

TAX ALERT



TAX ALERT is a commentary on topics of current interest – usually topics relating to recent changes in tax law, new CRA administrative practices or current interpretations arising from tax cases. Professional advice should be obtained before acting on any of this information. *ed.1/11*

HOLISTIC TAX PLANNING – JESSE JAMES STYLE

When I came to work one Monday morning not long ago there was a message on my answering machine to call Jesse James (not his real name but sounded familiar). Wonder what Jesse wants? So I called Jesse and he answered immediately – “I need to file a few years of back taxes”. CRA aren’t after Jesse and in fact told him they weren’t worried at all because each of the unfiled years gives Jesse a refund. “Take your time, Jesse,” they said! In the end, we found that Jesse had over \$16,000 in refunds coming back. Jesse is pretty laid back and wasn’t concerned about unfiled returns but it sure beats me why he didn’t file and put his money to work.

It turned out that Jesse only wanted to file because he was applying for a mortgage and needed three years of tax returns for the bank. We got the returns done and Jesse got the mortgage. The refund will take a few months.

In our meetings with Jesse it was clear that he was keen to know what he should be doing to cut his tax bill. Jesse’s a street smart guy but obviously no tax expert. You see Jesse makes about \$75,000 a year in construction and feels his tax bill is pretty stiff. He pays \$16,000 in taxes which makes his average rate at about twenty percent. People focus on their average tax rate in tax planning but what is really more important is the marginal rate – the tax paid on each additional dollar of income or the refund if additional deductions can be found. In Jesse’s case his marginal tax rate is approaching 40%. If Jesse can reduce his taxable income by \$100 he can put a \$40 tax saving in his pocket to spend or save – saving is the better idea. Jesse caught on to that pretty quickly.

Jesse is a likable guy and pretty smart and so the conversation moved on. Jesse says his friends often give up overtime because they think the tax man takes it all anyway. Jesse’s intuition tells him that’s not the case but he’s not sure why. We explained to Jesse that he keeps \$60 of every extra \$100 dollars he earns so the tax man never takes it all. The overtime isn’t such a bad idea after all. Jesse is going to talk to the boys back at the shop.

Jesse’s thoughts moved on. He also couldn’t understand why his buddies aren’t taking overtime if only to get employer pension contributions for their old age. Turns out Jesse’s employer contributes 3% of salary to Jesse’s pension so Jesse figures he should take as much of that as he can get. He should, and his buddies are mistaken – so better set them straight on that too.

When we looked at Jesse’s tax assessments to get some tax history, they showed that he had \$20,000 of unused RRSP contribution room from previous years. We suggested to Jesse that he contribute that amount to his RRSP or as much as he could afford in future. He figures he can put in about

\$5,000 a year towards this and lower his taxes by \$2,000 every year. Those tax refunds will pay down his new mortgage and reduce his interest bill. Jesse is on a roll.

On the out of town work Jesse has to pay all his expenses. His employer never supplied him with Form T2200 to allow him to deduct part of those expenses from taxable income. We estimate Jesse spends about \$4,000 in tax deductible out of town expenses every year so getting Form T2200 from his employer in future will put another \$1,600 in his bank account. Jesse will get on this right away so down goes his mortgage again. Retirement income just got bigger.

Jesse is not an unusual example of people squandering potential tax savings. Seems unusual for a guy whose name is Jesse James to get held up. So many people complain about the high cost of taxes and don't do anything about it. It doesn't matter whether you are a construction worker, a chief executive officer or a senior citizen – holistic tax planning does matter. Are you being held up, like Jesse James? *This article first appeared in the Exchange magazine.*

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