed Schedule 2)		**326**+	
Medical expenses (see line 330 in the guide; attach receipts)	**330**		
Minus: $1,637, or 3% of line 236, whichever is **less**	–		
Subtotal	=		
Minus: Medical expenses adjustment (see line 331 in the guide)	**331** –		
Allowable portion of medical expenses (if negative, enter "0")	=	▶ **332**+	
Add lines 300, 301, 303 to 326, and 332 (if this total is more than line 260, see the note at line 338 in the guide)		**335** =	
Multiply the amount on line 335 by 17% =			**338**
Donations and gifts: Complete Schedule 9 to calculate your tax credit for donations and gifts. Enter the amount from line 9 of Schedule 9 and attach a completed copy to your return.			**349**+
Add lines 338 and 349. Use this amount to determine your federal tax on Schedule 1. These are your **total non-refundable tax credits.**			**350** =

reached by telephone: you will find the telephone number for the closest service office in the blue pages of your local phone book.

Tax Publications Each year, several personal tax guides are published; most are available either directly from the issuers, in the case of various tax planning companies, or at a bookstore or library in the case of others. Some of the better-known publications from the financial-services sector include Deloitte & Touche's *How to Reduce the Tax You Pay*, KPMG's *Tax Planning for You and Your Family*, and CCH Canadian's *Preparing Your Tax Returns*. In various bookstores you may also find Evelyn Jacks'

EXHIBIT 3-5

(continued)

Refund or Balance owing

4

Federal tax: Complete Schedule 1 and enter the amount from line 11, **or** line 25, whichever applies		406
Total federal political contributions (attach receipts)	409	
Federal political contribution tax credit (see lines 409 and 410 in the guide)	410 •	
Investment tax credit (attach a completed Form T2038(IND))	412 + •	
Labour-sponsored funds tax credit Net cost 413 Allowable credit	414 + •	
Add lines 410, 412, and 414.	416 = ▶	–
Line 406 minus line 416 (if negative, enter "0") (if you have an amount on line 16 of Schedule 1, see Form T1206)		417 =
Additional tax on RESP accumulated income payments (attach a completed Form T1172)		418 +
Federal individual surtax (line 14 **or** line 32 of Schedule 1)		419 +
Add lines 417, 418, and 419. This is your **net federal tax.**		420 =
Canada Pension Plan contributions payable on self-employment and other earnings (from Schedule 8)		421 +
Social benefits repayment (enter the amount from line 235)		422 +
Provincial or territorial tax (see line 428 in the guide)		428 +
Add lines 420 to 428 This is your **total payable.**		435 = •
Total income tax deducted (from all information slips)	437 •	
Refundable Quebec abatement (see line 440 in the guide)	440 + •	
Canada Pension Plan overpayment (see line 448 in the guide)	448 + •	
Employment Insurance overpayment (see line 450 in the guide)	450 + •	
Refundable medical expense supplement (attach a completed Schedule 10)	452 + •	
Refund of investment tax credit (attach a completed Form T2038(IND))	454 + •	
Part XII.2 trust tax credit (box 38 on all T3 slips)	456 + •	
Employee and partner GST/HST rebate (attach a completed Form GST 370)	457 + •	
Tax paid by instalments (see line 476 in the guide)	476 + •	
Provincial or territorial credits (see line 479 in the guide)	479 + •	
Add lines 437 to 479 These are your **total credits.**	482 = ▶	–
Line 435 minus line 482		=

If the result is negative, you have a **refund**.
If the result is positive, you have a **balance owing**.
Enter the amount below on whichever line applies.

We do not charge or refund a difference of less than $2.

Refund 484 •

Balance owing 485 •

Direct deposit – Start or change (see line 484 in the guide)

You do not have to complete this area every year. Do not complete it this year if your direct deposit information for your refund has not changed.

Refund and GST/HST credit – To start direct deposit or to change account information only, attach a "void" cheque or complete lines 460, 461, and 462.

Note: To deposit your **CCTB** payments (including certain related provincial or territorial payments) into the **same** account, also check box 463.

Branch number	Institution number	Account number	CCTB
460	461	462	463 ☐
(5 digits)	(3 digits)	(maximum 12 digits)	

Amount enclosed 486 •

Attach to page 1, a **cheque** or **money order** payable to the Receiver General. Your payment is due no later than April 30, 2001.

Ontario Opportunities Fund

You can help reduce Ontario's debt by completing this area to donate some or all of your 2000 refund to the Ontario Opportunities Fund. Please see the provincial pages for details.

Amount from line 484 above		1
Your donation to the Ontario Opportunities Fund	465 –	• 2
Net refund (line 1 minus line 2)	466 =	• 3

I certify that the information given on this return and in any documents attached is correct, complete, and fully discloses all my income.

Sign here

It is a serious offence to make a false return.

Telephone ( ) Date

490 For professional tax preparers only.

Name:
Address:
Telephone: ( )

Do not use this area 487 ☐ 488 ☐ •

Privacy Act Personal Information Bank number CCRA/P-PU-005

annual *Jacks on Tax Savings*, Prentice Hall Canada's annual *Canadian Guide to Personal Financial Management*, and a number of other books on the topic. Though current taxation rules often change, since the basics usually remain the same you will also find that many non-current-year tax advisory and information publications are very relevant.

The Internet As with other personal finance topics, extensive information may be found on the Internet, especially the World Wide Web. The Web sites for the CCRA

EXHIBIT 3-6 Tax Tables and Tax Rate Schedules

2. INCOME TAX TABLE (2000)[1, 2] — PROVINCES OTHER THAN QUEBEC

Taxable Income	Newfoundland[3]		P.E.I.[4]		Nova Scotia[5]		N. Brunswick[6]		Ontario[7]		Manitoba[8]		Sask.[9]		Alberta[10]		B.C.[11]	
	Tax	%	Tax	%	Tax	%	Tax	%	Tax	%	Tax	%	Tax	%	Tax	%	Tax	%
20,000	3,582	28.2	3,419	26.8	3,418	26.8	3,440	26.9	2,984	23.4	3,592	27.0	3,513	26.7	3,226	25.0	3,218	25.4
22,000	4,146	28.2	3,954	26.8	3,954	26.8	3,979	26.9	3,452	23.4	4,132	27.0	4,049	27.6	3,725	25.0	3,726	25.4
24,000	4,709	28.2	4,490	26.8	4,489	26.8	4,518	26.9	3,919	23.4	4,672	27.0	4,602	27.6	4,225	25.0	4,234	25.4
26,000	5,273	28.2	5,025	26.8	5,024	26.8	5,056	26.9	4,386	23.4	5,212	27.0	5,154	27.6	4,725	25.0	4,742	25.4
28,000	5,836	28.2	5,561	26.8	5,560	26.8	5,595	26.9	4,854	23.4	5,752	27.0	5,707	27.6	5,224	25.0	5,250	25.4
30,000	6,400	28.2	6,096	26.8	6,117	31.9	6,155	32.2	5,321	23.4	6,309	33.2	6,259	27.6	5,724	25.0	5,758	25.4
30.004	6,401	41.4	6,098	39.4	6,118	39.9	6,157	40.2	5,322	34.6	6,311	41.2	6,261	39.9	5,725	36.5	5,759	37.4
32,000	7,228	41.4	6,884	39.4	6,916	39.9	6,960	40.2	6,013	34.6	7,134	41.2	7,056	39.9	6,454	36.5	6,506	37.4
34,000	8,057	41.4	7,671	39.4	7,715	39.9	7,764	40.2	6,706	34.6	7,958	41.2	7,853	39.9	7,184	36.5	7,254	37.4
36,000	8,885	41.4	8,459	39.4	8,514	39.9	8,568	40.2	7,398	34.6	8,783	41.2	8,650	39.9	7,914	36.5	8,002	37.4
38,000	9,714	41.4	9,246	39.4	9,313	39.9	9,372	40.2	8,090	34.6	9,607	41.2	9,447	39.9	8,644	36.5	8,750	37.4
40,000	10,543	41.4	10,034	39.4	10,112	39.9	10,176	40.2	8,873	34.6	10,431	41.2	10,244	39.9	9,374	36.5	9,498	37.4
42,000	11,371	41.4	10,821	39.4	10,911	39.9	10,981	40.2	9,475	34.6	11,256	41.2	11,041	39.9	10,104	36.5	10,246	37.4
44,000	12,200	41.4	11,609	39.4	11,710	39.9	11,785	40.2	10,168	34.6	12,080	41.2	11,868	41.9	10,834	36.5	10,994	37.4
46,000	13,028	41.4	12,396	39.4	12,509	39.9	12,589	40.2	10,860	34.6	12,905	41.2	12,706	41.9	11,564	36.5	11,742	37.4
48,000	13,857	41.4	13,184	39.4	13,308	39.9	13,393	40.2	11,552	34.6	13,729	41.2	13,543	41.9	12,294	36.5	12,490	37.4
50,000	14,686	41.4	13,971	39.4	14,107	39.9	14,197	40.2	12,245	34.6	14,553	41.2	14,381	41.9	13,024	36.5	13,238	37.4
52,000	15,514	41.4	14,778	40.8	14,906	39.9	15,002	40.2	12,938	36.5	15,378	41.2	15,218	41.9	13,754	36.5	13,986	37.4
54,000	16,343	41.4	15,594	40.8	15,705	39.9	15,806	40.2	13,669	36.5	16,202	41.2	16,056	41.9	14,484	36.5	14,734	37.4
56,000	17,171	41.4	16,410	40.8	16,504	39.9	16,610	40.2	14,400	36.5	17,027	41.2	16,893	41.9	15,214	36.5	15,482	37.4
58,000	18,000	41.4	17,226	40.8	17,303	39.9	17,414	40.2	15,131	36.5	17,851	41.2	17,731	41.9	15,944	36.5	16,247	41.1
60,000	18,829	41.5	18,043	40.8	18,116	41.7	18,233	42.0	15,862	36.5	18,687	42.6	18,568	41.9	16,674	36.5	17,070	41.1
60,009	18,832	49.9	18,046	47.3	18,119	45.7	18,237	46.0	15,864	42.4	18,691	46.6	18,572	48.3	16,677	42.3	17,074	47.7
62,000	19,825	49.9	18,989	47.3	19,029	45.7	19,152	46.0	16,741	46.4	19,619	46.6	19,533	48.3	17,518	42.3	18,022	47.7
64,000	20,822	49.9	19,935	47.3	19,942	45.7	20,071	46.0	17,669	46.4	20,552	46.6	20,498	48.3	18,363	42.3	18,976	47.7
66,000	21,819	49.9	20,882	47.3	20,856	45.7	20,990	46.0	18,597	46.4	21,484	46.6	21,464	48.3	19,209	42.3	19,929	47.7
68,000	22,816	49.9	21,829	47.3	21,769	45.7	21,909	46.0	19,525	46.4	22,417	46.6	22,429	48.3	20,054	42.3	20,862	47.7
70,000	23,813	49.9	22,776	47.3	22,682	45.7	22,828	46.0	20,454	46.4	23,349	46.6	23,395	48.3	20,899	42.3	21,835	47.7
75,000	26,317	51.3	25,154	48.8	24,977	47.1	25,137	47.4	22,785	47.9	25,692	48.1	25,819	49.7	23,023	43.7	24,229	49.1
80,000	28,882	51.3	27,594	48.8	27,341	48.8	27,508	47.4	25,178	47.9	28,096	48.1	28,306	49.7	25,208	43.7	26,684	49.1
85,000	31,448	51.3	30,033	48.8	29,780	48.8	29,878	47.4	27,571	47.9	30,500	48.1	30,792	49.7	27,394	43.7	29,219	51.3
90,000	34,013	51.3	32,473	48.8	32,219	48.8	32,249	47.4	29,964	47.9	32,904	48.1	33,278	49.7	29,579	43.7	31,782	51.3
95,000	36,578	51.3	34,913	48.8	34,659	48.8	34,619	47.4	32,357	47.9	35,308	48.1	35,764	49.7	31,765	43.7	34,345	51.3
100,000	39,144	51.3	37,352	48.8	37,098	48.8	37,002	48.8	34,750	47.9	37,712	48.1	38,251	49.7	33,950	43.7	26,908	51.3
105,000	41,709	51.3	39,792	48.8	39,538	48.8	39,440	48.8	37,143	47.9	40,116	48.1	40,737	49.7	36,136	43.7	39,471	51.3
110,000	44,274	51.3	42,231	48.8	41,977	48.8	41,878	48.8	39,536	47.9	42,250	48.1	43,223	49.7	38,321	43.7	42,034	51.3
115,000	46,840	51.3	44,671	48.8	44,416	48.8	44,317	48.8	41,929	47.9	44,924	48.1	45,709	49.7	40,507	43.7	44,597	51.3
120,000	49,405	51.3	47,111	48.8	46,856	48.8	46,755	48.8	44,322	47.9	47,328	48.1	48,196	49.7	42,692	43.7	47,159	51.3
125,000	51,970	51.3	49,550	48.8	49,295	48.8	49,193	48.8	46,715	47.9	49,732	48.1	50,682	49.7	44,876	43.7	49,722	51.3
130,000	54,536	51.3	51,990	48.8	51,734	48.8	51,632	48.8	49,108	47.9	52,136	48.1	53,168	49.7	47,063	43.7	52,285	51.3

1. This table reflects the basic federal credit ($7,231 X 17% = $1,229) and the 5% surtax on federal tax in excess of $15,500. Use Table 8 to find out the value of the other amounts converted to credits to subtract from the federal tax, as established above.
2. The marginal rate applies to each additional dollar of income.
3. This table reflects the 6% surtax on provincial tax in exces of $250 and the 10% surtax on provincial tax in excess of $7,050.
4. This table reflects the 10% surtax on provincial tax in excess of $5,200
5. This table reflects the basic credit ($7,231 x 9.77% = $706.47) and the 10% surtax on provincial tax in excess of $10,000, but does not reflect the tax reduction.
6. This table reflects the basic credit ($7,231 x 9.94% = $718.76) and the 8% surtax on provincial tax in excess of $13,500.
7. This table reflects the basic credit ($7,231 x 6.37% = $460.62), the 20% surtax on provincial tax in excess of $3,561 and the 36% surtax on provincial tax in excess of $4,468, but does not reflect the tax reduction.
8. This table reflects the basic credit ($7,231 x 8% = $578.48), the 2% tax on net income (deemed equal to taxable income) and the 2% surtax on net income in excess of $30,000, but does not reflect the tax reduction.
9. This table reflects the 1.5% flat tax on net income (deemed equal to taxable income), the 10% surtax on the total of the tax and the flat tax, this surtax being reduced by $150, and the 15% surtax on the total of the tax and the flat tax in excess of $4,000, but does not reflect the tax reduction.
10. This table reflects the 0.5% flat tax on net income (deemed equal to taxable income), but does not reflect the tax reduction.
11. This table reflects the basic credit ($7,531 x 8.4% = $632.60), the 30% surtax on provincial tax in excess of $5,300 and the 15% surtax on provincial tax in excess of $8,660.

SOURCE: www.taxprep.com

NOTE: updated tables for tax rates will be available on the text's Web site

and the Québec Ministère du Revenu are great places to start. As mentioned before, the CCRA is available at www.ccra-adrc.gc.ca, while the Québec Ministère du Revenu site can be found at www.revenu.gouv.qc.ca. Both agencies can also be reached by telephone. Sites such as *IE:Money* magazine at www.iemoney.com and Canoe Money at www.canoe.ca/Money, the Fraser Institute at www.fraserinstitute.ca, CANTAX at www.cantax.com, and the Canadian Taxpayer Federation at www.taxpayer.com are all excellent sources of Canadian tax information. Two of Canada's largest accounting firms, Ernst & Young and KPMG, provide quality links to many other Internet resources and can be found at www.eycan.com and www.kpmg.ca/tax, respectively. In addition, the Web sites of companies that sell tax software and tax-related organizations can be useful (see the Web sites suggested in the next section).

EXHIBIT 3-7

Tax-Planner Calendar

January	February	March
• Establish a recordkeeping system for your tax information • If you expect a refund, file your tax return for the previous year	• Deadline for RRSP contribution • Check to make sure you received T4 forms from all organizations from which you had income during the previous year; these should have been received by late February; if not, contact the organization	• Organize your records and tax information in preparation for filing your tax return; if you expect a refund, file as soon as possible • The first installment for tax is due March 15 for income not covered by withholding
April	**May**	**June**
• April 30 is the deadline for filing your federal tax return; if it falls on a weekend, you have until the next business day (usually Monday)	• Review your tax return to determine whether any changes in withholding, exemptions, or marital status have not been reported to your employer	• The second installment for tax is due June 15 for income not covered by withholding
July	**August**	**September**
• With the year half over, consider or implement plans for a personal retirement program such as an RRSP or RPP or some other tax deferral plan	• Tax returns are due August 30 for those who received an extension	• The third installment for tax is due September 15 for income not covered by withholding
October	**November**	**December**
• Determine the tax benefits of selling certain investments by year-end	• Make any last-minute changes in withholding by your employer to avoid penalties for too little withholding	• Determine if it would be to your advantage to make payents for next year before December 31 of the current year • Decide if you can defer income for the current year until the the following year • Make your final estimated quarterly installment for income not covered by withholding

NOTE: Children born before the end of the year give you a full-year exemption.

Tax Preparation Software and Electronic Filing

More and more taxpayers are using personal computers for tax recordkeeping and income tax preparation. A spreadsheet program can be very helpful in maintaining and updating tax data on various income and expense categories. There are also a number of different software packages that allow you complete your return and then either file online or print the completed form for mailing. Popular choices are QuickTax, Home Tax, TaxWiz, and the Macintosh-based GriffTax. For more information, see www.intuit.com/canada/quicktax, www.hometax.com, www.taxstuff.com, and www.grifftax.com, respectively.

Electronic Filing The CCRA allows most taxpayers to file their returns in electronic form using a personal computer. The system is called EFILE and is available across the country. It permits authorized tax return preparers or transmitters to file returns using tax return preparation and transmission software. The system is not complete, however, and as a result you will incur a small transmission fee charged by EFILE preparers to transmit your return even if you prepare it yourself.

There are many advantages to using this method to file your return. Besides the obvious benefit to the environment, filing this way will allow you to receive a refund within as little as two weeks, versus the six to eight weeks it might normally take. Also, you can keep all your records and are required to send them in only if expressly asked, thus reducing the paper burden. The Québec Ministère du Revenu offers a similar service, the details of which are available at its Web site.

Under the CCRA's TELEFILE program, qualifying employees, students, or seniors can file their returns by telephone. If you are eligible for this program you will be sent an invitation to use TELEFILE and your personalized income tax package will include an access code: you use a touch-tone phone to call the service and enter your information as prompted. As with EFILE, you are not required to send in supporting documents and you will likely receive your refund much sooner.

Tax Preparation Services

Many Canadian taxpayers pay someone to prepare their income tax returns. The fee for this service can range from $40 at a tax preparation service for a simple return to several thousand dollars to a chartered accountant for a complicated return.

Many people prepare their own tax returns. This experience can help you improve your understanding of your financial situation. Doing your own taxes can be complicated, however, particularly if you have sources of income other than salary. The sources available for professional tax assistance include the following:

- Tax services ranging from local services to national firms with many offices, such as H&R Block.
- Many accountants who offer tax assistance along with other business services. A chartered accountant (CA), a certified general account (CGA), or a certified management account (CMA) with special training in taxes can help with tax planning and the preparation of your annual tax return.
- Tax lawyers usually do not complete tax returns; however, you can use legal services when you are involved in a complicated tax-related transaction or when you have a difference of opinion with the government.

Even if you hire a professional tax preparer, you are responsible for supplying accurate and complete information and for the contents of your income tax return. Hiring a tax preparer will not guarantee that you pay the *correct* amount. A U.S. study conducted by *Money* magazine of 41 tax preparers reported fees ranging from $375 to $3,600, with taxes due ranging from $31,846 to $74,450 for the same fictional family. If you owe more tax because your return contains errors or you have made entries that are disallowed, it is your responsibility to pay that additional tax, plus any interest and penalties.

Beware of tax preparers and other businesses that offer your refund in advance. These "refund anticipation loans" frequently charge very high interest rates for this type of consumer credit. Studies reveal that interest rates sometimes exceed 300 percent (on an annualized basis).

Advice from a Pro

A Pro Speaks on Tax Planning

Any attempt to calculate your investment return must include the least exciting, most annoying financial subject: taxes. Even the word makes me cringe!

The government *will* get their share of your money—no exceptions. Smart tax planning helps you pay less tax legally. The federal government isn't fooling around: Those who use illegitimate techniques to avoid paying taxes get socked with high-priced penalties or jail time. Pay your taxes on time.

Toward the first of the year, you will begin to receive a series of statements from the jobs at which you have worked or financial institutions where you hold accounts. This includes brokerage firms, banks, mutual funds, and other intermediaries. Scrounge up the receipts from any charitable donations you've made and proof of any employment-related expenses you plan on writing off. Keep these materials together: Lost forms waste time and money!

Your tax return has several sections to be aware of. Generally, your income should be added up, including any losses. Figure your taxable income, factor in additional credits or taxes, and write a cheque. *You've just paid your taxes!*

For those with a home business, complicated returns, or sketchy paperwork, some professional tax guidance is highly recommended—*and worth it!* Spending some money on a tax preparer or CA might seem daunting, but will ensure that your return is filed accurately and rapidly.

What If Your Return Is Audited?

Canada Customs and Revenue Agency reviews all returns for completeness and accuracy. If you make an error, your tax is automatically recalculated and you receive either a bill or a refund. If you make an entry that is disallowed, you will be notified by mail. A **tax audit** is a detailed examination of your tax return by the CCRA. In most audits, the revenue department requests more information to support the entries on your tax return. Be sure to keep accurate records to support your return. Keep receipts, cancelled cheques, and other evidence to support the amounts that you claim. Avoiding common filing mistakes (see Exhibit 3–8) helps to minimize your chances of an audit.

tax audit A detailed examination of your tax return by the Canada Customs and Revenue Agency.

Types of Audits The simplest and most common type of audit is the *desk audit*. This mail inquiry requires you to clarify or document minor questions about your tax return. You usually have 30 days to provide the requested information.

The *field audit* is more complex. An auditing agent visits you at your home, your business, or the office of your accountant so you have access to records. A field audit may be done to verify whether an individual has an office in the home as claimed.

If you use EFILE or TELEFILE, you won't need to file receipts with your return. However, the CCRA or the Québec Ministère du Revenu may later ask to check certain claims, such as donations, RRSP contributions, or tuition fees. This is normally just a formality designed to maintain the integrity of the electronic filing system.

Your Audit Rights While most audits of individual taxpayers are desk audits, some are field audits. In either case, you should be aware of your rights. The auditor is not entitled to scrutinize all of your documents at will. He or she may request only specific information, and you have a right to ask why that information is needed. In any situation

EXHIBIT 3-8

Top Ten Filing Errors

1. Mathematical errors, such as adding or subtracting amounts incorrectly.
2. Forgetting to reduce income by identifying workers' compensation, social assistance payments, and net federal supplements.
3. Calculating and claiming provincial tax credits incorrectly.
4. Not including pension adjustments, which affect RRSP contribution room for the coming year.
5. Claiming GST/HST credits incorrectly by using incorrect spousal income amounts.
6. Entering the wrong amounts on lines referring to Canada Pension Plan, Quebec Pension Plan, and Employment Insurance contribution and overpayments.
7. Claiming incorrect amounts as RRSP contributions.
8. Forgetting to claim the basic personal amount.
9. Claiming the spousal amount incorrectly.
10. Forgetting to claim the age amount, or claiming it incorrectly.

where you anticipate that you will have problems, you have the right to and should seek assistance from professional advisers. Generally, however, an audit is a simple verification and should not be cause for alarm if you have filed your return in good faith.

If either an audit of your return or an audit of another person's return gives an indication that your tax payable is not what you have calculated and declared, the CCRA will issue a reassessment. In cases where this means that you will need to pay more taxes, you will normally be contacted first and given the opportunity to make representations on your behalf. The reassessment cannot be issued if more than three years have passed from the last assessment, except in cases of fraud or misrepresentation stemming from "neglect, carelessness or wilful default," whereby a reassessment can be issued at any time.

Another situation where the three-year limitation might not apply is where you have signed a waiver regarding a specific disputed issue, as asked by the CCRA. You have the right to refuse to sign and can also revoke a signed waiver if you give six months' notice. Refusing to sign may be a sound strategy if the three-year limit is almost up, as it means that the reassessment may not be made if the revenue department does not have adequate time to complete its audit.

If you find yourself unable to pay your taxes or make a tax filing on time due to a natural or human-made disaster, serious illness, or accident, the *Income Tax Act*'s fairness rules give a degree of latitude to the CCRA to waive penalties and interest on overdue payments. You should be aware, however, that your past compliance to taxation rules may be considered if you make a fairness-related request.

Objections and Appeals You have the right to file a Notice of Objection through your local Chief of Appeals in cases where you do not agree with an assessment. Doing so will allow you to have your objection considered by the independent Appeals Officer, but you must file your notice either within 90 days of the disputed assessment.

The Appeals Officer is normally your highest possible level of appeal within the CCRA. The next step would be to appeal to the Tax Court of Canada, at which point you would be just two steps and extensive legal wrangling away from the Supreme Court of Canada.

Be aware that it is usually best to pay your full taxes, including items in dispute. Doing so will avoid late charges if you lose your appeal, and interest on your payment will be returned to you if you win. Paying disputed amounts in advance of an appeals decision is not an admission of guilt, but rather a sound financial decision that should have no legal bearing on your dispute.

Concept Check 3-4

1. What are the main sources available to help people prepare their taxes?
2. What actions can reduce the chances of an audit?
3. What appeal options do taxpayers have if they disagree with an audit decision?

TAX PLANNING STRATEGIES

Obj. 5
Select appropriate tax strategies for different financial and personal situations.

tax planning The use of legitimate methods to reduce one's taxes.

tax evasion The use of illegal actions to reduce one's taxes.

Most people want to pay their fair share of taxes—no more, no less. They do this by practising **tax planning,** the use of legitimate methods to reduce one's taxes. In contrast, **tax evasion** is the use of illegal actions to reduce one's taxes. To minimize taxes owing, follow these guidelines:

- If you expect to have the *same* or a *lower* tax rate next year, *accelerate deductions* into the current year.
- If you expect to have a *lower* or the *same* tax rate next year, *delay the receipt of income* until next year. This means income will be taxed at a lower rate or at a later date.
- If you expect to have a *higher* tax rate next year, consider *delaying deductions,* since they will have a greater benefit. A $1,000 deduction at 29 percent lowers your taxes by $290; at 26 percent, your taxes are lowered by $260.
- If you expect to have a *higher* tax rate next year, *accelerate the receipt of income* to have it taxed at the current year's lower rate.

As Exhibit 3–9 shows, people in different life situations can take advantage of various tax rules. When considering financial decisions in relation to your taxes, remember that purchasing, investing, and retirement planning are the areas most heavily affected by tax laws.

Consumer Purchasing

The buying decisions most directly affected by taxes are the purchase of a residence, the use of credit, and job-related expenses.

Place of Residence

Owning a home is one of the best tax shelters, primarily because it is exempt from capital gains taxes as long as it qualifies as your principal residence. In addition, a home can be a reliable hedge against inflation and a retirement savings vehicle. While renting may seem less expensive than owning, the latter may be financially advantageous in the long run. Chapter 7 presents specific calculations for comparing renting and buying.

Home Buyers' Plan

If you qualify as a first-time buyer, this plan allows you to withdraw up to $20,000 as a loan from your RRSP to build or buy a home, without it counting as a withdrawal. You must then repay the loan, without interest, over the next 15 years. Further, the funds you withdraw must have been in the plan for at least 90 days prior. This plan will be discussed more fully in later chapters.

Student Loans

Students and former students can claim a 17-percent, non-refundable federal tax credit on the interest on their student loans under the *Canada Student Loans Act* or equivalent provincial programs. You may claim this credit for any interest paid in the current year and in the five preceding years (after 1997). The credit is not transferable, but it can be carried forward for up to five years.

EXHIBIT 3-9 Special Tax Situations

Business in your home	• If you have an office in your home, you can claim a portion of your home expenses as business expenses, subject to certain restrictions. The proportional expenses you can claim include rent if you are a tenant, mortgage interest if you are a homeowner, utilities, telephone, and home insurance. The portion you will be allowed to claim will depend on the fraction of your home that is used for business purposes, excluding any common areas.
Divorced persons	• Before a ruling on May 1, 1997, alimony, child support, and spousal maintenance payments were deductible to the payer and taxable to the recipient. No longer. Under the newer rules, the child support payments are generally calculated as a percentage of the support-paying parent's income, and adjusted to account for the impact of taxes, certain special child care expenses, and undue hardship. The rules for alimony and maintenance remain the same, earning a deduction for the payer and taxable income for the payee.
Single parents	• If you are single, widowed, divorced, or separated, and you support another family member (such as a child), you will be allowed to claim that person under the "equivalent-to-married" credit. This will allow you to claim the same amount as if that person were your spouse, a credit worth approximately $1,460.
Retired persons	• Between the ages of 60 and 70, you can apply to begin receiving your monthly benefits under the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP), with some restrictions if you are less than 65 years old. At this point you may strategically direct that up to half of your CPP benefits be paid to your spouse, provided that you are both over the age of 60. If you are 65 or older by the end of the year you will also be allowed to claim an additional federal credit of up to $592, with the exact amount depending on your net income under $25,921.

NOTE: Individual circumstances and changes in the tax laws can affect these examples.

Employment-Related Expenses

As previously mentioned, certain work expenses, such as union dues, some travel and education costs, and business tools, may be deducted if the employer has completed the required authorization forms.

Investment Decisions

A major area of tax planning involves the wide variety of decisions related to investing.

Tax-Exempt Investments

All individuals in Canada are entitled to a lifetime $500,000 capital gains exemption on qualified small business corporation shares and farm property. This exemption is limited to the total gains on both small business shares and family farms over a person's lifetime.

A gain on selling your home is normally completely exempt from taxation, provided that the home served as your principal residence. This single residence can be a house, a condominium, a share in a co-operative housing corporation, or something else. The value of the land up to one-half hectare will also be included.

Tax-Deferred Investments

Although from a tax standpoint tax-deferred investments, whose income will be taxed at a later date, are less beneficial than tax-exempt investments, they also have financial advantages. According to basic opportunity cost, paying a dollar in the future instead of today gives you the opportunity to invest (or spend) it now. In addition, an individual could withdraw tax-deferred income in years that his/her marginal tax rate is low.

Registered Education Savings Plans (RESPs) allow you to build an education fund for a child by earning tax-deferred investment income. Your contributions are not tax deductible, but any and all income in the plan grows tax-free until withdrawn by the recipient. You may invest up to $4,000 per year up to a lifetime contribution limit of $42,000, and the government will provide a direct grant to the RESP of 20 percent of the first $2,000 in annual contributions. The maximum period over which income generated in an RESP may be sheltered is 26 years.

capital gains Profits from the sale of a capital asset such as stocks, bonds, or real estate.

Capital gains, profits from the sale of a capital asset such as stocks, bonds, or real estate, are tax deferred; you do not have to pay the tax on these profits until the asset is sold. Fifty percent of the capital gain is taxable. The sale of an investment for less than its purchase price is, of course, a *capital loss.* Capital losses can be used to offset capital gains. Unused capital losses may be carried back up to three years or forward indefinitely to offset capital gains. Capital losses are recognized only on non-depreciable assets, such as land and securities.

Self-Employment

Owning your own business has certain tax advantages. Self-employed persons may deduct expenses such as health insurance as business costs.

Children's Investments

Given the Canadian tax system's use of progressive tax rates, with the marginal rates increasing with higher incomes, many taxpayers attempt to minimize taxes by investing in the name of their children under age 18. Given that children generally have little or no income, this is an attempt at income splitting whereby the tax rate paid on the investment is lower or even nothing.

Despite the apparent logic of this scheme, this strategy is not a good one. The federal *Income Tax Act* contains a number of "attribution rules" to prevent income splitting, and states that any payment or transfer made "pursuant to the direction of, or with the concurrence of" a taxpayer to some other person is to be included in the taxpayer's income to the extent it would have been if paid to the taxpayer. That signifies that any income earned on an investment resulting from your transfer of money, property, or other to your child will be attributed back to you and will be taxed at your marginal rate.

Exceptions to this "attribution" rule with regard to children's investments occur when the money given to your child is classified as being lent, with interest on the loan being paid back to you. In this case, if the interest charged is at least equal to the CCRA's prescribed interest rate at the time and the interest is actually paid for that year before January 30, then the returns on investment will be taxed in the hands of your child. In any case where the interest payment is not made by the January 30 deadline, that year's income and all future income from the loaned property will be attributed back to the lender. As well, capital gains are not attributed to parents.

Retirement Plans

A major tax strategy of benefit to working people is the use of tax-deferred retirement plans such as RRSPs, RPPs, IPPs, and Deferred Profit Sharing Plans (DPSPs).

RRSP

Registered Retirement Savings Plans are the quintessential tool in the Canadian taxpayer's toolbox. Virtually all taxpayers benefit from having these, and setting them up can be easily done at almost any bank or trust company or through a stockbroker or life insurance agent. The basic concept is simple: If you agree to put some of your salary away and not have immediate access to it, the tax system will tax that income and all proceeds from its investment when it is withdrawn from the RRSP, rather than when it is earned by the taxpayer.

Contributions to an RRSP are deductible for any year in which they are made or for the prior year if made within the first 60 days of the year. The contribution that you are allowed to make will depend on three factors. First, the most that can be contributed in any year is $13,500 until 2003, and then $14,500 for 2004 and $15,500 for 2005. Second, you can only contribute up to 18 percent of your prior year's earned income, subject to the above limitations, plus any contribution room that you may have carried forward from prior years. Third is your pension adjustment, defined as the deemed value of your pension earned for the previous year. In other words, the amount you will be allowed to contribute to your RRSP will be diminished by the amount that you and your employer put aside for your retirement pension. The amount of your pension adjustment will be shown on your T4 slip.

> **? Did You Know**
>
> The value of your RRSP contribution in terms of tax savings will depend on your marginal rate of tax. Roughly speaking, with the rates varying due to different provincial tax rates, the value of your contribution will be:
>
> 27% on income up to $29,590
> 41% on income from $29,590 to $59,180
> 50% on income over $59,180
>
> *Source:* KPMG's *Tax Planning for You and Your Family*, 1999.

RPP A Registered Pension Plan is set up for employees by their employers. Larger companies and many smaller ones have such plans, in which your employer contributes an annual amount on your behalf. Occasionally, you will be required or allowed to contribute to the plan and you will be able to deduct your contribution in the year that it is made.

In general, there are two types of registered pension plans: money-purchase and defined benefit. The former is much like an RRSP in that the amount of your pension will depend on the contributions made and the growth achieved with those funds. Large and public employers often provide the latter, defined benefit plans. With this type of plan, the amount you will receive as a pension is known in advance and is usually based on a percentage of your actual salary over a specified number of years.

If you are allowed to contribute to a money-purchase RPP, consider making your payment to an RRSP instead. Though the benefits in terms of taxes are the same, the amount you hold in your RPP will be locked in and inaccessible.

If you terminate your employment but are not yet eligible to receive pension income, you are allowed to transfer a lump-sum payment from your RPP to a locked-in RRSP or Registered Retirement Income Fund (RRIF). The amount allowed for transfer is limited, however, and you may be required to accept an immediate partial cash payment on which you will be taxed.

IPP An individual pension plan is a defined-benefit registered pension plan designed and structured for one individual. IPP contributions are made according to the benefit payable at retirement. This type of plan may be to your advantage if you are already in your employer's group RPP but the benefits are not as high as you would want. Generally, this type of plan is optimal for executives or owner-managers, people over 53, or those earning more than $100,000 as a base salary.

DPSP Deferred Profit Sharing Plans are less common than RPPs but they operate in essentially the same way. Your employer makes contributions and you are taxed only when you receive the funds. The contributions are based on current or accrued company profits but may have a defined minimum contribution amount. Further, they are limited to no more than 18 percent of your earnings in a year or a set maximum amount. You are not allowed to contribute to this type of plan and the amounts contributed by your employer will be reported as a pension adjustment on your T4, thereby reducing your RRSP contribution allowance.

Changing Tax Strategies

Someone once said that "death and taxes are the only certainties of life." Changing tax laws seem to be another certainty. Each year, the CCRA modifies the tax return and filing procedures. In addition, the government frequently passes legislation that changes the *Income Tax Act*. These changes require that you regularly determine how to best consider the tax laws for personal financial planning. Carefully consider changes in your personal situation and your income level. You should monitor your personal tax strategies to best serve your daily living needs and your long-term financial goals.

Concept Check 3-5

1. How does tax avoidance differ from tax evasion?
2. What common tax-saving methods are available to most individuals and households?

Summary of Objectives

Obj. 1 Describe the importance of taxes for personal financial planning.

Tax planning can influence spending, saving, borrowing, and investing decisions. A knowledge of tax laws and maintenance of accurate tax records allows you to take advantage of appropriate tax benefits. An awareness of income taxes, sales taxes, excise taxes, property taxes, estate taxes, and other taxes is vital for successful financial planning.

Obj. 2 Calculate taxable income and the amount owed for federal income tax.

Taxable income is determined by subtracting deductions and allowances for exemptions from total income. Your total tax liability is based on taxes computed on taxable income, less any tax credits.

Obj. 3 Prepare a federal income tax return.

The major sections of your tax return require you to calculate (1) your filing status, (2) income, (3) deductions, (4) other deductions, (5) tax credits, and (6) your refund or the additional amount you owe.

Obj. 4 Identify tax assistance sources.

The main sources of tax assistance are CCRA services and publications, other publications, the Internet, computer software, and professional tax preparers such as commercial tax services, accountants, and attorneys.

Obj. 5 Select appropriate tax strategies for different financial and personal situations.

You may reduce your tax burden through careful planning and making financial decisions related to consumer purchasing, the use of debt, investments, and retirement planning.

Financial Planning Problems

1. *Computing Taxable Income.* Franklin Stewart arrived at the following tax information:

   Gross salary, $47,780
   Interest earnings, $225
   Dividend income, $80
   Basic personal amount, $7,131
   Deductions, $3,890
   Other losses, $1,150

   What amount would Franklin report as taxable income? (Obj. 1)

2. *Calculating the Average Tax Rate.* What would be the average tax rate for a person who paid taxes of $4,864.14 on a total income of $39,870? (Obj. 2)

3. *Determining a Refund or Taxes Owed.* Based on the following data, would Ann and Carl Wilton receive a refund or owe additional taxes? (Obj. 2)

   Net income, $48,190
   Deductions, $11,420
   Child care tax deduction, $80
   Federal income tax withheld, $6,784
   Basic personal amount, $7,131
   Tax rate on taxable income, 17 percent

4. *Comparing Taxes on Investments.* Would you prefer a fully taxable investment earning 10.7 percent or a tax-exempt investment earning 8.1 percent? Why? (Obj. 5)
5. *Future Value of a Tax Savings.* On December 30, you decide to make a $1,000 charitable donation. If you are in the 24 percent tax bracket, how much will you save in taxes for the current year? If you deposit that tax savings in a savings account for the next five years at 8 percent, what will be the future value of that account? (Obj. 5)

Financial Planning Activities

1. *Searching the Internet for Tax Information.* Using Web sites such as the Virtual Tax Resource Centre at www.tax.ca, the Canadian Tax Foundation at www.ctf.ca, or Canoe Money at www.canoe.ca/Money, or library resources, obtain information about the tax implications of various financial planning decisions. (Obj. 1)
2. *Researching Tax-Exempt Income.* Using library resources or the World Wide Web, determine the types of income that are exempt from federal income tax. (Obj. 2)
3. *Planning Your Tax Payment.* Survey several people about whether they get a federal tax refund or owe taxes each year. Obtain information about the following: *(a)* Do they usually get a refund or owe taxes when they file their federal tax return? *(b)* Is their situation (refund or payment) planned? *(c)* What are the reasons they want to get a refund each year? *(d)* Are there situations where getting a refund may not be a wise financial decision? (Obj. 2)
4. *Researching Current Tax Forms.* Obtain samples of current tax forms you would use to file your federal income tax return. These may be ordered by mail, obtained at a local CCRA office or post office, or obtained on the Internet at www.ccra-adrc.gc.ca. (Obj. 4)
5. *Researching Tax Questions.* Use CCRA publications and other reference materials to answer a specific tax question. Contact a CCRA office to obtain an answer for the same question. What differences, if any, exist between the information sources? (Obj. 4)
6. *Analyzing Tax Preparation Software.* Visit a retailer that sells tax preparation software, such as www.intuit.com, or visit the Web sites of software companies to determine the costs and features of programs you may use to prepare and file your federal income tax return. (Obj. 4)
7. *Reducing Tax Errors.* Create a visual presentation (video or slide presentation) that demonstrates actions a person might take to reduce errors when filing a federal tax return. (Obj. 4)
8. *Determining Tax Planning Activities.* Survey friends and relatives about their tax planning strategies. (Obj. 5)

LIFE SITUATION CASE

A SINGLE FATHER'S TAX SITUATION

Ever since his wife's death, Eric Armano has faced difficult personal and financial circumstances. His job provides him with a fairly good income but keeps him away from his daughters, ages 8 and 10, nearly 20 days a month. This requires him to use in-home child care services that consume a large portion of his income. Since the Armanos live in a small apartment, this arrangement has been very inconvenient.

Due to the costs of caring for his children, Eric has only a minimal amount withheld from his salary for federal income taxes. This makes more money available during the year, but for the last few years he has had to make large payments in April—another financial burden.

Although Eric has created an investment fund for his daughters' education and for his retirement, he has not sought to select investments that offer tax benefits. Overall, he needs to look at several aspects of his tax planning activities to find strategies that will best serve his current and future financial needs.

Eric has assembled the following information for the current tax year:

Earnings from wages, $47,590
Interest earned on savings, $125
RRSP deduction, $2,000
Chequing account interest, $65
Basic personal amount, $7,131
Other deductions, $6,350
Amount withheld for federal income tax, $3,178
Child care deduction, $1,400
Filing status: head of household

Questions

1. What are Eric's major financial concerns in his current situation?
2. In what ways might Eric improve his tax planning efforts?
3. Is Eric typical of many people in our society with regard to tax planning? Why or why not?

4. What additional actions might Eric investigate with regard to taxes and personal financial planning?

5. Calculate the following

a. What is Eric's taxable income? (Refer to Exhibit 3–1, p. 64.)

b. What is his total tax liability? (Use Exhibit 3–6, p. 77.) What is his average tax rate?

c. Based on his withholding, will Eric receive a refund or owe additional tax? What is the amount?

Creating an E-Plan: Financial Decisions Using the Web

internet

TAX PLANNING ACTIVITIES

Taxes are a fact of financial planning. However, various actions can be taken to reduce the time and money that goes toward taxes.

Web Sites for Tax Planning

- For access to federal tax forms, CCRA regulations and other tax information, go to the CCRA's Web site at **www.ccra-adrc.gc.ca**. You may also find information at the Government of Canada site at **www.gc.ca**, and the Department of Finance Canada site, at **www.fin.gc.ca**.
- For access to provincial tax forms, regulations, and other tax information, go to the Québec Ministère du Revenu's Web site at www.revenu.gouv.qc.ca. You may also find information at the Government of Quebec site at **www.gouv.qc.ca**, and the Department of Finance site at **www.finances.gouv.qc.ca**.
- You will find a tremendous amount of investment and accounting company sites with tax information on the Web. Among the better known are Ernst & Young at **www.eycan.com**, Deloitte & Touche at **www.deloitte.ca**, H & R Block Canada at **www.hrblock.ca**, KPMG Canada at **www.kpmg.ca**, and Evancic Perreault Robertson at **www.epr.ca**.
- Online tax statistics and information is available at the Fraser Institute site at **www.fraserinstitute.ca**, the Canoe Money site at **www.canoe.ca/Money**, the Virtual Tax Resource Centre at **www.tax.ca**, the Canadian Taxpayer Federation at **www.taxpayer.com**, the CANTAX site at **www.cantax.com**, and the Canadian Tax Foundation site at **www.ctf.ca**.
- Information about tax return software is available at the GriffTax site at **www.grifftax.com**, the HomeTax site at **www.hometax.com**, the Intuit Canada site at **www.intuit.com/canada**, and the TaxWiz site at **www.taxstuff.com**.
- In cases where you may have a dispute with the CCRA regarding your taxes, the Tax Court of Canada at **www.tcc-cci.gc.ca** is a government organization operating independently to settle tax disputes.

(Note: Addresses and content of Web sites change, and new sites are created daily. Use search engines to update and locate Web sites for your current financial planning needs.)

Short-Term Financial Planning Activities

1. Develop a system for filing and storing various tax records related to income, deductible expenses, and current tax forms (see Exhibit 3–2).
2. Using the CCRA site and other Web sites, identify recent changes in tax laws that may affect your financial planning decisions.
3. Using current CCRA tax forms and tax tables, estimate your tax liability for the current year.
4. Compare the cost of tax preparation services.

Long-Term Financial Planning Activities

1. Identify saving and investing decisions that would minimize future income taxes.
2. Develop a plan for actions to take related to your current and future tax situation.

Government Web Sites

Government of Canada **www.gc.ca**
Department of Finance Canada **www.fin.gc.ca**
Canada Customs and Revenue Agency **www.ccra-adrc.gc.ca**
Government of Quebec **www.gouv.qc.ca**
Department of Finance **www.finances.gouv.qc.ca**
Department of Revenue **www.revenu.gouv.qc.ca**

Other provincial and territorial governments:

Alberta **www.gov.ab.ca**
British Columbia **www.gov.bc.ca**
Manitoba **www.gov.mb.ca**
New Brunswick **www.gov.nb.ca**
Newfoundland **www.gov.nf.ca**
Northwest Territories **www.gov.nt.ca**
Nova Scotia **www.gov.ns.ca**
Nunavut **www.gov.nu.ca**
Ontario **www.gov.on.ca**
Prince Edward Island **www.gov.pe.ca**
Saskatchewan **www.gov.sk.ca**
Yukon **www.gov.yk.ca**

United States **www.info.gov**
Internal Revenue Service **www.irs.ustreas.gov**

Other countries **www.intergov.gc.ca**

Continuous Case for Part 1

GETTING STARTED: PLANNING FOR THE FUTURE

Life Situation
Single; age 22; starting a career; no dependants

Financial Goals

- Evaluate current financial situation
- Establish a personal financial plan
- Develop a budgeting system for spending and savings

Financial Data

Monthly income	$2,400
Living expenses	1,980
Assets	6,200
Liabilities	1,270
Emergency fund	300

While in college, Pamela Jenkins worked part time and was never concerned about long-term financial planning. Rather than creating a budget, she used her chequebook and savings account (which usually had a very low balance) to handle her financial needs.

After completing college, Pamela began her career as a sales representative for a clothing manufacturer located in Montreal. After one year, her assets consist of a 1995 Chevrolet, a television set, a stereo, and some clothing and other personal belongs, with a total value of $6,200.

Since a portion of her income is based on commissions, her monthly income varies from one month to the next. This situation has made it difficult for Pamela to establish a realistic budget. During lean months, she has had to resort to using her credit card to make ends meet. In fact, her credit card debt, $1,270, is her only liability at this time. Her only other source of income is a large tax refund. In the past, she has always used tax refunds to finance major purchases (a vacation or furniture) or pay off credit card debt.

Questions

1. What financial decisions should Pamela be thinking about at this point in her life?
2. What are some short-term, intermediate, and long-term financial goals that Pamela might want to develop?
3. How should Pamela budget for fluctuations in her income caused by commission earnings?
4. Assume Pamela's federal tax refund is $1,100. Given her current situation, what should she do with the refund?
5. Based on her life situation, what type of tax planning should Pamela consider?