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Planner

## Income Tax Strategies

# MAINTAINING TAX REGULARITY

Every year they blow their taxes.

Like the year they could have deducted little Polenta's hockey camp as childcare expenses. Or the year they could have declared as medical expenses the trip to see a specialist in Victoria. But the best, or the worst, was the year they so cleverly borrowed big bucks to make a Registered Retirement Savings Plan contribution on March 1st. . . . when the cutoff was February 29.

That hurt. It was the last year Granola worked as a school teacher. She didn't receive the \$3,000 tax refund intended to kick start her new business; she's still paying interest on the loan; and, as her business has yet to show a profit, hasn't even been able to use the contribution as a tax deduction. Worse, when she can apply the deduction, she'll lose over \$900 in real cash dollars. (For the math, see note below.)

Whatever it may be, that frantic last minute flurry is not tax planning. She and her spouse Muesli have now taken professional advice.

### HOME WORKSPACE

Granola works as a graphic artist from home, Muesli as an elementary teacher. Her

Tax planning is done at "marginal tax rates," the rate charged on the last dollar earned; that is, "at the margin." For 2005, if she shows a net income over \$8676, Granola's MTR is 22%. If she were able to use her entire \$10,000 RRSP deduction (that is, if she had a net income over \$18,676), she would save \$2,200 in taxes. In her last year of employment, her MTR on \$45,000 salary was 31.15%. Thus, if she had made her RRSP contribution on time, her tax refund would then have been \$3,115, \$915 more.

workspace occupies 10% of their home, and she keeps track of all household expenses: mortgage interest, hydro, insurance, maintenance, and Rayfayel the bronzed yardboy. She reviews all such expenses monthly to make sure none are missed: for instance, the hundred bucks Muesli gave Rayfayel to help remove a windfall (from over a fallen Hydro line. Muesli hoped the dozey Rayfayel might get zapped.) Ten percent are business expenses.

### AUTO EXPENSE

Granola keeps a little spiral notebook in the glove boxes of both her island beater and Muesli's prestige SUV. She knows a round trip to the post office takes 16.3 km. For each trip, she jots the date and the odometer reading into the notebook. (It doesn't matter that she does her grocery shopping on the same trip.) At the end of each month, when tracking down eligible deductions and expenses, she updates her auto log. She maintains a record of all relevant expenses, including insurance, maintenance, gas and oil, rub downs from Rayfayel. Based on usage, she figures on deducting about 90% of beater expenses, 5% of the SUV's.

Boring? Tedious? It takes one half hour monthly from her life, and saves her hundreds in otherwise squandered tax dollars.

### FAMILY INCOME SPLITTING

Granola no longer provides Polenta an allowance, instead paying her to clean the workspace. Each dollar transferred this way to Polenta saves at least 22c in income tax.

## MEDICAL EXPENSES

When doing her monthly review, Granola scans a long list of eligible medical expenses, surprised at what's allowed. (For a list, send an email, with "Eligible medical expense" as the subject. Use address below.)

For her referral to a Victoria specialist, using the "simplified" calculation, she's permitted 43c per kilometer, \$15 per meal on the road. (There is always a challenge in making a medical expenses claim, as it is reduced by 3% of net income. But the claim can be made by either spouse, and Granola estimates her net income at \$10,000. Thus, all family medical expenses over \$300 will be entitled to the tax credit.) Again, her return will be 22c on the dollar.

## IMPROVED CASH FLOW

Muesli, for his part, makes an automatic \$200 monthly contribution to a spousal RRSP in Granola's name. This practice could provide Muesli a tax refund of \$744. But, rather than allow government an interest free loan on his own money, he's filed Form 1213 to request less tax deducted at source, more cash into his hands. (This form can be used to reduce tax at source for various reasons: regular child care expenses, charitable donations, alimony, child support payments.)

## THE CLIP AND SAVE OR SEND TO STUDENTS SECTION

- \$ Most youngsters owe no tax on summer income. But their employers automatically deduct it, and the kids wait until April to claim refunds. . . . if they bother. The TD1 form, available from the employer, authorizes wages to be paid without any tax withheld.
- \$ If the move home from school to take summer employment is more than 40 km, such expenses are deductible against income. Even without receipts.
- \$ The move back to school is similarly deductible against any grant or scholarship income.
- \$ Interest on student loans is now deductible. But if no tax is owing for the year in which the interest is paid, the deduction can be carried forward up to five years.
- \$ File. Even if no tax is due, one should file an income tax return to build up RRSP contribution room. An island girl, now a big lawyer in the big city, worked as a resort waitress for seven years, earning about \$6,000 each year. She didn't need to file, and didn't. She missed out on \$7560 RRSP contribution room -- and paid an additional \$4,082 in income tax by missing this escape hatch when trying to defer tax on a bonus.
- \$ Another reason to file: Cash in the mail! From the year in which one turns 19, every taxpayer of modest (or no) means becomes entitled to the GST credit, a quarterly reimbursement.
- \$ And yet another: If tuition and education tax credits cannot be exhausted against income, they can be carried forward — or transferred to parents or grandparents. (But not both. Careful.)
- \$ Download Students and Income Tax: <http://www.cra-arc.gc.ca/E/pub/tg/p105/p105-04e.pdf>

## MAXIMIZING DONATIONS

One last little trick Granola has learned is around charitable donations. The first \$200 earns a tax credit at the lowest bracket rate, no matter what one's income. Amounts above that earn a credit at the highest rate (22% versus 43%). Each donates \$200. This provides a total \$88.20 tax credit. But, when combined on one return, the same donations

provide a credit of \$131.50 -- \$43.30 saved simply by being sensible.

The trick is using the first \$200 threshold only once. Which can be taken another step. For tax purposes, donations are allowed to be carried forward five years. If Granola were to carry forward the \$400 in combined annual donations, her total credit would be \$155.20 greater. (\$131.50 x 5 versus \$830.70.)

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