Planning for Your Income Tax Refund

In addition to the warmer weather, for many Canadians spring signals the arrival of their income tax refund from the Canada Revenue Agency (CRA) or Revenue Quebec (RQ), if you also file your taxes in Quebec. If you are receiving a tax refund from your 2014 income tax return, it may be worthwhile meeting with your BMO Nesbitt Burns Investment Advisor to discuss your plans for these funds, such as repaying non-deductible debt, or catching up on your Registered Retirement Savings Plan (RRSP), Tax-Free Savings Account (TFSA) or Registered Education Savings Plan (RESP) contributions.

Generally, the CRA and RQ process paper returns in four to six weeks, but electronically filed returns can be processed by the CRA in as little as eight business days (or by RQ within 14 working days). However, both the CRA and RQ advise to wait at least four weeks after filing your return before contacting them about the status of your refund (longer if you file a paper return with the CRA after April 15). Last year, according to the CRA, the average individual tax refund received was $1,655.

A survey[1] undertaken by BMO Nesbitt Burns in early 2015 revealed that 40 per cent of Canadians who were expecting to receive a refund were planning to use it to cover household bills and/or reduce their overall debt load. Canadians also planned to use their tax refunds (or a portion of them) to:

- Save or invest (25 per cent)
- Travel and/or purchase leisure items (14 per cent)
- Do home renovations or pay down their mortgage (9 per cent)
- Donate to charitable causes (1 per cent).

The remaining respondents were either unsure or did not indicate a specific use for their refund.

With this in mind, here are some recommendations for using your tax refund to build your net worth:

Contribute to your RRSP

Build your retirement savings by making an RRSP contribution. By making your 2015 RRSP contribution now, instead of waiting until the deadline next year, it will allow you to benefit from (almost) an extra year of tax-deferred growth. The maximum RRSP contribution limit for 2015 is $24,930.

Manage credit card debt

Pay down credit card debt, beginning with those cards that carry the highest interest rate. Going forward, consider using a credit card with a low interest rate for purchases and try to pay more than the minimum payment due, if not the balance in full, every month.

Make a lump sum mortgage payment

If you have a mortgage, check the terms of your mortgage and consider using your tax refund to make a lump sum payment. Applied directly to your principal, a lump sum payment could save you significant money in interest costs over the life of your mortgage.

Build an emergency fund

Having money set aside in case of an emergency is not only a good financial strategy, but will also help you sleep easier at night. A good rule of thumb is to have at least three months' salary saved as a safety net. If you feel your job might be at risk or if you are self-employed, six months is a better cushion. Your emergency fund should be easily accessible and it should be kept separate from your day-to-day bank account; perhaps in a high-interest savings account.

Top-up your TFSA savings

If you are not carrying any extra debt, then make your tax refund work for you. Making your TFSA contribution can help you grow your money tax-free.

Continued

The 2015 Federal Budget proposes to increase the annual TFSA limit to $10,000 from $5,500 effective this year. The Canada Revenue Agency (CRA) has confirmed that financial institutions and individuals may now act upon this change. As a result, BMO Nesbitt Burns clients can take advantage of this increased contribution limit, effective immediately.

Save for education

A post-secondary education is becoming increasingly expensive. Contributing to a RESP can help alleviate some of the pressure that all parents feel when planning for their children's future. Consider opening or contributing to an RESP using your income tax refund. A $2,500 contribution to an RESP can earn a $500 Canada Education Savings Grant (CESG) from the federal government. By maximizing your contributions every year you could earn up to $7,200 in lifetime CESGs for each of your children.

Income tax assessments

From a tax perspective, ensure that you take the time to review your Notice of Assessment with your tax advisor to determine if the CRA or RQ has made any adjustments to your filed tax return. It is important to review the Assessment upon receipt and understand any changes since there are specific time limits to object to disputed assessments.

Planning for next year: Manage income tax withholding /instalments

If you typically receive an income tax refund each year, ask yourself "Why am I giving the government an interest-free loan?" Refunds generally result because the income taxes that are withheld by your employer exceed your actual tax liability. Income tax withholding rates are an estimate of the taxes you will owe for the year if your only income source is the one upon which the taxes are being calculated. Withholding rates do not take into consideration all income tax deductions and credits, such as RRSP contributions, deductible alimony payments or charitable donations. This can result in an overpayment of tax during the year and a refund when you file your tax return.

If you would like your employer to reduce the amount of withholding taxes from your earnings, you must make your request in writing to the CRA and/or RQ. You will need to include supporting documentation with your request such as RRSP contribution receipts or a written court order for support payments. If you qualify, your employer will receive a letter of authorization to reduce the withholding taxes on your employment income. The reduced withholding allows you to improve your cash flow by increasing your net take home pay throughout the year, instead of receiving a lump-sum tax refund the following year.

Similarly, many investors are required to remit quarterly personal income tax instalments on significant investment income which is not subject to withholding tax at source. If you do not adequately review the appropriate amount of tax instalments to remit, it can lead to an 'interest free loan' to the government for over-remittances or non-deductible interest and penalties for late or deficient remittances. Consequently, if you own significant investment assets consider reviewing and planning for potential instalment requirements with your tax advisor – with assistance from your BMO Nesbitt Burns Investment Advisor.

Your BMO Nesbitt Burns Investment Advisor can help you plan for the tax efficiency of your investment assets. Please contact your BMO Nesbitt Burns Investment Advisor if you have any questions about the planning tips discussed in the article.

BMO Wealth Management
BMO Nesbitt Burns

[1] Pollara Strategic Insights: (2015). *BMO Tax Survey*.