Last minute tax-filing strategies (April 2011)

By the time most Canadians sit down to gather together information slips and receipts to prepare their 2010 tax return, any opportunities to minimize tax payable for the year are, for the most part, gone. Most tax-planning or tax-saving strategies, in order to be effective for 2010, would have to have been put in place by the end of that calendar year. The major exception to that rule is, of course, registered retirement savings plan (RRSP) contributions, but even those had to have been made by March 1, 2011 in order to be claimed on the 2010 return.

Notwithstanding, 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. What follows is an outline of some of the tax-filing strategies which are available to many, if not most, Canadian taxpayers.

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. Finally, costs incurred by members of a family for public transit use can be combined to ensure that they are claimed by the family member or members who can make the best use of them for tax purposes.

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 2010, that threshold is equal to the lesser of $2,024 or 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 2010 but who incurred significant medical expenses (perhaps for unexpected dental care costs or prescription drug expenses) in the first two months of 2011. When filing the return for 2010, it might make sense to defer the claim for medical expenses paid during 2010, where that claim might only produce a small credit or no credit at all, and the medical expenses incurred during calendar 2010 would be “wasted” from a tax point of view. When the 2011 return is filed at this time next year, claiming all medical expenses incurred between March 1, 2010 and February 28, 2011 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.

Public transit tax credit

Millions of Canadians use public transit every day to get to and from work or school, and the cost of such public transit use can run to hundreds of dollars each month. In order to encourage the use of public transit, the federal government provides a non-refundable tax credit to taxpayers who purchase monthly (or longer) transit passes throughout the year. The cost of shorter duration passes may also qualify for the credit if they are for a minimum 5-day period and enough of them are purchased to provide the purchaser with 20 days of unlimited travel each month.

The credit itself is equal to 15% of the amount of eligible public transit costs incurred, with no limit on that amount. So, a taxpayer who purchased a $250 monthly commuter train pass each month for the entire year could claim a credit of $450. ($250 ×12 ×15%) and reduce his or her federal taxes by that amount.

The full potential of the public transit tax credit, however, is realized when eligible public transit costs incurred by members of a family are combined. Many users of public transit are high school or university students, who use transit for reasons of economy. However, for most such students, their income for the year is unlikely to be high enough (over about $10,000 for 2010) to result in a federal tax liability. Since the public transit credit is a non-refundable one, meaning that it can only reduce federal tax otherwise payable and can't create or increase a refund, it's of no use to someone who doesn't pay federal tax. And, since the credit can't be carried over, but must be claimed in the year the qualifying expense is incurred, any potential credit in the hands of someone who isn't taxable for federal purposes would simply be lost.

Recognizing this reality, the federal tax rules governing the public transit tax credit permit all eligible costs incurred by a taxpayer, his or her spouse, and any of their children who are under the age of 19 (which would in many cases include children at university) to be combined and claimed on either spouse's return, as follows. If the taxpayer in the example above spent $3,000 ($250 per month) for eligible public transit costs, his or her spouse spent a like amount, and each of their two teenage children incurred $100 per month in eligible public transit costs, then the total claim would be as follows:

Taxpayer - $3,000

Spouse - $3,000

Teenage child - $1,200

Teenage child - $1,200

TOTAL - $8,400 ×15% = $1,260

It doesn't matter which spouse claims the total eligible public transit costs of $8,400, as the total credit will remain $1,260, no matter who makes the claim. What matters is that the person making the claim has at least $1,260 in federal tax payable after all other non-refundable credits (e.g., personal credit) are claimed, so that that credit can be fully utilized.

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!