“Just-in-time” tax planning?

No sensible tax advisor would suggest starting your tax planning for the year as you sit down to complete your return. The standard advice correctly holds that the best year-end tax planning begins on January 1 of the tax year. However, all is not lost by tax return filing time, as there are some tax planning strategies (more properly described as tax filing strategies) which can still minimize the tax bite for the current year or future ones.

File on time

It may seem obvious, but every year some taxpayers pay unnecessary (and non-deductible) penalties and interest for no reason other than that they simply didn’t get their returns in on time. For the record, a personal tax return is late-filed if it isn’t sent to the Canada Revenue Agency (CRA) on or before April 30 or, if you or your spouse are self-employed, on or before June 15. In all cases, **amounts due must be paid on or before April 30.**

For some taxpayers, late-filing is just a matter of not having gotten around to it – few people view preparing their tax returns as anything other than an unpleasant chore. For others, missing or mislaid information slips are to blame. In many cases, where there is tax owing and the cash just isn’t available to pay those taxes, taxpayers assume that it’s better just to put off filing until the money is available and the payment can be made. Whatever the reason, not filing on time is, in all cases, the wrong decision.

Where taxes are owed, late-filing means an automatic penalty will be imposed equal to 5% of those outstanding taxes, plus an additional 1% for every full month following during which the return is not filed, to a maximum of 12 months (or a total of 17% of the unpaid amount). As well, interest starts being charged on those unpaid taxes the very first day they are overdue. Few taxpayers realize that the interest rate charged by the CRA is, by law, well in excess of commercial rates of interest. Specifically, the rate of interest charged by the CRA is equal to its “prescribed rate” plus 4%, and any interest charges levied are compounded daily. The rate charged by the CRA from April to June 2010 will be 5%.

For taxpayers who make a habit of filing late, the news is even worse. If a late-filing penalty has been charged by the CRA in any of the previous three years, and another return is late-filed, both the immediate penalty and the recurring monthly penalty are doubled to, 10% and 2%, respectively, per month, to a maximum of 20 months. In the very worst-case scenario, where the taxpayer was assessed a late-filing penalty within the previous three years, the current return is more than 20 months late and the Minister has issued a formal “demand to file”, the penalty assessed can reach 50% of the unpaid tax amount.

Even where a refund is expected, and there is consequently no risk of incurring late-filing penalties, it doesn’t make sense to put off filing. While the CRA pays compound daily interest (at a rate of 3% for the April to June 2010 period) on overpayments of taxes, the interest clock on such payments doesn’t start running until the *latest* of the following three dates: May 31, 2010, the 31st day after the return is filed, or the day after the taxes are overpaid.

So, no matter what your situation, getting your return in on time makes sense. In the worst case scenario, it can save you from paying substantial interest and penalties (now or in the future) or, where a refund is expected, can get your money into your hands more quickly, perhaps with interest added.

Figuring out what to claim

It would seem to make intuitive sense to claim whatever eligible costs you have incurred during the year in order to minimize your tax bill or increase your refund. But, in some areas, “giving away” your deductions to other family members or deferring the claim until a future year can actually give you a much better tax result than just automatically claiming whatever amounts are available as those costs are incurred.

Taxpayers who are married enjoy some advantages in this area. By law, medical expenses incurred within a family (that is, by each spouse or by their children) can be claimed by either spouse. As well, charitable donations made by married individuals can be claimed by the person who made the donation or by his or her spouse. The ability to transfer or combine the amounts matters because, in the case of medical expenses, amounts claimable must pass certain income thresholds and, in the case of charitable donations, the credit percentage rises as donation amounts increase.

Medical expense claims

Under Canadian tax law, a 15% federal tax credit (as well as a provincial credit, the amount of which varies depending on the taxpayer’s province of residence) may be claimed for qualifying medical expenses over a specified income threshold. Federally, for 2009, that threshold is equal to the lesser of $2,011or 3% of net income. Consequently, it makes sense to maximize the amount of claimable expenses by having one member of the family make the claim for qualifying expenses incurred by all family members, and for the person claiming to be the lower-income spouse.

It is also possible to plan around the timing of medical expenses. Medical expenses claimed on a tax return can be any qualifying expenses incurred in any 12-month period which ended during the tax year. So, it makes sense to pick the 12-month period which maximizes the amount of expenses. Take, for instance, a family whose medical expenses were not out of the ordinary during 2009 but who incurred significant medical expenses (perhaps for unexpected dental care costs or prescription drug expenses) in the first two months of 2010. When filing the return for 2009, it might make sense to defer the claim for medical expenses paid during 2009, where that claim might only produce a small credit or no credit at all, and the medical expenses incurred during calendar 2009 would be “wasted” from a tax point of view. When the 2010 return is filed at this time next year, claiming all medical expenses incurred between March 1, 2009 and February 28, 2010 might produce a better tax result. Because each case is different, in terms of when medical expenses are incurred, and the income of the taxpayer or taxpayers for different tax years, there are no real rules of thumb which can determine when it makes sense to defer a medical claim. In all cases, it’s a matter of doing the calculations to determine which claim period produces the best tax result.

Claiming charitable donations

Our tax system provides a credit, at both the federal and provincial levels, for all charitable donations made. Unlike the medical expense claim, the income of the taxpayer plays no part in determining the availability or amount of such a claim. However, our tax system does reward more generous donors, in that the percentage amount of the credit increases as donation levels rise. Specifically, the first $200 in donations is eligible for a non-refundable tax credit equal to 15% of the donation amount, while donations over $200 qualify for the same non-refundable tax credit at the rate of 29%.

As noted above, charitable donations made by an individual can be claimed by that individual or by his or her spouse. Since the credit percentage increases as donation levels rise, it only makes sense to combine the donations made by both spouses and claim them on one return. Since the available credit is unaffected by income level, it doesn't matter which spouse makes the claim, with one caveat. Since the credit is non-refundable, it should only be claimed by a taxpayer who has an actual tax liability for the year.

Taxpayers also have some flexibility in timing the claiming of their charitable deduction contributions. Contributions made can be claimed in the year they are made or in any of the five successive taxation years. So, it will usually make sense, where donation amounts for a single year do not exceed the $200 threshold, to wait and aggregate donations made in two or more years, in order to maximize the credit claimable.

As the tax filing deadline gets closer and closer, it's true that the chances to make any really significant changes to one's tax liability for the year diminish. But, nonetheless, paying close attention to the details when filing can produce a better bottom line result – and an incentive to start planning earlier next year!