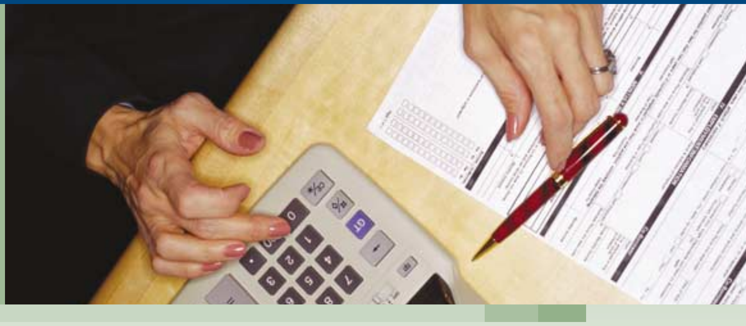
CHAPTER 3



Planning Your Tax Strategy

I OWE HOW MUCH IN TAXES?

The year is 2005. Stephanie Seymour is currently employed full time and earns an annual salary of $30,500. It has been a year since she graduated from university; however, she continues to take a few part-time courses in the evenings. Stephanie is currently paying off her student loan; she makes monthly contributions to her RRSP and has begun to build an income-generating investment portfolio. She recently moved away from her parents' home and into her own apartment in downtown Toronto, which allows her to be 40 km closer to work and school. It should also be noted that Stephanie has made contributions to a few charities over the year. Stephanie is currently preparing to file her 2005 personal income taxes and has gathered the following information:

Income—$30,500 plus $1,500 bonus (T4 Slip)
Federal Tax paid on income—$3,536 (T4 Slip)
Provincial Tax paid on income—$1,626 (T4 Slip)
Canada Pension Plan (CPP) contributions (T4 Slip) $1,410.75
Employment Insurance premiums (T4 Slip) $633.50)
Tuition (2 semesters = 8 part-time months)—$565 (T2202A slip)
Interest portion of payments on student loan—$835
Rent—$9,000
Moving expenses—$963.80
Rent on safety deposit box—$30
Investment income (Dividends)—$125 (T5 Slip)
RRSP contributions—$2,050
Charitable contributions—$65

We will follow Stephanie Seymour throughout the chapter as she completes her 2004 federal income tax return. All values are taken from this case as well as from Exhibits 3-6a and 3-6b (on pages 72–78) that present her *T1 General 2004 – Income Tax and Benefit Return* and federal *Appendix 1*, respectively.

LEARNING OBJECTIVES

1. Describe the importance of taxes for personal financial planning.
2. Illustrate how federal income taxes are computed by completing a federal income tax return.
3. Select appropriate tax strategies for different financial and personal situations.
4. Identify tax assistance sources.

TAXES AND FINANCIAL PLANNING

OBJECTIVE 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 to maximize your after-tax cash flows and net worth.

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 employment, purchase, and investment decisions that leave you with the greatest after-tax cash flows and net wealth.

Visit the Web site See the Chapter Overview under Chapter 3 on the online learning centre at www.mcgrawhill.ca/college/kapoor.

Notice that the planning objective is *not* stated as minimizing taxes. While taxes are an important consideration in any financial decision, focusing solely on reducing taxes can lead to undesirable results. Consider, for example, the asset allocation decision. Deposits and other safe investments generate interest income that is 100 percent taxable. Common shares of growing companies often increase in value, resulting in a capital gain when the shares are eventually sold. However, only one-half of capital gains is taxable and so the tax treatment of capital gains is much more favourable than that of interest income. However, shifting your asset allocation toward high-risk common shares solely to reduce taxes may not match your financial goals and risk tolerance. A better approach, encompassing both investment and tax considerations, would be to select an asset allocation based on your goals and risk tolerance and then decide in which account to hold the investments in order to maximize after-tax investment cash flows. This concept will be discussed later in the chapter under tax strategies.

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

The principal purpose of taxes is to finance government activities. As citizens, we expect the government to provide such services 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.

TAXES ON PURCHASES

You probably pay sales tax on many of your purchases—for example, the 7 percent federal goods and services tax, commonly referred to as the GST. Provinces also charge an additional sales tax (with the exception of Alberta). In order to reduce the economic burden of such taxes on the poor, certain goods and services—including most food items and prescription drugs—are exempt from sales taxes, and low-income individuals may be eligible for a refund of a portion of the GST and provincial sales taxes they have paid.

In addition to the sales tax, an **excise tax** may be imposed by the federal and provincial governments on specific goods and services, such as gasoline, cigarettes, alcoholic beverages, tires, air travel, and telephone service.

DID YOU KNOW ?

Tax Freedom Day provides Canadians with a true picture of their tax burden. According to the Fraser Institute's annual calculations, income earned prior to June 28, 2004 was used to pay the total tax bill imposed by all levels of government. This means that on the average, every dollar you earned in the first half of 2004 was not for you, but for the government.

SOURCE: "Canadians Celebrate Tax Freedom Day on June 28th," by N. Veldhuis and M. Mullins, June 21, 2004, www.fraserinstitute.ca

TAXES ON PROPERTY

Real estate property tax is a major source of revenue for local governments. This tax is based on the assessed 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 impose a tax on the increase in an individual's wealth, called a capital gains tax. With few exceptions, the increase in value of any capital asset that is realized at the time of sale or transfer is subject to capital gains tax. Most exceptions involve transfers to spouses and financially dependent or disabled children. Fifty percent of capital gains, net of any capital losses, are taxable in the year they are incurred.

The sale of an asset, such a stock or bond, can trigger a capital gain (or loss). Transferring ownership of an asset through a gift or inheritance can also trigger capital gains and losses. Although the federal and provincial governments do not impose estate or inheritance taxes, there is a deemed disposition of all capital property by the deceased at the time of death, triggering any accrued capital gains. The executor of the estate must file a "terminal" income tax return for the deceased and include the deemed disposition of all assets. Thus, bequests and property passed on to heirs other than a spouse are received after-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.

DID YOU KNOW?

Personal Taxes paid in Canada in 2003 totalled $9.5 billion.

Source: www.cba.ca

FILING YOUR FEDERAL AND PROVINCIAL 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 identify which basic form you will be required to complete, most often the *T1 General Income Tax and Benefit Return* for a particular province, and any necessary schedules or supplementary forms. Finally, you must decide whether to complete a paper return, file by telephone, or file electronically.

Each taxpayer is personally responsible for the information provided to the government in his income tax return. If any individual or firm has helped you to complete your return, take the time to review it before filing. There is no excuse for being ignorant of your tax situation.

WHO MUST FILE?

All residents of Canada must file a federal income tax return for any year in which they have a balance of taxes owing. A resident is considered to be anyone living in Canada, but also includes non-Canadians who are present 183 days (one-half of a year) or more. Canadian residents are taxed on their worldwide income. Usually, taxes paid to a foreign government can be offset by a foreign tax credit that alleviates potential double taxation of foreign income. In addition, the federal government will tax nonresidents of Canada on certain income earned from Canadian sources, such as investment income.

Your province of residency as of December 31 of the taxation year will determine which provincial income tax return you are required to file. 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 www.gouv.qc.ca.

All other provinces and territories apply a Tax on Income (TONI) system that permits the province to decide its own tax rates to be applied to taxable income, as well as different non-refundable and refundable tax credits.

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

employment income Remuneration received for personal effort.

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?
3. Who must file an income tax return?

INCOME TAX FUNDAMENTALS

OBJECTIVE 2

Illustrate how federal income taxes are computed by completing a federal income tax return.

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. Exhibit 3-1 outlines the steps required in the calculation of your federal and provincial income tax due for all provinces other than Quebec.

STEP 1: DETERMINING TOTAL INCOME

net business income Net income from an activity that is carried out for profit, after expenses have been deducted.

investment income Income from property, including income in the form of interest, dividends, and rents net of expenses.

taxable capital gains Net gains from the sale of capital assets such as stocks, bonds, and real estate. One-half of net capital gains are taxable.

TYPES OF INCOME With minor exceptions, most income earned by Canadian residents is subject to federal and provincial income tax. Your total income consists of five main components:

1. **Employment income** is remuneration received for personal effort, including salaries, wages, commissions, tips, bonuses, and taxable employee benefits.
2. **Net business income** includes any income from an activity that is carried out for profit, including income from a sole proprietorship, partnership, corporation, or profession, after expenses have been deducted.
3. **Investment income**, or income from property, includes income in the form of interest, dividends, and rental income net of expenses. Dividend income is grossed-up by 25 percent to compute taxable dividends.
4. **Taxable capital gains**, although commonly referred to as investment income, is not defined as such by the *Income Tax Act*. As mentioned earlier, it is a tax on accumulated wealth. Capital gains are generated upon the sale of capital assets such as stocks, bonds, and real estate. Any capital losses incurred in the same calendar year are first subtracted from capital gains, and 50 percent of the resulting amount is taxable.

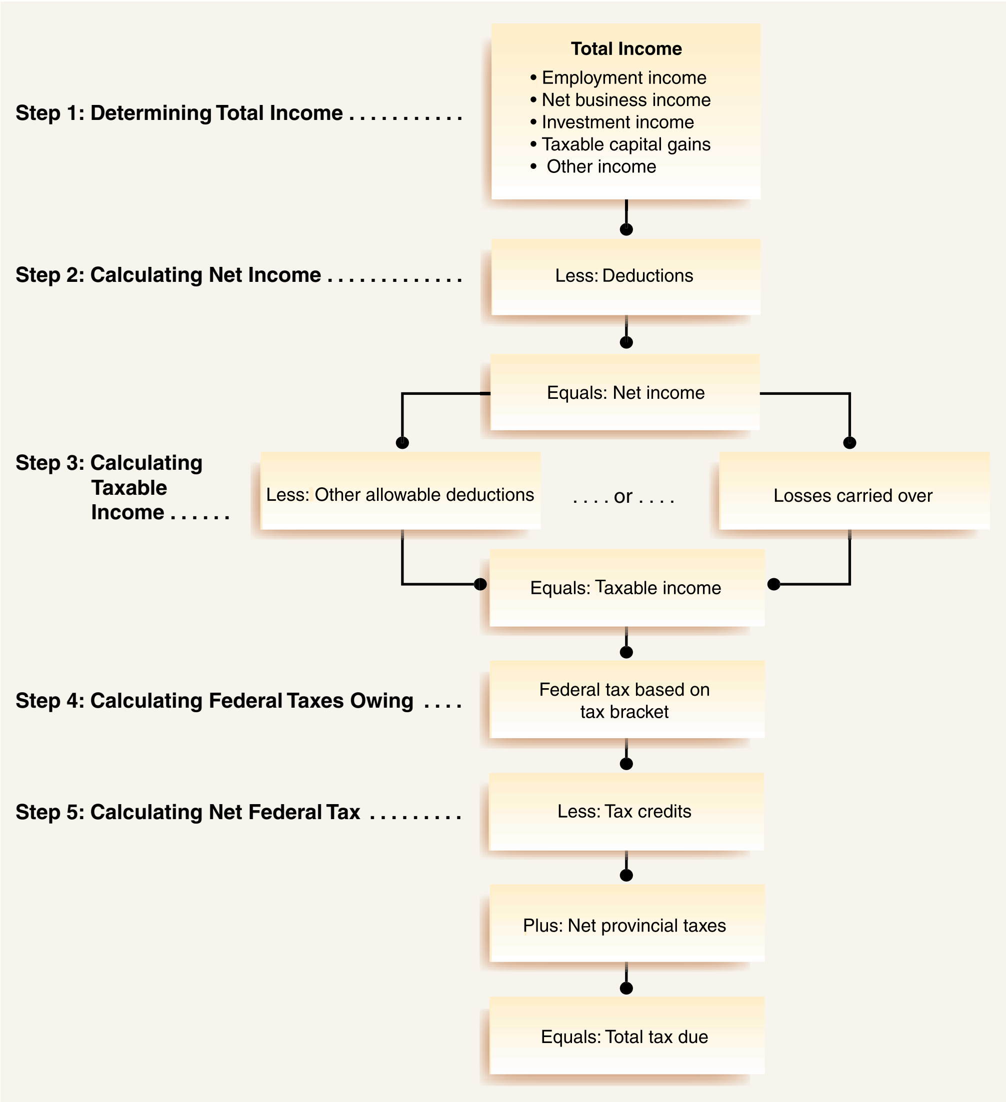


Exhibit 3–1
Computing Taxable Income and Your Tax Liability

5. *Other income* includes retirement income from corporate pension plans and RRSPs; payments from government plans such as the Canada Pension Plan, Employment Insurance, or Old Age Security; spousal and certain child support payments; research grants; and other education-related payments in excess of $3,000.

Income that is not subject to income tax includes lottery winnings, gifts, inheritances, certain child support payments, the GST/HST rebate, and the Canada child tax benefit. Owning a home is one of the best tax shelters available in Canada, primarily because any capital gain realized upon its sale will be exempt from capital gains tax as long as it qualifies as your principal residence. The residence can be a house, a condominium, a share in a co-operative housing corporation, or a summer cottage. The value of the land up to one-half hectare is also included.

STEP 2: CALCULATING NET INCOME

Net income is total income less certain deductions, described below. Its importance lies in the fact that it is often a critical factor in determining the eligibility and size of various federal and provincial income tax deductions, tax credits, and government payments, such as the Guaranteed Income Supplement. In addition, federal payments of Old Age Security must be

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

repaid at a rate of 15 percent for every dollar of net income in excess of $59,789 (in 2004). This is referred to as the OAS clawback.

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

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

- *Contributions* to deferred income plans. Common examples of tax-deferred income plans are corporate Registered Pension Plans (RPPs) and Individual Pension Plans (IPPs), as well as personal Registered Retirement Savings Plans (RRSPs). Income from these plans is taxed at a later date, when withdrawals are made.
- *Union and professional dues* are generally deductible although for Quebec provincial taxes they are included under non-refundable tax credits. 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.
- *Child care expenses* can be deducted, usually by the spouse with the lower net income in a two-parent family, subject to various limitations. This is also true for common-law couples who meet certain criteria. Single parents can deduct child 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. In Quebec, the refundable child care tax credit replaces the child care expense deduction and is based on family net income.
- *Disability supports deduction* This deduction includes both attendant care expenses as well as other paid disability expenses that permit the disabled individual to go to school or to earn taxable income.
- *Moving expenses* are largely deductible if you move to start working at a new location, to move closer to school, 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.
- *Other deductions* that include:
  - Deductible business investment losses, defined as 50 percent of capital losses incurred on investments in Canadian-controlled private corporations.
  - Spousal and child support payments that are made under certain conditions.
  - Interest paid on loans, the proceeds of which are used to earn taxable investment income. This excludes loans for RRSP and RESP contributions. Other costs related to investing, referred to as carrying costs are also deductible.
  - Employment expenses, if the employer requires the employee to pay for his or her own travel and/or other costs of employment by signing form T2200.

Your deductions are subtracted from total income to obtain your net income.

STEP 3: CALCULATING TAXABLE INCOME

Once net income has been determined, additional deductions and losses carried forward from prior years are permitted in the determination of taxable income. These include the following:

- *Security options deduction* that equals one-half of the stock option benefit included under employment income, if certain conditions are met. This deduction effectively renders the taxation of the benefit conferred by exercising a corporate stock option equivalent to that on a capital gain.
- *Capital gains deduction* equal to one-half of the eligible capital gains exemption. Current regulations entitle individuals to a $500,000 lifetime “capital gains exemption” on qualified small business corporation shares and eligible farm property. Taxable

capital gains are included in net income, but then offset by this deduction in order to determine taxable income.

- *Net capital losses of prior years* can be carried forward indefinitely and used to offset any taxable capital gains reported under total income that are not eligible for the capital gains deduction discussed above.
- *Other deductions* that include the employee home relocation loan deduction, special deductions for Northern residents and those employed in the Canadian Forces, and the carry forward of non-capital losses from prior years.

You are required to maintain sufficient records to support tax deductions. Financial advisers recommend a home filing system (see Exhibit 3–2) 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.

Exhibit 3–2 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

STEP 4: CALCULATING FEDERAL 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. This calculation is performed on CRA Schedule 1, not directly on the *T1 General Income Tax and Benefit Return*. The impact of non-refundable tax credits also appears on Schedule 1.

The four federal tax brackets and corresponding rates in 2004 were:

Taxable Income	Tax Rate
0 – $35,000	16%
$35,001 – $70,000	22%
$70,001 – $113,804	26%
Over $113,804	29%

With the exception of Quebec, all provinces and territories have adopted the Tax on Income also known as the TONI system. TONI is a method of calculating provincial and territorial personal income tax, which parallels the federal calculations with taxable income as the starting point. The TONI system replaces the tax on tax calculations. The province of Quebec continues to administer its own provincial income taxes.

Your **marginal tax rate** is the rate you pay on the next dollar of taxable income earned. For example, suppose you earn $45,000 of taxable income. Your 2004 federal tax liability would be calculated as 16 percent on the first $35,000, while the remaining $10,000 ($45,000 − $35,000) would be taxed at 22 percent. In total, your federal taxes would equal 16 percent of $35,000 = $5,600 and 22 percent of $10,000 = $2,200, for a total of $7,800 before the consideration of any tax credits. Your federal marginal tax rate would be 22 percent, the rate applied to the next dollar of taxable income.

marginal tax rate The rate of tax paid on the next dollar of taxable income.

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 taxable income. Except for taxpayers in the 16 percent tax bracket, this rate is less than a person's marginal tax rate. To continue our example, your average federal tax rate would be calculated as your total tax bill of $7,800 divided by your taxable income of $45,000, resulting in an average federal tax rate of 17.33 percent.

Exhibit 3–3 shows the combined federal and provincial tax brackets for each province and territory for 2004.

Exhibit 3–3

Province	Combined Income Tax Rate (2004)	
Newfoundland and Labrador	first $29,590	26.57%
	over $29,590 up to $35,000	32.16%
	over $35,000 up to $59,180	38.16%
	over $59,180 up to $70,000	40.02%
	over $70,000 up to $113,804	44.02%
	over $113,804	47.02%
Prince Edward Island	first $30,754	25.80%
	over $30,754 up to $35,000	29.80%
	over $35,000 up to $61,509	35.80%
	over $61,509 up to $70,000	38.70%
	over $70,000 up to $113,804	42.70%
	over $113,804	45.70%
Nova Scotia	first $29,590	24.79%
	over $29,590 up to $35,000	30.95%
	over $35,000 up to $59,180	36.95%
	over $59,180 up to $70,000	38.67%
	over $70,000 up to $93,000	42.67%
	over $93,000 up to $113,804	43.50%
	over $113,804	46.50%
New Brunswick	first $32,183	25.68%
	over $32,183 up to $35,000	30.82%
	over $35,000 up to $64,368	36.82%
	over $64,368 up to $70,000	38.52%
	over $70,000 up to $104,648	42.52%
	over $104,648 up to $113,804	43.84%
	over $113,804	46.84%
Quebec	first $27,635	32.00%
	over $27,635 up to $35,000	36.00%
	over $35,000 up to $55,280	42.00%
	over $55,280 up to $70,000	46.00%
	over $70,000 up to $113,804	50.00%
	over $113,804	53.00%
Ontario	first $33,375	22.05%
	over $33,375 up to $35,000	25.15%
	over $35,000 up to $66,752	31.15%
	over $66,752 up to $70,000	33.16%
	over $70,000 up to $113,804	37.16%
	over $113,804	40.16%

(continued)

Exhibit 3–3
(Continued)

Province	Combined Income Tax Rate (2004)	
Manitoba	first $30,544	26.90%
	over $30,544 up to $35,000	30.00%
	over $35,000 up to $65,000	36.00%
	over $65,000 up to $70,000	39.40%
	over $70,000 up to $113,804	43.40%
	over $113,804	46.40%
Saskatchewan	first $35,000	27.00%
	over $35,000 up to $36,155	33.00%
	over $36,155 up to $70,000	35.00%
	over $70,000 up to $103,300	39.00%
	over $103,300 up to $113,804	41.00%
	over $113,804	44.00%
Alberta	first $35,000	26.00%
	over $35,000 up to $70,000	32.00%
	over $70,000 up to $113,804	36.00%
	over $113,804	39.00%
British Columbia	first $32,476	22.05%
	over $32,476 up to $35,000	25.15%
	over $35,000 up to $64,954	31.15%
	over $64,954 up to $70,000	33.70%
	over $70,000 up to $74,575	37.70%
	over $74,575 up to $90,555	39.70%
	over $90,555 up to $113,804	40.70%
	over $113,804	43.70%
Yukon	first $35,000	23.04%
	over $35,000 up to $70,000	31.68%
	over $70,000 up to $113,804	37.44%
	over $113,804	41.76%
Northwest Territories	first $33,245	23.20%
	over $33,245 up to 35,000	25.90%
	over $35,000 up to $66,492	31.90%
	over $66,492 up to $70,000	33.95%
	over $70,000 up to $108,101	37.95%
	over $108,101 up to $113,804	39.55%
	over $113,804	42.55%
Nunavut (only 2003 available)	first $35,000	20.00%
	over $35,000 up to $70,000	29.00%
	over $70,000 up to $113,804	35.00%
	over $113,804	40.50%

SOURCE: http://www.taxtips.ca/tax_rates.htm

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

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	_____	_____
7. GST/HST Credit	_____	_____

Note: These taxable income items and deductions are based on the 2004 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
8. Life insurance premiums	_____	_____
9. Cosmetic surgery for improved looks	_____	_____
10. Fees for traffic violation tickets	_____	_____
11. Mileage for driving to volunteer work	_____	_____
12. A notary's fee for preparing a will	_____	_____
13. Income tax preparation fee	_____	_____

Answers: 3, 5, 6, 9—yes; 1, 2, 4, 7, 8, 10, 11, 12,13 —no.

STEP 5: NET FEDERAL TAX

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

There are two types of **tax credits** that can reduce the amount of tax you owe: non-refundable tax credits and refundable tax credits. The more common are non-refundable tax credits, which are subtracted from the amount of taxes owed but can never reduce net federal tax below zero. (See the Financial Planning Calculations feature above.)

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.

The first step in calculating a non-refundable tax credit is to determine the maximum applicable amount. (See Exhibit 3-4 on page 69 for the maximum federal amounts in 2005.) Sometimes, the amount is preset by the government, as is the case for the basic personal amount set at $8,148 for 2005 federal tax purposes (this amount is indexed to inflation every year). In other cases, a calculation is required. The medical amount, for example, is calculated by subtracting 3 percent of your net income (to a maximum of $**[MISSING]** in 2005) from eligible medical expenses. Once the maximum amounts are determined, the non-refundable tax credit is calculated by multiplying the amount by 16 percent, with the exception of the tax credits for charitable and political contributions, and dividends, where different rates are applied.

At the federal level, there are very few refundable tax credits. These are sums that are refunded to individuals, if they qualify, even if their tax liability is zero. One such credit is the refundable medical expense supplement that can be claimed by individuals who have disproportionately high medical costs with respect to their net income.

Each province and territory has its own refundable and non-refundable tax credits. However, the maximum amounts, calculations, and percentage rates used to convert amounts to credits may be very different. Consult your provincial government's Web site for more details.

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.

All non-refundable 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 16 percent to arrive at the tax credit. For example, if $100 is spent on tuition, then about $16 can be claimed as a direct reduction of taxes ($100 × .16).

On the other hand, a deduction of $100 may or may not reduce your taxes by $16 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 $16 if you are in the 16 percent tax bracket and by $22 if you are in the 22 percent tax bracket.

Exhibit 3–4 2005 Federal Non-Refundable Tax Credit Amounts

Credit Type	Maximum 2004 Federal Base Amounts
Basic personal amount	8,012
Age amount (65 years of age or older)	3,912
—eliminated when taxpayer's net income exceeds	55,204
Spousal/common-law partner/dependant amount	6,803
—eliminated when dependant's net income exceeds	7,484
Infirm dependant amount (over 18 years of age)	3,784
—eliminated when dependant's net income exceeds	9,152
CPP/QPP contributions (employee)	1,831.50
CPP/QPP contributions (self-employed)	3,663
EI premiums	772.20
Pension income amount	1,000
Caregiver amount for in-home care of parent or grandparent over 65 years of age, or of infirm adult relative	3,784
—eliminated when relative's income exceeds	16,705
Disability amount	6,486
Disability amount supplement for taxpayers under 18 years of age	3,784
—eliminated when child/attendant care expenses exceed	6,000
Interest paid on student loan	Amount paid
Tuition and education amount	Tuition paid + $400 per month of full-time attendance
Medical amount	Amount paid in excess of 3% of net income or $1,813, whichever is less

SOURCE: Adapted from www.taxtips.ca/tax_rates.htm

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 CRA as well as the Québec 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.

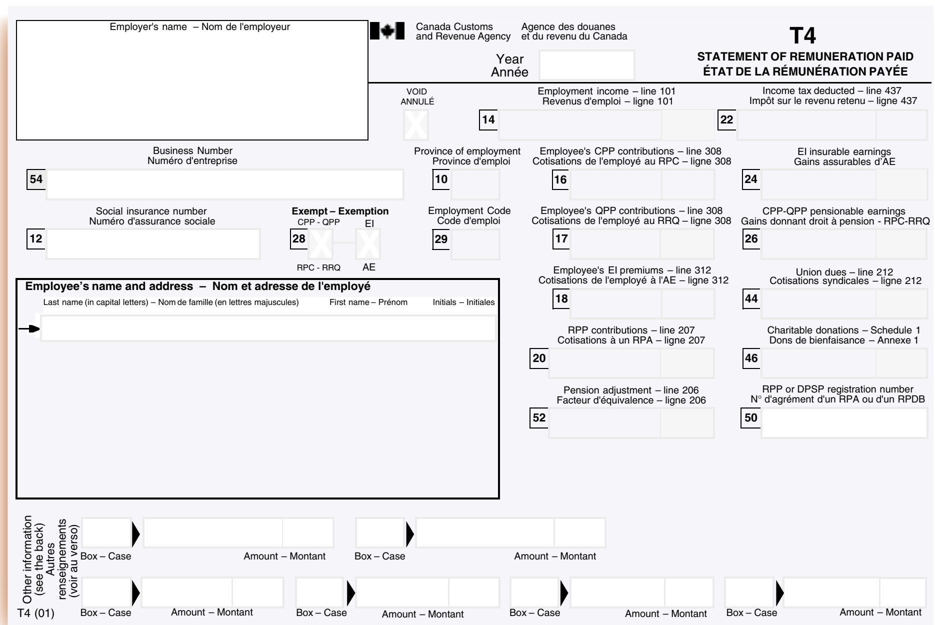
After the end of the year, you will receive a federal T4 form (see Exhibit 3–5), which reports your annual earnings and the amounts that have been deducted for income tax, social benefits, and other taxes. A copy of the T4 form is filed with your tax return to document your earnings and the amount you 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 spousal and child support payments. The CRA 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

Exhibit 3–5


Employer's name – Nom de l'employeur
Canada Customs and Revenue Agency / Agence des douanes et du revenu du Canada
T4
STATEMENT OF REMUNERATION PAID
ÉTAT DE LA RÉMUNÉRATION PAYÉE
Year / Année
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
28 Exempt – Exemption: 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 1 / Dons de bienfaisance – Annexe 1
52 Pension adjustment – line 206 / Facteur d'équivalence – ligne 206
50 RPP or DPSP registration number / N° 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 (01)

SOURCE: Statement of Remuneration Paid. www.ccra-adrc.gc.ca Reproduced with permission of the Minister of Public Works and Government Services Canada 2002.

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?

According to the Fraser Institute, the average Canadian family's tax bill has increased by 1,550 percent since 1961! In 2003, the average family income earned was $58,782 and total tax paid was $27,640, or 47 percent of gross income. In 1961, the average family income was $5,000 and the total tax bill was $1,675 or 33.5 percent.

SOURCE: J. Clemens and N. Veldhuis, February 4, 2004, www.fraserinstitute.ca

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 CRA 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 that both parents must file a return to qualify for family support payments and 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.) Exhibit 3–6a on page 72 recaps the general section of your federal return.

CONCEPT CHECK 3–2

1. What are the five sections of the federal tax return?
2. What information is needed to compute net income?
3. What information is needed to compute taxable income?
4. What is the difference between your marginal tax rate and your average tax rate?
5. How does a tax credit affect the amount owed for federal and provincial income taxes?

STEPHANIE SEYMOUR'S 2004 FEDERAL TAX RETURN

IDENTIFICATION Let's turn now to Stephanie Seymour's *T1 General 2004 - Income Tax and Benefit Return*, shown on the following pages as Exhibit 3–6a. On the first page, Stephanie has filled in the Identification section with her full name, address, province of residence as of December 31, social insurance number, date of birth, and marital status. She has given her consent to the CRA to provide basic personal information to the National Register of Electors. Stephanie has also applied for the GST/HST credit and, at the top of the second page, has indicated that she does not hold foreign property in the amount of $100,000 or more.

Exhibit 3–6a Stephanie Seymour's *T1 GENERAL Income Tax and Benefit Return for 2004*

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

T1 GENERAL 2004

Income Tax and Benefit Return

Identification

ON 8

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: Stephanie A.

Last name: Seymour

Mailing address: Apt. No. – Street No. Street name: 1414 King Street #6

P.O. Box, R.R.

City: Toronto | Prov./Terr.: ON | Postal code: M6J 3B1

Information about you

Enter your social insurance number (SIN) if you are not attaching a label: 671 234 567

Enter your date of birth: Year 1980 Month 01 Day 01

Your language of correspondence: / Votre langue de correspondance : English [X] Français [ ]

Check the box that applies to your marital status on December 31, 2004: (see the "Marital status" section in the guide for details)

1 [ ] Married 2 [ ] Living common law 3 [ ] Widowed
4 [ ] Divorced 5 [ ] Separated 6 [X] Single

Information about your spouse or common-law partner (if you checked box 1 or 2 above)

Enter his or her SIN if it is not on the label, or if you are not attaching a label:

Enter his or her first name:

Enter his or her net income for 2004 to claim certain credits: (see the guide for details)

Check this box if he or she was self-employed in 2004: 1 [ ]

Information about your residence

Enter your province or territory of residence on **December 31, 2004:** ONTARIO

Enter the province or territory where you **currently** reside if it is not the same as that shown above for your mailing address:

If you were self-employed in 2004, enter the province or territory of self-employment:

If you **became** or **ceased** to be a **resident of Canada in 2004**, give the date of: entry (Month, Day) or departure (Month, Day)

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

Do not use this area

Elections Canada

THIS SECTION APPLIES ONLY TO CANADIAN CITIZENS.
DO NOT ANSWER THIS QUESTION IF YOU ARE NOT A CANADIAN CITIZEN.

As a Canadian citizen, I authorize the Canada Revenue Agency to provide my name, address and date of birth to Elections Canada for the National Register of Electors. .... Yes [X] 1 No [ ] 2
Your authorization is required each year. This information will be used only for purposes permitted under the *Canada Elections Act*.

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

See the guide for details.

Are you applying for the GST/HST credit? .... Yes [X] 1 No [ ] 2

Your guide contains valuable information to help you complete your return.

When you come to a line on the return that applies to you, look up the line number in the guide for more information.

Do not use this area	172					171				

5006-R

Exhibit 3–6a Stephanie Seymour's *T1 GENERAL Income Tax and Benefit Return for 2004 (Continued)*

2

Please answer the following question

Did you own or hold foreign property at any time in 2004 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 dealings with a non-resident trust or corporation in 2004, see the "Foreign income" section in the guide.

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

Total income

Employment income (box 14 on all T4 slips)			101	32,000 00
Commissions included on line 101 (box 42 on all T4 slips)	102			
Other employment income			104 +	
Old Age Security pension (box 18 on the T4A(OAS) slip)			113 +	
CPP or QPP 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			115 +	
Employment Insurance and other benefits (box 14 on the T4E slip)			119 +	
Taxable amount of dividends from taxable Canadian corporations (see the guide)			120 +	156 25
Interest and other investment income (**attach** Schedule 4)			121 +	
Net partnership income: limited or non-active partners only (**attach** Schedule 4)			122 +	
Rental income	Gross 160		Net 126 +	
Taxable capital gains (**attach** Schedule 3)			127 +	
Support payments received	Total 156		Taxable amount 128 +	
RRSP income (from all T4RSP slips)			129 +	
Other income 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	145 +			
Net federal supplements (box 21 on the T4A(OAS) slip)	146 +			
Add lines 144, 145, and 146 (see line 250 in the guide)	=		▶ 147 +	
Add lines 101, 104 to 143, and 147 This is your **total income**.			150 =	32,156 25

Exhibit 3–6a Stephanie Seymour's *T1 GENERAL Income Tax and Benefit Return for 2004 (Continued)*

3

Attach your Schedule 1 (federal tax) and Form 428 (provincial or territorial tax) here. Also attach here any other schedules, information slips, forms, receipts, and documents that you need to include with your return.

Net income

Enter your **total income** from line 150		150	32,156 25
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 and **attach** receipts)	208 + 2,050 00		
Saskatchewan Pension Plan deduction (maximum $600)	209 +		
Annual union, professional, or like dues (box 44 on all T4 slips and receipts)	212 +		
Child care expenses (**attach** Form T778)	214 +		
Disability supports deduction	215 +		
Business investment loss Gross 228 Allowable deduction	217 +		
Moving expenses	219 + 963 80		
Support payments made Total 230 Allowable deduction	220 +		
Carrying charges and interest expenses (**attach** Schedule 4)	221 + 30 00		
Deduction for CPP or QPP contributions on self-employment and other earnings (**attach** Schedule 8)	222 +	•	
Exploration and development expenses (**attach** Form T1229)	224 +		
Other employment expenses	229 +		
Clergy residence deduction	231 +		
Other deductions Specify:	232 +		
Add lines 207 to 224, 229, 231, and 232.	233 =	▶ –	3,043 80
Line 150 minus line 233 (if negative, enter "0"). This is your **net income before adjustments**.		234 =	29,112 45
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"). If you have a spouse or common-law partner, see line 236 in the guide. This is your **net income**.		236 =	29,112 45

Taxable income

Canadian Forces personnel and police deduction (box 43 on all T4 slips)	244		
Employee home relocation loan deduction (box 37 on all T4 slips)	248 +		
Security options deductions	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	254 +		
Northern residents deductions (**attach** Form T2222)	255 +		
Additional deductions Specify:	256 +		
Add lines 244 to 256.	257 =	▶ –	
Line 236 minus line 257 (if negative, enter "0") This is your **taxable income**.		260 =	29,112 45

Use your taxable income to calculate your federal tax on Schedule 1 and your provincial or territorial tax on Form 428.

Exhibit 3–6a Stephanie Seymour's *T1 GENERAL Income Tax and Benefit Return for 2004 (Continued)*

4

Refund or Balance owing

Net federal tax: enter the amount from line 19 of Schedule 1 (**attach** Schedule 1, even if the result is "0")	420	2,640 16
CPP contributions payable on self-employment and other earnings (**attach** Schedule 8)	421 +	
Social benefits repayment (enter the amount from line 235)	422 +	
Provincial or territorial tax (**attach** Form 428, even if the result is "0")	428 +	1,135 37
Add lines 420 to 428. This is your **total payable**.	435 =	3,775 53 •

Total income tax deducted (from all information slips)	437	5,162 00 •
Refundable Quebec abatement	440 +	•
CPP overpayment (enter your excess contributions)	448 +	•
Employment Insurance overpayment (enter your excess contributions)	450 +	•
Refundable medical expense supplement	452 +	•
Refund of investment tax credit (**attach** Form T2038(IND))	454 +	•
Part XII.2 trust tax credit (box 38 on all T3 slips)	456 +	•
Employee and partner GST/HST rebate (**attach** Form GST370)	457 +	•
Tax **paid** by instalments	476 +	•
Provincial or territorial credits (**attach** Form 479)	479 +	•
Add lines 437 to 479. These are your **total credits**.	482 =	5,162 00 ► – 5,162 00
Line 435 minus line 482	=	−1,386 47

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.

Generally, we do not charge or refund a difference of $2 or less.

Refund 484 −1,386 47 •

Balance owing 485 _____ •

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, 2005.

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.

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

Ontario Opportunities Fund

You can help reduce Ontario's debt by completing this area to donate some or all of your 2004 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 CRA/P-PU-005

TOTAL INCOME Box 14 of Stephanie's T4 slip, provided by her employer, shows that her employment income for the year 2004 was $32,000 ($30,500 salary plus $1,500 bonus). This amount is entered on line 101 on the second page of her federal return.

Stephanie received a T5 slip indicating that she had been paid $125 in Canadian dividends. This amount is "grossed-up" by 25 percent, and the amount of $125 × 1.25 = $156.25 is entered on line 120. See Chapter 10 for more details on the reasoning behind the dividend gross-up and offsetting dividend tax credit calculation.

Stephanie's total income, shown on line 150, is $32,156.25.

NET INCOME Stephanie is able to deduct $2,050 from her total 2004 income on line 208 of the third page of her federal return because she invested this amount in an RRSP before March 1, 2005. This amount is deductible as long as it does not exceed the maximum deduction limit indicated on her *2003 Federal Notice of Assessment* or *Notice of Reassessment*.

Stephanie could not find her *2003 Federal Notice of Assessment*. Luckily the CRA offers a service called "T.I.P.S." (Tax Information Phone Service) which can be reached by telephone at 1-800-267-6999 or online at www.cra.gc.ca/tips. This service provides information on your RRSP deduction limit, as well as any unused contributions. It also allows you to track the status of your refund and offers other useful information. By calling T.I.P.S., Stephanie was able to confirm that the $2,050 RRSP contribution was fully deductible in 2004.

During 2004, Stephanie had moved more than 40 km at a cost of $963.80 in order to start her new job. Stephanie completed Form T1-M (not included here) to determine that her moving expenses are fully deductible on line 219 of her federal return.

Finally, Stephanie is allowed to deduct her safety deposit box fees of $30.00 on line 221. She stores her stock certificate and other valuables in the safety deposit box.

After subtracting all eligible deductions, Stephanie calculates her net income on line 236 as $29,112.45.

TAXABLE INCOME Stephanie's taxable income (line 260, page 3 of the federal return) is equal to her net income of $29,112.45 because she has no additional deductions to claim.

NET FEDERAL TAX The federal Schedule 1 is used to determine an individual's net federal tax by first calculating her federal tax liability and then subtracting non-refundable tax credits. Stephanie's Schedule 1 is presented in Exhibit 3-6b. Her federal tax liability is calculated by multiplying her taxable income of $29,112.45 by the lowest federal tax rate of 16 percent. Before subtracting any tax credits, Stephanie's federal tax liability is $4,657.99.

Under the section "federal non-refundable tax credits," Stephanie is eligible to claim the basic amount (line 300), her CPP contributions (line 308), her Employment Insurance premiums (line 312), the interest paid on her student loan (line 319) and the tuition and education amount (line 323) by completing Schedule 11 (not shown here). The amount of $1,525 entered on line 323 equals her tuition costs of $565, plus an amount of $120 for each month of part-time study (8 × $120 = $960). The total of all amounts to be converted into non-fundable tax credits at the 16 percent rate is $12,416.25 (line 335). Thus far, Stephanie's non-refundable tax credits equal $1,986.60 (line 338).

The first $200 of charitable donations also generate a non-refundable tax credit at a rate of 16 percent. Amounts above $200 that are less than 75 percent of an individual's net income are converted into tax credits at a rate of 29 percent. In Stephanie's case, her charitable donation tax credit equals $10.40 ($65 × 0.16). The amount is calculated on federal Schedule 9 (not shown here) and entered on line 349 of *Schedule 1*.

Her final tax credit, the federal dividend tax credit, is calculated as 13.333 percent of the grossed-up dividends entered on line 120 in the income section of her federal return. Stephanie's dividend tax credit equals $20.83 ($156.25 × 0.1333). This amount is entered on line 425 of Schedule 1.

Exhibit 3–6b Stephanie Seymour's Federal Schedule 1 for 2004

T1-2004 **Federal Tax** **Schedule 1**

Complete this schedule to claim your federal non-refundable tax credits and to calculate your net federal tax.

You must attach a copy of this schedule to your return.

Enter your **taxable income** from line 260 of your return 29,112|45 1

Use the amount on line 1 to determine which **ONE** of the following columns you have to complete.

If the amount on line 1 is:	$35,000 or less		more than $35,000 but not more than $70,000		more than $70,000 but not more than $113,804		more than $113,804	
Enter the amount from line 1 above	29,112|45	2		2		2		2
Base amount	00,000|00	3	– 35,000|00	3	– 70,000|00	3	– 113,804|00	3
Line 2 minus line 3 (this amount cannot be negative)	= 29,112|45	4	=	4	=	4	=	4
Rate	× 16%	5	× 22%	5	× 26%	5	× 29%	5
Multiply the amount on line 4 by the rate on line 5	= 4,657|99	6	=	6	=	6	=	6
Tax on base amount	0,000|00	7	+ 5,600|00	7	+ 13,300|00	7	+ 24,689|00	7
Add lines 6 and 7	= 4,657|99	8	=	8	=	8	=	8

Federal non-refundable tax credits (Read the guide for details about these credits.)

Basic personal amount	claim $8,012	300	8,012|00
Age amount (if you were born in 1939 or earlier)	(maximum $3,912)	301	+
Spouse or common-law partner amount:			
Base amount 7,484|00			
Minus: his or her net income (from page 1 of your return) –			
Result: (if negative, enter "0") =	(maximum $6,803) ▶	303	+
Amount for an eligible dependant (**attach** Schedule 5)	(maximum $6,803)	305	+
Amount for infirm dependants age 18 or older (**attach** Schedule 5)		306	+
CPP or QPP contributions:			
through employment from box 16 and box 17 on all T4 slips	(maximum $1,831.50)	308	+ 1,410|75 •
on self-employment and other earnings (**attach** Schedule 8)		310	+ •
Employment Insurance premiums from box 18 on all T4 slips	(maximum $772.20)	312	+ 633|50 •
Pension income amount	(maximum $1,000)	314	+
Caregiver amount (**attach** Schedule 5)		315	+
Disability amount		316	+
Disability amount transferred from a dependant		318	+
Interest paid on your student loans		319	+ 835|00
Tuition and education amounts (**attach** Schedule 11)		323	+ 1,525|00
Tuition and education amounts transferred from a child		324	+
Amounts transferred from your spouse or common-law partner (**attach** Schedule 2)		326	+

Medical expenses for **self, spouse or common-law partner, and your dependent children born in 1987 or later** (see the guide)	330		
Minus: $1,813 or 3% of line 236, whichever is **less**		–	
Subtotal (if negative, enter "0")		=	(A)
Allowable amount of medical expenses for **other dependants** (see the calculation at line 331 in the guide and **attach** Schedule 5)	331	+	(B)
Add lines (A) and (B).		=	▶ 332 +

Add lines 300 to 326, and 332. 335 = 12,416|25

Multiply the amount on line 335 by 16% = 338 1,986|60

Donations and gifts (**attach** Schedule 9) 349 + 10|40

Total federal non-refundable tax credits: Add lines 338 and 349. 350 = 1,977|00

5000-S1

continue on the back ⇨

Exhibit 3–6b Stephanie Seymour's Federal Schedule 1 for 2004 *(Continued)*

Net federal tax

Enter the amount from line 8 on the other side		4,657 99	9		
Federal tax on split income (from line 4 of Form T1206)	424 +		• 10		
Add lines 9 and 10	=	4,657 99	▶	4,657 99	11
Enter the amount from line 350 on the other side	350	1,997 00			
Federal dividend tax credit (13.3333% of the amount on line 120 of your return)	425 +	20 83	•		
Overseas employment tax credit (**attach** Form T626)	426 +				
Minimum tax carry-over (**attach** Form T691)	427 +		•		
Add lines 350, 425, 426, and 427	=	2,017 83	▶ –	2,017 83	12
Basic federal tax: Line 11 minus line 12 (if negative, enter "0")	429 =			2,640 16	13
Federal foreign tax credit: Complete the federal foreign tax credit calculation below and enter the amount from line (i) or line (ii), whichever is **less**			–		14
Federal tax: Line 13 minus line 14 (if negative, enter "0")	406 =			2,640 16	15
Total federal political contributions (**attach** receipts)	409				
Federal political contribution tax credit (see the guide)	410		•		
Investment tax credit (**attach** Form T2038(IND))	412 +		•		
Labour-sponsored funds tax credit — Net cost 413 — Allowable credit	414 +		•		
Add lines 410, 412, and 414.	416 =		▶ –		16
Line 15 minus line 16 (if negative, enter "0") (if you have an amount on line 424 above, see Form T1206)	417 =				17
Additional tax on RESP accumulated income payments (**attach** Form T1172)	418 +				18
Net federal tax: Add lines 17 and 18. Enter this amount on line 420 of your return.	420 =			2,640 16	19

Federal foreign tax credit: (see lines 431 and 433 in the guide)

Make a separate calculation for each foreign country. Enter the result on line 14 above.

Non-business income tax paid to a foreign country 431 ____ •(i)

$\frac{\text{Net foreign non-business income * 433}}{\text{Net income **}}$ X Basic federal tax *** ____ = ____ (ii)

* Reduce this amount by any income from that foreign country for which you claimed a capital gains deduction, and by any income from that country that was, under a tax treaty, either exempt from tax in that country or deductible as exempt income in Canada (included on line 256). Also reduce this amount by the lesser of lines E and F on Form T626.

** Line 236 plus the amount on line 3 of Form T1206, minus the total of the amounts on lines 244, 248, 249, 250, 253, 254, and minus any amount included on line 256 for foreign income deductible as exempt income under a tax treaty, income deductible as net employment income from a prescribed international organization, or non-taxable tuition assistance from box 21 of the T4E slip. If the result is less than the amount on line 433, enter your **Basic federal tax***** on line (ii).

*** Line 429 plus the amount on lines 425 and 426, and minus any refundable Quebec abatement (line 440) and any federal refundable First Nations abatement (line 441 on the return for residents of Yukon).

5000-S1

After subtracting her non-refundable tax credits, Stephanie's net federal tax is $2,640.16. This amount is carried forward to line 420 at the top of page 4 of her federal return (see page 75).

REFUND OWING The calculation of Stephanie's Ontario tax of $1,135.37, entered on line 428, is presented in Appendix 1 on page 96 at the end of this chapter.

From box 22 on her 2004 T4 slip, Stephanie determines that the total amount of federal and provincial taxes deducted at source by her employer equals $5,162 ($3,536 for federal income taxes and $1,626 for Ontario provincial taxes). This amount is entered on line 437 of her federal return. As it exceeds her total taxes payable of $3,775.53 (line 435) by $1,386.43, this is the amount of her 2004 tax refund (line 484).

TAX PLANNING STRATEGIES

Most people want to pay no more than their fair share of taxes. 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 maximize after-tax cash flows, some simple strategies can be investigated:

1. Are you choosing the form of remuneration that is most advantageous to you?
2. Are you taking full advantage of all deductions and credits that are available to you? If you have a legal or common-law spouse, is the right person taking the deduction? Should amounts be accumulated and the tax credit only taken periodically?
3. Are you taking advantage of all possibilities to defer the payment of taxes to a later date?
4. Should you adopt "income-splitting" techniques that permit a lower-income member of your family to declare investment income and pay less tax on it?
5. Have you organized your investment portfolio so that it attracts the lightest tax liability?

We will explore each strategy in turn.

OBJECTIVE 3

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.

HOW SHOULD YOU RECEIVE INCOME?

If you are an employee, you may be able to arrange your compensation to improve your after-tax income. First, will you be paid a salary or by commission? If you are a salaried employee, in most cases no employment-related deductions are available. If you earn commission income and are required by your employer to travel and/or absorb costs associated with your employment, then these costs may be deductible. This also applies to salaried employees who are required to absorb certain employment-related costs. (Form T-2200 must be signed by the employer.) Second, do you have a choice between receiving employment compensation in the form of a salary or via employee benefits? While most employee benefits are taxable, some, such as the benefit conferred by a stock option, receive more favourable tax treatment than regular income. (A stock option plan permits the employee to acquire shares of the company at a price that is less than the going market price of the stock.) Finally, if part of your remuneration involves a bonus, can the bonus be paid after December 31? The personal taxation year coincides with the calendar year, but some companies have a year-end that differs from December 31. They may be willing to pay your bonus in January of the following year if this still falls within their corporate fiscal year.

One question often asked of a financial planner is whether it is better for a small business owner to pay him- or herself a salary or receive remuneration in the form of dividends. The co-ordination of personal and corporate taxation for small business owners earning less than $250,000 of taxable income means that, in effect, there is very little difference. In the first instance, the owner would be taxed on his or her salary only. In the second instance, the business would be required to pay corporate taxes before it could declare a dividend. The dividend paid out would then be grossed-up, taxed at the owner's personal tax rate and partially reduced by the dividend tax credit. The combined result of the corporate tax and personal tax on dividends would be very close to the tax levied on the salary alone.

What elements of the tax law would play a role in deciding the salary versus dividend dilemma for the small corporate business owner? First, salaries form part of "earned income" for purposes of calculating an individual's RRSP contribution limit, whereas dividends do not. In 2005, the RRSP contribution maximum is set as $16,500. If a person's maximum RRSP contribution equals 18 percent of his or her prior year's earned income, this implies that receiving a salary of $91,667 in 2004 ($16,500 ÷ 0.18) would bring him or her to the maximum 2005 RRSP contribution. Second, if the business is a Canadian-controlled private corporation and meets certain qualifying criteria, any capital gain earned on the sale or transfer of the common shares in the business would qualify for the $500,000 capital gains exemption discussed on page 81. For the small entrepreneur who plans to grow his or her business by retaining earnings, the resulting increase in the value of the shares of the business, to a maximum of $500,000, could be sheltered from capital gains tax.

Self-employment income from a non-incorporated business or profession is reported on both a gross and net basis and is taxed at the individual's personal tax rate. Any reasonable expense incurred in order to generate taxable income is deducted from gross income to derive net income. This includes the cost of administrative support, leasing or buying an automobile and maintaining it for business purposes, office rent, equipment and supplies, advertising, and utilities. Only 50 percent of entertainment costs, however, are deductible. Of special interest are deductions permitted for maintaining a home office. 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 or mortgage interest, utilities, maintenance, 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.

MAXIMIZING THE BENEFIT OF DEDUCTIONS AND TAX CREDITS

There are a multitude of tax deductions and credits available at both the federal and provincial level. Keeping up to date on the current tax laws and regulations is vital if you wish to ensure that you are taking full advantage of any deductions and credits available to you, your spouse, and your family.

The most common federal income tax deductions were described earlier in this chapter, in the section Income Tax Fundamentals. Contributions to corporate or personal retirement plans result in a tax deduction in the year of contribution, but their most important role is in deferring taxes on income until savings are withdrawn in retirement. With few exceptions, financial planners recommend that you contribute the maximum possible to your RRSP and contribute as early as possible in any taxation year. These plans will be described in the following section, Tax Deferral Techniques.

Other important facts to remember with respect to common deductions are as follows:

- Generally, the lower income spouse is required to take the child care deduction, but there are exceptions to this rule, including situations where one spouse is a full or part-time student.
- Before a ruling on May 1, 1997, alimony, child support and spousal maintenance payments were deductible to the payer and taxable to the recipient. This is no longer the case. Under the new rules, child support payments are not deductible. Assess whether it is prudent to change any legal agreement reached prior to May 1, 1997, as it would then fall under the new tax legislation.

- All or part of the interest charged on funds invested to earn taxable investment income (interest and dividends) is tax deductible. Therefore, it makes better tax sense to use cash flows to acquire personal possessions, such as a car, and borrow to invest. However, as mentioned earlier in the chapter, the financial planning objective is not to *minimize taxes* but to *maximize after-tax cash flows*. Borrowing to invest (commonly referred to as leveraging) entails significant risk if the value of the investment declines, and this strategy should not be adopted merely to reduce one's tax liability.
- If part of your employment remuneration involves a stock option plan, the taxable benefit incurred when the option is exercised must be included in taxable income, unless the shares belong to a Canadian-controlled private corporation (CCPC) or an election has been made to defer the taxable benefit until the shares are ultimately sold. An offsetting deduction, referred to as the security options deduction, can be taken if, at time of issue, the exercise price of the option did not exceed the fair market value of the share (i.e., the employee could not derive an immediate benefit from exercising the option) or, in the case of a CCPC, the employee had owned the shares for two years prior to selling them. This deduction is equal to 50 percent of the taxable benefit included in total income. Care should be taken, therefore, in deciding when to exercise the option and when to sell the shares.
- Capital losses incurred in any year can be subtracted from capital gains earned in the same year to compute net capital gains. Fifty percent of net capital gains will be taxable in the year they are incurred. If capital losses exceed capital gains in any year, then the net capital loss can be carried back three years to offset any capital gains already declared and taxed. However, the window of opportunity is only three years. Once the period of three years has elapsed, the tax paid on the net capital gains can no longer be reclaimed. However, net capital losses can also be carried forward and applied to reduce any capital gains earned at any time in the future. Special care should be taken to track, record, and report capital losses when filing your income tax return. Although they may not be of immediate value, they should not be overlooked in future years when capital gains must be reported.
- Each individual is eligible for a lifetime $500,000 capital gains exemption on shares of qualifying small businesses and eligible farm property. However, several conditions must be met. One of the qualifying criteria is a holding period of two years prior to sale or transfer of the shares. In addition, the firm itself must meet certain criteria over the two-year holding period and at the moment of sale in order that any gain earned on the sale of its shares qualifies for the exemption. Verify that all conditions have been met before you sell shares in a small business.

In addition to various deductions, all individuals qualify for at least the basic personal amount and corresponding income tax credit. The following additional credits can be claimed:

- If you are single, widowed, divorced, or separated and you support another family member (such as a minor or a disabled parent living with you), you will be allowed to claim that person in calculating the amount for an eligible dependent.
- If you paid interest on a student loan made under the *Canada Student Loans Act* or equivalent provincial program, you can claim this credit for any interest paid in the current year and in the five preceding years (after 1997). This credit is not transferable, but it can be carried forward for up to five years.
- If you took post-secondary courses on a full- or part-time basis, your tuition fees and an education amount can be transformed into a tax credit in the current year; transferred to a supporting spouse, parent, or grandparent; or carried forward and used by you in the future.
- If you had medical expenses, you can choose any 12-month period ending in the calendar year and group together expenses incurred by you, your spouse, and minor children. (A separate calculation can be made to claim the medical expenses of dependent adult

children 25 years of age or less who are pursuing full-time studies.) The list of eligible expenses is extensive and is updated frequently, so all receipts for any health-related expense should be retained. All amounts in excess of 3 percent of the claimant's net income can be converted into a tax credit. It is best if the lower-income spouse claims the credit.

- If you made charitable contributions, the first $200 of charitable contributions can be converted into a tax credit at the rate of 16 percent. Amounts in excess of $200 that do not exceed 75 percent of an individual's net income are converted at a rate of 29 percent. To maximize the credit, charitable donations for spouses should be taken by one individual. Charitable contributions may be carried forward five years, and it may be beneficial to wait and accumulate contributions before claiming them in order to benefit the most from the 29 percent rate.

Finally, certain unused non-refundable tax credits can be transferred between spouses. These include credits relating to the age amount, pension income amount, tuition and education amount, and disability amount. The transferring spouse must reduce his or her taxable income to zero before transferring any excess amounts.

TAX DEFERRAL TECHNIQUES

Several techniques are available that permit taxpayers to defer the taxation of income until a later date when, presumably, their combined average income tax rate will be lower. Furthermore, during the deferral period, any investment income earned can be reinvested free of tax.

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 has been set at $15,500 for 2004, $16,500 for 2005, $18,000 for 2006, to rise to $20,000 by 2010. 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.

An additional advantage offered by RRSPs is that funds can be borrowed from the plan and paid back free of tax under the Home Buyers' Plan and Lifelong Learning Plan. Under the Home Buyers' Plan, you may withdraw up to $20,000 as a loan, if you qualify as a first-time buyer, without it counting as a withdrawal. You must then repay the loan over 15 years. The funds you withdraw must have been in the plan for at least 90 days. This plan will be discussed more fully in later chapters.

The Lifelong Learning Plan permits a maximum tax-free withdrawal of $20,000 to permit you or your spouse to study full-time at a qualifying institution. Withdrawals must be repaid within 10 years, starting in the year after the last year of study. However, a disadvantage of withdrawals under both plans is that repayments are made without interest and the growth potential of your RRSP will be less.

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, also referred to as a Defined Contribution Pension Plan (DCPP), 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 corporations and public employers often provide the latter, defined benefit plans (DBPP). Defined Benefit Pension Plans are becoming less common due to the high cost to the employer of administering them. 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 Defined Contribution Pension Plan, 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.

Additional tax deferral techniques include:

- Investing in capital assets, such as real estate or financial assets, that generate capital gains, as these gains only become taxable in the year of disposition.
- Opening a Registered Education Savings Plan (RESP) or an in-trust investment account to fund your child's higher education. These investment vehicles can be viewed as a means by which to defer taxes, as well as an opportunity to have investment income taxed in the hands of lower-income family members. They will be described in the following section on Income Splitting Techniques.

INCOME SPLITTING TECHNIQUES

Given the Canadian tax system's use of progressive tax rates, with the marginal rate increasing with higher incomes, taxpayers may be tempted to invest in the name of their lower-income spouse or minor children in order to have any investment income taxed in their hands at a lower rate. However, this strategy is not permitted by law. The federal *Income Tax Act* contains a number of "attribution rules" to prevent income splitting in this fashion. In essence, these rules state that if a taxpayer transfers money or assets to a spouse or child under the age of 18, any investment income (interest, dividends, or rents) earned on the amount transferred will be taxed in the hands of the taxpayer, unless the spouse or minor child purchases the asset at its fair market value. In the case of a spouse, future capital gains on any assets transferred are also attributed back to the taxpayer. Attribution of capital gains does not apply to in the situation of a minor.

The assets may be purchased outright with money, but can also be acquired through a swap of assets or loan. The loan can be extended by the taxpayer, as long as interest is charged at a rate at least equal to the CRA prescribed rate and paid by the borrowing spouse or minor by January 31 of the following year.

Other legal means of income splitting include

- Making contributions to a spousal RRSP. Withdrawals are taxed in the hands of the recipient spouse as long as the funds are not withdrawn within two calendar years following the year of contribution.
- Splitting your Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) benefits with your spouse. You may direct that up to half of your CPP/QPP benefits be paid to your spouse, provided that you are both over the age of 60.
- Having the high income spouse pay living expenses, while the lower income spouse invests his income.
- Transferring assets that will be used to generate business income, as business income is not attributable.
- Opening a Registered Education Savings Plan (RESP) for your minor children. RESPs allow you to build an education fund for a child by earning tax-deferred investment income. The contributions are not tax deductible, but all income in the plan grows tax-free until withdrawn and taxed in the hands of the recipient. The maximum lifetime contribution per beneficiary is $42,000 (maximum $4,000 per year). Contributions to an RESP can earn the Canada Education Savings Grant, formerly set at a maximum of $7,200 per beneficiary. However, the limit was increased in the federal budget of March 23, 2004, when it was proposed that the grant on the first $500 of annual contributions for minors be enriched for families with an income of less than $70,000 per year.
- Setting up an in-trust investment account for a minor to acquire capital gains-generating assets, as capital gains earned on funds invested for children under 18 years of age are not attributable.
- Investing the federal Child Tax Benefit in the child's name.
- Transferring assets to an adult child. Transfers to adult children are not subject to the attribution rules as long as they are not made through a loan that charges interest at less than the prescribed rate.

It should be noted that second-generation investment income (i.e., investment income earned on a prior year's reinvested income) is not attributable.

ENSURING THAT YOUR PORTFOLIO IS TAX EFFICIENT

While the taxation of investment income should not affect your choice of asset allocation or specific asset choices, it will play a role in the decision of which investment account should hold which type of asset. Some financial assets pay interest or generate income that is taxed in the same manner as interest—for example, the dividends paid on foreign stocks. Interest income is fully taxable at your marginal tax rate and to minimize the tax burden, such financial assets should be held in registered accounts, such as RRSPs, that defer taxes until withdrawals are made. Other financial assets pay dividends or are expected to appreciate in value and generate a capital gain when sold. Both dividends on Canadian stocks and capital gains are taxed less heavily than interest income, and financial assets that pay dividends and/or generate capital gains should be held in non-registered investment accounts.

Tax efficiency also refers to whether the interest on a loan made for investment purposes can be deducted from taxable income. If the proceeds of a loan are invested in assets that generate taxable dividends, interest, or rents, then the interest paid on the loan is tax deductible, subject to certain conditions.

TAX ISSUES IMPORTANT TO STUDENTS

The CRA has issued a guide called *Students and Income Tax – P105*, which addresses tax issues of special importance to students. This guide can be accessed at the CRA's Web site at www.cra-arc.gc.ca/E/pub/tg/p105/p105-04e.pdf. In brief, the guide describes:

[1] How to report income from scholarships, fellowships, bursaries, grants, and RESPs.

Exhibit 3–7

Five General Sections of Your Federal Tax Return Form

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]
—Scholarships, bursaries and grants

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
 —Spousal or common-law
 —Certain dependants
 —Age
 —Disability
—Other credits
 —Retirement income
 —Charitable donations and gifts
 —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.

SOURCE: Five General Sections of Your Federal Tax Return Form. From "Things to Remember," Booklet published by CCH Canadian Tax Compliance Group © 2001. Reprinted with permission.

[2] Common deductions, such as moving expenses, child care expenses and interest paid on a student loan.
[3] Non-refundable tax credits such as the tuition and education amount.
[4] Other tax credits, such as the GST/HST credit and Canada Child Tax Benefit (CCTB).

In addition, most provinces offer tax deductions and credits designed to assist full- and part-time students.

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 CRA 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 3–3

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

TAX ASSISTANCE AND THE AUDIT PROCESS

OBJECTIVE 4

Identify tax assistance sources

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

Visit the Web site
See the Weblinks under Chapter 3 on the online learning centre at www.mcgrawhill.ca/college/kapoor.

As with other aspects of personal financial planning, many resources are available to assist you with your taxes. Both the Canada Revenue Agency and the Québec Ministère du Revenu offer comprehensive guides to help you plan and complete 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 maximize after-tax wealth and cash flows. In addition, most daily newspapers frequently contain articles related to personal taxes and their various effects. See Exhibit 3–8 for an example of a tax-planning system.

The fastest way to find information on the various rules and regulations for both the CRA and the Québec Ministère du Revenu is by searching online at their respective Internet sites. The CRA is available at www.cra-arc.gc.ca, while the Québec Ministère du Revenu site can be found at www.revenu.gouv.qc.ca. Both can also be 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 Income Tax Returns*. In various bookstores, you may also find Evelyn Jacks's annual *Jacks on Tax Savings*,

January
- Establish a recordkeeping system for your tax information
- If you expect a refund, file your tax return for the previous year

February
- 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

March
- 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
- April 30 is the deadline for filing your federal tax return if you have a balance owing; if it falls on a weekend, you have until the next business day (usually Monday)

May
- Review your tax return to determine whether any changes in withholding, exemptions, or marital status have not been reported to your employer

June
- The second installment for tax is due June 15 for income not covered by withholding

July
- 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

August
- Tax returns are due August 30 for those who received an extension

September
- The third installment for tax is due September 15 for income not covered by withholding

October
- Determine the tax benefits of selling certain investments by year-end

November
- Make any last-minute changes in withholding by your employer to avoid penalties for too little withholding

December
- Make your final estimated quarterly installment for income not covered by withholding
- Determine if it would be to your advantage to make payments for next year before December 31 of the current year
- Decide if you can defer income for the current year until the following year

Exhibit 3–8
Tax-Planner Calendar

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 CRA and the Québec Ministère du Revenu are great places to start. Both agencies can also be reached by telephone. Such sites as Canoe Webfin at www.webfin.com, 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.ey.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).

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 to complete your return and then either file online or print the completed form for mailing. Popular choices are QuickTax, TaxWiz, and Ufile.ca. For more information on these programs, see www.quicktax.ca, www.taxwiz.ca, and www.ufile.ca, respectively.

ELECTRONIC FILING The CRA 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 CRA's TELEFILE program, qualifying wage earners, students, seniors, and credit or benefit filers 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. NETFILE is a new service introduced by the CRA which allows you to file your return directly to the CRA over the Internet. Visit www.netfile.gc.ca for more information.

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.

Be wary 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).

WHAT IF YOUR RETURN IS AUDITED?

Canada Revenue Agency (CRA) 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 CRA. 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 3–9) helps to minimize your chances of an audit.

tax audit A detailed examination of your tax return by the Canada 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, TELEFILE, or NETFILE you won't need to file receipts with your return. However, the CRA 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 where you anticipate that you will have problems, you have the right to, and should, seek assistance from

Exhibit 3–9
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.

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.

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 CRA 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 CRA. 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 CRA 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 within 90 days of the disputed assessment or one year after the due date of the return.

The Appeals Officer is normally your highest possible level of appeal within the CRA. 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?

SUMMARY OF OBJECTIVES

Objective 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.

Objective 2

Illustrate how federal income taxes are computed by completing 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.

Objective 3

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.

Objective 4

Identify tax assistance sources.

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

KEY TERMS

average tax rate 66
deductions 64
employment income 62
excise tax 60
investment income 62
marginal tax rate 65
net business income 62
net income 63
tax audit 89
tax credit 68
tax evasion 79
tax planning 79
taxable capital gains 62
taxable income 62

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, $7,412
   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.* On the basis of the following data, would Ann and Carl Wilton receive a federal tax refund or owe additional taxes in 2004? (Obj. 2)

   Net income, $48,190
   Deductions to determine net income, $11,420
   Federal income tax withheld, $6,784
   Total non-refundable tax credit amounts, excluding medical expenses, $10,244
   Medical expenses, $2,300

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? Assume a combined 2004 marginal tax rate of 42 percent. (Obj. 3)

5. *Future Value of a Tax Savings.* On December 30, you decide to make a $1,000 charitable donation. If you are in the 22- percent federal tax bracket, how much will you save in taxes for 2004? 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. 3)

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 Webfin at www.webfin.com, 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. *Determining Tax Planning Activities.* Survey friends and relatives about their tax planning strategies. (Obj. 3)

5. *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)

6. *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)

7. *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)

8. *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)

CREATING A FINANCIAL PLAN

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, CRA regulations and other tax information, go to the CRA's Web site at **www.cra-arc.gc.ca.** You may also find information at the Government of Canada site at **www.gc.ca**, and the Depart-ment 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 Webfin site at **www.webfin.com**, 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 Intuit Canada site at **www.intuit.com/canada**, and the TaxWiz site at **www. taxwiz.ca**.
- In cases where you may have a dispute with the CRA 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.
2. Using the CRA site and other Web sites, identify recent changes in tax laws that may affect your financial planning decisions.
3. Using current CRA 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.cra-arc.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**

LIFE SITUATION CASE (2)

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 requires him to hire a caregiver for 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.

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	$47,500
Interest earned on GIC	$ 125
RRSP deduction	$ 2,000
Savings account interest	$ 65
Federal income tax deducted at source	$ 4,863
Total non-refundable tax credit amounts	$13,200
Child care deduction	$ 6,300
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 2004 federal taxable income? (Refer to Exhibit 3-1, page 63).
   b) What is his total 2004 federal tax liability? What is his average 2004 federal tax rate?
   c) Will Eric receive a tax refund or owe additional taxes to the federal government for 2004?

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. On the basis of her life situation, what type of tax planning should Pamela consider?

APPENDIX 3

Stephanie's 2004 *Ontario Tax T1 General Return*

The following is Stephanie's two-page 2004 *Ontario Tax T1 General - 2004* (ON428) return, along with Schedule ON(S11), *Provincial Tuition and Education Amounts*, upon which she calculated her Ontario tuition and education amount of $1,605 and the Ontario *Provincial Worksheet* used to determine Stephanie's Ontario Health Premium of $300. Stephanie's total Ontario tax of $1,135.37 (line 70) is transferred to line 428 of her Federal *T1 General 2004 - Income Tax and Benefit Return*. Stephanie would not be eligible to receive the Ontario property and sales tax credits.

Ontario

Ontario Tax

ON428
T1 General – 2004

Complete this form and **attach a copy** of it to your return. For details, see pages 1 to 5 in the forms book.

Step 1 – Ontario tax on taxable income

Enter your **taxable income** from line 260 of your return 29,112|45 1

Use the amount on line 1 to determine which **ONE** of the following columns you have to complete.

	If line 1 is **$33,375** or less		If line 1 is more than **$33,375**, but not more than **$66,752**		If line 1 is more than **$66,752**	
Enter the amount from line 1 in the applicable column	29,112 45	2		2		2
	– 0 00	3	– 33,375 00	3	– 66,752 00	3
Line 2 minus line 3 (cannot be negative)	=	4	=	4	=	4
	× 6.05%	5	× 9.15%	5	× 11.16%	5
Multiply line 4 by line 5	=	6	=	6	=	6
	+ 0 00	7	+ 2,019 00	7	+ 5,073 00	7
Add lines 6 and 7 **Ontario tax on taxable income**	= 1,761 30	8	=	8	=	8
	Go to Step 2		**Go to Step 2**		**Go to Step 2**	

Step 2 – Ontario non-refundable tax credits

Important: Provincial non-refundable tax credits may be **different** from the federal amounts claimed on Schedule 1. For details, see the *Provincial Worksheet* and pages 1 to 4 in the forms book.

For internal use only 5605

Basic personal amount	**claim $8,044**	5804	8,044 00	9
Age amount (if born in 1939 or earlier)	(use provincial worksheet)	5808	+	10
Spouse or common-law partner amount				
Base amount 7, 513 00				
Minus: his or her net income from page 1 of your return –				
Result: (if negative, enter "0") =	**(maximum $6,830)** ▶	5812	+	11
Amount for an eligible dependant	(use provincial worksheet)	5816	+	12
Amount for infirm dependants age 18 or older	(use provincial worksheet)	5820	+	13
Canada Pension Plan or Quebec Pension Plan contributions:				
	(amount from line 308 of your federal Schedule 1)	5824	+ 1,410 75	•14
	(amount from line 310 of your federal Schedule 1)	5828	+	•15
Employment Insurance premiums	(amount from line 312 of your federal Schedule 1)	5832	+ 633 50	•16
Pension income amount	(use provincial worksheet)	5836	+	17
Caregiver amount	(use provincial worksheet)	5840	+	18
Disability amount	(see line 5844 on page 2 of the forms book)	5844	+	19
Disability amount transferred from a dependant	(use provincial worksheet)	5848	+	20
Interest paid on your student loans	(amount from line 319 of your federal Schedule 1)	5852	+ 835 00	21
Your tuition and education amounts	**[attach Schedule ON(S11)]**	5856	+ 1,605 00	22
Tuition and education amounts transferred from a child		5860	+	23
Amounts transferred from your spouse or common-law partner	**[attach Schedule ON(S2)]**	5864	+	24

Medical expenses (see line 5868 in the forms book)	5868		25			
Enter $1,821 or 3% of line 236, whichever is **less**		–	26			
Line 25 minus line 26 (if negative, enter "0")		=	27			
Allowable amount of medical expenses for other dependants calculated for line 5872 on the *Provincial Worksheet*	5872	+	28			
Add lines 27 and 28	5876	=	▶	+	29	
Add lines 9 through 24, and line 29			5880	= 12,528 25	▶	12,528 25 30
Non-refundable tax credit rate						× 6.05% 31
Multiply line 30 by line 31					5884	= 757 96 32
Donations and gifts:						
Amount from line 345 of your federal Schedule 9	65 00	× 6.05% =		3 93	33	
Amount from line 347 of your federal Schedule 9		× 11.16% =		+	34	
Add lines 33 and 34			5896	= 3 93	▶	+ 3 93 35
Add lines 32 and 35		**Ontario non-refundable tax credits**			6150	= 761 89 36

Complete Steps 3 to 6 and also Step 7 (Ontario Health Premium) on the back ⇨

5006-C

Step 3 – Ontario tax

Enter your Ontario tax on taxable income from line 8			1,761 30	37
Enter your Ontario tax on split income from Form T1206	6151		+	• 38
Add lines 37 and 38			= 1,761 30	39
Enter your Ontario non-refundable tax credits from line 36		761 89		40
Ontario dividend tax credit Amount from line 120 on your return 156 25 × 5.13% =	6152	+ 8 02		• 41
Ontario overseas employment tax credit: Amount from line 426 on federal Schedule 1 × 38.5% =	6153	+		• 42
Ontario minimum tax carryover from Form T1219-ON	6154	+		• 43
Add lines 40 through 43		= 769 91 ▶	– 769 91	44
Line 39 minus line 44 (if negative, enter "0")			= 991 39	45
Ontario additional tax for minimum tax purposes: Amount from line 95 of Form T691 × 37.81% =			+	46
Add lines 45 and 46			= 991 39	47
Ontario surtax				
(Line 47 minus $3,856) × 20% (if negative, enter "0")				48
(Line 47 minus $4,864) × 36% (if negative, enter "0")		+		49
Add lines 48 and 49		= ▶	+	50
Add lines 47 and 50			= 991 39	51
			Go to Step 4	

Step 4 – Ontario tax reduction

Basic reduction		186 00		52
If you had a spouse or common-law partner on December 31, 2004, **only** the individual with the **higher net income** can claim the reductions on lines 53 and 54. Reduction for dependent children born in 1986 or later Number of dependent children × $343 =	6269	+		53
Reduction for disabled or infirm dependants (see line 54 on page 4 of the forms book) Number of disabled or infirm dependants × $343 =	6097	+		54
Add lines 52, 53, and 54		= 186 00		55
If line 55 is equal to or more than line 51,and you are **not** claiming the credits in Step 5 and Step 6, enter "0" on line 68 and **go to Step 7**. Otherwise, continue on line 56.				
Enter the amount from line 55 186 00 × 2 =		372 00		56
Enter the amount from line 51		– 985 37		57
Line 56 minus line 57 (if negative, enter "0") **Total Ontario tax reduction claimed**		= Ø ▶	– Ø	58
Line 51 minus line 58 (if negative, enter "0")			= 985 37	59
			Go to Step 5	

Step 5 – Ontario foreign tax credit

Enter the Ontario foreign tax credit from Form T2036	–	60
Line 59 minus line 60	= 985 37	61
	Go to Step 6	

Step 6 – Ontario labour sponsored investment fund (LSIF) and employee ownership (EO) tax credits

Total cost of shares from boxes **02** and **04** of **LSIF** Tax Credit Certificate(s) **A** × 15% = (max. $750)	6275			• 62
Total cost of ROIF eligible shares from boxes **03** and **05** **B** × 5% = (max. $250)	6276	+		• 63
Credit amount from boxes 09 and 11 of **EO** Tax Credit Certificate(s) (maximum $4,150)	6280			• 64
Unused employee ownership (EO) tax credits from the previous five years		+		65
Add lines 64 and 65		= ▶	+	66
Add lines 62, 63, and 66 **LSIF and EO tax credits**		= ▶	–	67
Line 61 minus line 67 (if negative, enter "0")			= 985 37	68
			Go to Step 7	

Step 7 – Ontario Health Premium

Enter the amount calculated for Step 7 on the *Provincial Worksheet* OHP 300 00 × 50% = **2004 Ontario Health Premium** ▶	+ 150 00	69
Add lines 68 and 69 Enter the result on line 428 of your return **Ontario tax**	= 1,135 37	70

5006-C

Ontario **Provincial Tuition and Education Amounts** **Schedule ON(S11)**
T1 General – 2004

Only the student must complete this schedule. Use it to:
- calculate your Ontario tuition and education amounts to claim on line 5856 of your Form ON428;
- determine the provincial amount available to transfer to another designated individual; and
- determine the unused Ontario amount, if any, available for you to carry forward to a future year.

Attach a copy of this schedule to **your** return.

Ontario tuition and education amounts claimed by the student for 2004

Ontario unused tuition and education amounts from your 2003 *Notice of Assessment* or *Notice of Reassessment**			∅	1
Eligible tuition fees paid for 2004	5914	565 00		2
Education amount for 2004: Use columns B and C of forms T2202, T2202A and TL11A; (only one claim per month, maximum 12 months)				
Enter the number of months from Column **B** (do not include any month that is also included in Column C) 8 × **$130** =	5916	+ 1,040 00		3
Enter the number of months from Column **C** × **$433** =	5918	+		4
Add lines 2, 3, and 4 Total 2004 tuition and education amounts		= ▶	+	5
Add lines 1 and 5 Total available tuition and education amounts			= 1,605 00	6
Taxable income from line 1 of your Form ON428		29,112 45		7
Total of lines 5804 to 5848 of your Form ON428		– 10,088 25		8
Line 7 minus line 8 (if negative, enter "0")		= 18,924 20		9
Unused Ontario tuition and education amounts claimed for 2004: Enter the amount from line 1 or line 9, whichever is **less**		– ▶	∅	10
Line 9 minus line 10		= 18,924 20		11
2004 tuition and education amounts claimed for 2004: Enter the amount from line 5 or line 11, whichever is **less**			+	12
Add lines 10 and 12. Enter this amount on line 5856 of your Form ON428. **Ontario tuition and education amounts claimed by the student for 2004**			= 1,605 00	13

Transfer / Carry forward of unused amount

Amount from line 6				14
Amount from line 13			–	15
Line 14 minus line 15 **Total unused amount**			=	16

If you are transferring an amount to another individual, continue on line 17.
Otherwise, enter the amount from line 16 on line 21.

Enter **$5,562** or the amount from line 5, whichever is **less**		17
Amount from line 12	–	18
Line 17 minus line 18 (if negative, enter "0") **Maximum transferable**	=	19

You can transfer all or part of the amount on line 19 to your spouse or common-law partner, to his or her parent or grandparent, or to your parent or grandparent. To do this, you have to **designate** the individual and **specify the provincial amount** that you are transferring to him or her on Form T2202, T2202A or TL11A. Enter the amount on line 20 below.

Note: If you have a spouse or common-law partner, special rules may apply. See line 5856 in the forms book.

Enter the amount you are transferring (cannot be more than line 19) **Provincial amount transferred**	5920	–	20
Line 16 minus line 20 **Unused provincial amount available to carry forward to a future year**		=	21

The person claiming the transfer should not attach this schedule to his or her return.

* If you resided in another province or territory on December 31, 2003, you must enter on line 1 your unused provincial or territorial tuition and education amounts from your 2003 *Notice of Assessment* or *Notice of Reassessment*.
If there are no provincial or territorial amounts, enter your unused federal tuition and education amounts.

5006-S11

Provincial Worksheet *(continued)*

Line 5844 – Disability amount (calculation if you were **under age 18** on December 31, 2004)
(see line 5844 on page 2 of the forms book)

Maximum supplement			3,791 00	1
Total child care and attendant care expenses claimed for you by anyone		2		
Base amount	– 2,220 00	3		
Line 2 minus line 3 (if negative, enter "0")	=	▶	–	4
Line 1 minus line 4 (if negative, enter "0")			=	5

Enter, on line 5844 of Form ON428, **the amount on line 5 plus $6,499** (maximum claim $10,290), unless this chart is being completed for the claim on line 5848.

Line 5848 – Disability amount transferred from a dependant

Complete this calculation for each dependant.

Base amount	6,499 00	1
If the dependant was **under age 18** on December 31, 2004, enter the amount from line 5 of the chart for line 5844 for the dependant. If the dependant was age **18 or older**, enter "0".	+	2
Add lines 1 and 2	=	3
Total of amounts your dependant can claim on lines 5804 to 5840 of his or her Form ON428	+	4
Add lines 3 and 4	=	5
Dependant's taxable income (from line 260 of his or her return)	–	6
Allowable amount for this dependant: Line 5 minus line 6 (if negative, enter "0") Enter, on line 5848 of Form ON428, the amount on line 3 or line 7, whichever is **less.**	=	7

Enter, on line 5848, the total amount claimed for **all** disabled dependants.
If, at the end of the year, you and your dependant were not residents of the same province or territory, special rules may apply. Call us to determine the amount you can claim.

Line 5872 – Allowable amount of medical expenses for other dependants

Complete this calculation for each dependant.

Medical expenses for other dependant		1
Enter $1,821 or 3% of dependant's net income (from line 236 of his or her return), whichever is **less**	–	2
Line 1 minus line 2 (if negative, enter "0"; if it is more than $5,000, enter $5,000)	=	3

Enter, on line 5872 of Form ON428, the total amount claimed for **all** dependants.

Step 7 – Ontario Health Premium

Enter your **taxable income** from line 260 of your return 29,112 45 1
To calculate your Ontario Health Premium, **first go to Part A**.

Part A ⇨

If the amount on line 1 is **not in Part A**, complete the chart in **Part B**.

	income range	premium amount
If the amount on line 1 is in one of the income ranges in Part A, enter the corresponding premium amount beside the **OHP box** in Step 7 of Form ON428.	$20,000 or less	**zero**
	$25,000 to $36,000	**$300** ←
	$38,500 to $48,000	**$450**
	$48,600 to $72,000	**$600**
	$72,600 to $200,000	**$750**
	more than $200,600	**$900**

Part B If line 1 is: ⇨

	more than **$20,000**, but not more than **$25,000**	more than **$36,000**, but not more than **$38,500**	more than **$48,000**, but not more than **$48,600**	more than **$72,000**, but not more than **$72,600**	more than **$200,000**, but not more than **$200,600**	
Enter the amount from line 1 in the applicable column.						2
Line 2 minus line 3	– 20,000 00	– 36,000 00	– 48,000 00	– 72,000 00	– 200,000 00	3
(cannot be negative)	=	=	=	=	=	4
	× 6%	× 6%	× 25%	× 25%	× 25%	5
Multiply line 4 by line 5	=	=	=	=	=	6
Add lines 6 and 7, enter the result beside the **OHP box**	+ 0 00	+ 300 00	+ 450 00	+ 600 00	+ 750 00	7
in **Step 7** of Form ON428	=	=	=	=	=	8

5006-D