

Smart Tax Tips



Sangita Tulsiani, Pay Less Taxes

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Introduction

This book was written to help you get ready for tax season and to help you save taxes. I start off with important tips about filing your taxes.

Then we discuss issues important to employees who have employment income with deductions and tax credits. We will look at how to use a tax deduction waiver to increase your monthly income.

Next we look at self employed people and small business owners. They have deductions which must be handled correctly in order to maximize their benefit.

Together we'll examine some common investment pitfalls and review the best way to maximize your assets while minimizing your taxes.

Finally we will look at some questions that are important to your financial plan and how they affect your tax situation.

Remember – although it's illegal to avoid or evade taxes, it's perfectly okay to minimize the amount you must pay.

Filing Tips

Our first filing tip is the most important. File early.

Individuals don't have to file until April 30th, and if you are registered as a small business, you have until June 15th to complete your taxes. You will get a faster refund faster if you have overpaid, and the government owes you. Avoid penalties' and interest by planning ahead and paying before the deadline.

Secondly, have all your paperwork in order. Separate your personal and business expenses. You might be charged extra bookkeeping fees if you dump a big envelope of unsorted receipts on your tax preparer's desk.

Thirdly, if you will be transferring certain credits between spouses or children, bring everyone's tax packages in to be completed at the same time. If you use bookkeeping software, give your tax preparer both an electronic copy and a printout. Don't forget to bring along last year's notice of assessment to help in picking up deductions carried forwards.

Employment Income

Make your employment income tax efficient by negotiating non-taxable benefits from your employer. Some of these benefits could be: education cost (for employer's benefit), premium for private health services plan, loans from employers (interest benefit taxed), in city/out of city travel meal allowance, recreational, sporting or dining club fees (for employer's benefit), home computer and internet services, personal counselling (for you and your family), contributions to a registered pension plan, in house day care facilities, parking space (car needed for employment), \$10000.00 death benefit. Use loyalty program benefits earned through employment for personal use.

If you are one of those people who get a huge tax refund every year, it's possible that you have more deductions than the average.

A lot of people like to get that big refund, but it's not necessarily a good thing. A tax refund is your money which the government gives back. Instead of giving the government an

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interest free loan every year, you may be better off to keep that money, and get a bigger paycheque every month.

If the reason for your big refund is a regular deduction that reduces your taxes, like a company pension plan, union dues or monthly RRSP contributions, then you might be eligible to complete a form T1213 Source Deduction Waiver, and have the amount of tax deducted from your paycheque reduced.

Deductions & Credits

Most people confuse the difference between a tax deduction and a tax credit. A lot of things you might think are a deduction are actually a credit.

A tax deduction is something which is deducted from your gross income before the amount of tax you owe is calculated including union dues, childcare expenses, RRSPs (Registered Retirement Savings Plan), RPPs (Registered Pension Plan), etc are deductions from your total income. They have dollar to dollar value.

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A tax credit is an amount which is deducted from the tax you owe. Like the education tax credit or the political contribution credit. They work like you are applying a gift card for a certain amount to reduce how much you need to pay. Tax credits are same for everyone, where as tax deductions are not same for everyone.

You use the deductions to get your income down to it's lowest tax bracket, perhaps by making a large RRSP contribution. Then you reduce the amount of tax you owe by applying the credits available from your charitable contributions.

There are many tax credits that you can transfer to your spouse or family member if you don't need them.

Claiming your Deductions & Credits

Which deductions and credits you can claim will depend on your own personal situation. Do you have children? Are they in school? Or University? Are you responsible for a disabled person? Do you or your spouse have medical bills? Do you

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make political contributions? Or donate to your church or charity?

Child care expenses are usually claimed by the lower income spouse. Don't forget to claim the Children's Fitness tax credit. If you have a disabled child, ask about the various disability credits and benefits you might be able to claim. University and college students can transfer extra credits to their parents.

Medical expenses can be combined between two spouses and claimed on the tax return of the lower income earner as they have to be over 3% of net your net income. Maximize your charitable tax credit by combining your donations with your spouse's or combining 2 years worth of donations to get a bigger credit.

If you moved closer to work this year, claim that too.

Should I Incorporate?

Incorporation is a hot topic. And the answer is – It depends.

If you have a company with a number of employees, buildings and equipment, all of which need to be kept separate from your personal property, then yes, you probably should incorporate.

If you are in a business that might leave you open to the risk of being sued by a customer, yes, you should incorporate.

If your business is making lots of money, and you would prefer to leave it in the company where it is taxed at a lower rate, or pay it out as dividends taxed at a lower rate, yes, you should incorporate.

If you plan to build up your business and sell it as a single entity to someone else in the future, yes, by all means, you may want to incorporate.

If you are a small business, and all the income goes to you and your spouse, and you can deduct a bunch of personal things

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like your home office, or cars, then it may not be to your benefit to (no, don't) incorporate.

Office Expenses

A home office is only deductible if it is your principal place of business and is used “regularly and continuously” exclusively for your business.

Commissioned Sales People – If you are required to pay a share of the common office expenses, supplies, and the cost of an assistant, you can deduct all of these.

If your employer requires you to maintain a home office, they will have to fill out a T2200 for you. The home office will need to be where you complete the majority of your work.

Incorporated or Small Businesses – In addition to the usual supplies and equipment expenses, you can claim home office expenses equal to the percentage of your home that is used for business. If you use 15% of the square footage of your home, then you can claim 15% of the heat, hydro, cell phone,

business phone (not home phone), property taxes and 15% of the interest on your mortgage. *Note; this is the interest only, not the principal. You will have to get an annual statement of interest from your mortgage provider every year.

Vehicle Expenses

You must keep a vehicle log. This should include business miles (kilometres) driven, dates, names and events attended. Include all licences and insurance, gas receipts, oil changes, car washes, maintenance and repairs.

The percentage of automobile expenses you can deduct is based on the percentage of kms you drive for business purposes, compared to the kms for personal use. For example, if you drive 20,000 kms per year and you drove 10,000 for your business, you may be able to deduct half of your total expenses.

Canada Revenue Agency has set a \$30,000 dollar limit on the deductible price of a vehicle. If you are driving a company car

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worth more than \$30,000 you can be on the hook for an extra taxable benefit. If you want a fancier car, you might actually be better off to purchase or lease the car yourself, and then directly deduct the percentage which you use for business purposes.

If you have purchased or leased a new car in the past year, make sure that you give your tax preparer the purchase or lease documents so that they can calculate your Capital Cost Allowance (depreciation), or lease expense.

Business Income

One of the advantages of having an incorporated business is that you have a number of choices in how you pay yourself. Of course the first option is to pay yourself a salary. But you don't want to pay yourself so much that you bump yourself into the top tax bracket.

Paying out corporate profits in the form of a dividend can let you pay less tax. It is also a good way to split income by

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making your spouse, children and other family members shareholders who will also receive dividend payments.

If you put a lot of capital into the business to get it started, you might consider taking a repayment of capital, which could be tax free.

CPP for the Self Employed

Self employed people do have to pay Canada Pension Plan (CPP), contributions on employment income from their business, not including investment income paid out as dividends or return of capital. It's a bit more complicated than for other employees, because you pay it out, and then claim it back as a credit.

You have to pay both employer and employee portions of CPP. Then you can claim back a deduction equal to the employer's share on the tax return. You are also entitled to claim the standard 15% credit on the employee's share.

The benefit of course, is that you will be able to claim Canada Pension Plan benefits when you retire. You will also be able to claim CPP disability benefits if you qualify at some time in the future.

New Employment Insurance Rules

It used to be that self employed people couldn't claim Employment Insurance, and therefore weren't supposed to pay EI.

However – Beginning in January 2011, self employed people will be able to pay into Employment Insurance if they wish, and will be entitled to claim limited special benefits.

You must pay into EI for a full 12 months before you will be eligible to make a claim for maternity, paternal, sickness and compassionate care benefits.

Since you will not be eligible to claim for being unemployed, it is up to you to decide if it is worthwhile to pay into the system.

Income Splitting

Income splitting can be a very effective method of reducing taxes in a family where one person earns significantly more money than the other. In order for it to work, you have to follow the rules very carefully, and make sure that you watch out for a couple of pitfalls.

The Attribution Rule says that if you transfer an income producing asset to a family member in order to avoid taxes you can get stuck with their tax bill. To avoid this, the asset must be transferred at fair market value. In other words, you can't just put a rental property in your wife's or child's name. You must be compensated by either a direct payment or a by a loan secured by a promissory note on which interest is paid.

Before you do any of this, you should talk to your tax advisor about whether this will trigger a capital gain or loss or other taxable event. There are also a number of Antiavoidance Rules they can tell you about, these affect the correct way to transfer assets to Family Trusts, or make loans to family members to buy income producing property or assets.

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So what is the correct way to split income? You can choose a number of methods, each of which will depend on your family's specific circumstances.

Spouses have the most options. If you own a business, you can hire your spouse or children, but their pay must reflect the job they are doing. You can't pay a 12-year-old \$50,000 a year to sweep out the garage every Saturday. Gifts to adult children to invest, and gifts to minor children or grandchildren to invest can run afoul of the antiavoidance rules, and trigger a capital gain in your name.

Business owners can assign shares to family members, and pay them dividends from the profits of the business. You can lend your spouse or child money to buy an income producing asset like stocks, bonds, rental property or another business, but make sure you get paid interest on the loan, no or low interest loan won't work! The loan must be at CRA's prescribed rate of interest, the prescribed current rate of interest is 1%. Lock it in now!!!!

You can also contribute to a Spousal RRSP which will help even out your income in retirement.

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When you retire, you can assign the taxable portion of your pension income, including your CPP payments between two spouse's tax returns in order to lower your tax bracket and pay less tax. The pension itself is not split, just how it is reported on the tax return.

RRSPs

Your Registered Retirement Savings Plan is one of your most important tax planning and retirement planning tools.

How much you can put into an RRSP is calculated on how much you earned last year, plus any contribution room you didn't use from previous years.

If you have a number of years worth of available RRSP space, maxing out your limit can reduce your taxes all the way to zero in the year the contribution is made. If you have room to contribute more than the amount which will reduce you to zero, you can carry that over to the next year, and claim it against next year's taxes.

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Sometimes you know that you are going to receive a large bonus, or buyout package, or other income in the coming year. You can make your regular RRSP contributions this year and delay claiming them until next year, when they can help reduce the tax which will be due on that large bonus.

Make your contribution early; you might as well have the money earning you interest. Or arrange for monthly contributions. Your bank or investment advisor can set up a monthly investment plan that will keep you on track.

Some employers match their employee's RRSP contributions or contribute so much per hour worked. If your employer does this, you should participate in the program, it's like getting a monthly raise equal to the amount they put in to your retirement account.

If you are behind on your contributions, you can borrow money to top up your RRSPs. But be very careful, you should only do this if you know you can pay off the loan within one year. This can also be a good strategy if you know that you will be entering a higher tax bracket next year.

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Generally speaking, withdrawing money from your RRSP before retirement may be a bad idea, and you will be charged income tax at your highest marginal rate if you take any money out. If you think you might need some of this money before retirement, you may want to put it in a Tax Free Savings Account (TFSA) instead.

Tax Free Savings Account

Tax Free Savings Accounts (TFSA) are new enough that a lot of people still don't understand how they work and what their benefits are.

Basically a TFSA is not too different from an RRSP. In a RRSP you put the money in, and get a tax deduction. When you take the money out, you pay the taxes.

A TFSA works the opposite way. When you put the money in, there is no tax deduction, and when you take the money out, you pay no taxes on the principal or on the interest and gains

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your money earned. So for a RRSP, you pay the taxes later, for a TFSA you pay the taxes at the beginning.

There are a few other differences that make TFSAs a good way to save. Everyone gets a \$5,000 limit per year. That means that people who don't earn an income, or earn more than the RRSP maximum can still put away money.

You can take money out of a TFSA any time without penalty. But if you don't need the money, it can sit there happily growing tax free.

You can use a TFSA to save for a house, build up a nest egg, invest for retirement or put money away to take a year off to have a baby. It's up to you.

One of the major mistakes people make with TFSAs is assuming that they are just a plain old savings account like at the bank which pays a tiny 2% interest. This isn't true.

You can have a TFSA GIC account. You can have a TFSA investment account with Stocks and Bonds. You can have a TFSA mutual fund account.

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Since everyone over the age of 18 gets a \$5,000 limit, even if they aren't working, a TFSA is a perfect way for grandparents to help out their grandchildren, by gifting them with up to \$5,000 a year in their accounts.

You Need a Will

As the name suggests "it must be you who decides how your estate is distributed upon your death." If you don't have a will, you are allowing the government to decide what happens to your money, your property and your minor children if you die.

If you make a will without consulting a lawyer and your tax advisor, you run the risk of the government scooping up more than their fair share of taxes and probate fees.

A will made without proper advice also runs the risk of being declared invalid. Your will must be in accordance with the Family Law Act or beneficiaries can go to court and petition to get it thrown out.

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If you are leaving your principal residence to someone, consider having it made in joint tenancy with them, so that it doesn't have to be included in probate. Transferring assets to a corporation (estate freeze) and making multiple wills also helps you "Live rich and die poor".

Ask if an "alter ego" or "joint partner" trust is right for your personal and tax situation. This can allow you to transfer assets outside the will, again avoiding inclusion in probate.

Conclusion

I hope you enjoyed this digital book. My goal is to remind you to file your taxes on time, take advantage of all the deductions that offered by CRA so you can pay less taxes and to consult with your income tax expert to file correctly.

If you have any questions or need my help, including, advice about your previous years taxes, or helping you create a business or tax plan – I would love to hear from you.

About the Author

Sangita Tulsiani is an income tax expert who has helped thousands of her clients save taxes since 1993. Her goal is to work with each individual client to reduce their tax burden. Together with her clients she plans, educates and ensures you pay the least amount of taxes.

She works with small businesses, Real Estate Investors, small corporations and regular people. Her tax tips have been published in Mississauga News and across other websites.

Her clients say that they appreciate the personal touch, the honesty and the relationship that is built over the years.

This E-Book was written to help you realize that you too can save taxes (even if you don't have a business) just like many of Sangita's clients and you do not need to spend hundreds of dollars doing your taxes.

Disclaimer: This book is not intended as a substitute for professional, personal, tax advice. Please consult your tax preparer for advice related to your own personal circumstances.

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Sangita Tulsiani

PAY LESS TAXES

38 Vespahills Crescent
Brampton, Ontario L6P 2V2
905.915.3399

www.pay_less_taxes.com

sangita@pay_less_taxes.com

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