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CESTNICK

TAX MATTERS

Five lessons your tax return can teach you

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I was reminded recently of the tale of the little girl who was forever optimistic. A pile of manure was dumped in the family's driveway for fertilizer. Her parents found her rummaging through the pile with excitement. "What are you doing!?" her mother asked. "You can't fool me mom," the girl replied, "with a pile of manure this big, there's got to be a pony!"

Some might liken their tax preparation to shovelling a pile of manure. The job stinks, but it has to get done. And be optimistic.

Here are five things you can learn from your tax return which can help you improve your overall financial well-being. Think of this as finding a pony in that pile.

Make sure you're on track for retirement

Are you going to make ends meet in retirement? Your tax return can act as a barometer. If you're setting aside funds in a registered plan, you should see figures showing up on certain lines on your tax return. Check out lines 20600 (pension adjustment), 20700 (RPP deduction), 20800 (RRSP deduction) and 20810 (pooled RPP contributions).

Are those lines blank? Then perhaps you're not doing enough to save for retirement. And if you're not retired yet, but you have a figure on Line 12900 (RRSP income), then you've been withdrawing funds from your RRSP – perhaps before you should. This might be a red flag that your retirement savings are not where they should be.

Ensure that you reduce the cost of your debt

Do you have debt of any kind? If so, the debt will cost you less if you're able to deduct your interest costs. Check out Line 22100 (carrying charges and interest expenses) on your tax return. Have you claimed interest costs there? If you have debt, but no interest deduction, then you might be able to improve things.Make your interest deductible by ensuring your borrowed money is used for income-producing purposes. You can do this, for example, by starting a home-based business to make some of your mortgage interest deductible. Or consider liquidating investments to pay down non-deductible debt, then borrow to replace the investments. This will create a deduction for the newly borrowed funds. As for student loans, make sure you've claimed a credit on Line 31900 for the interest you've paid.

Take advantage of self-employment

I have often talked about self-employment, even part-time, as one of the greatest tax shelters still available. The reason? You can claim a deduction for any costs incurred for the purpose of earning income from your business, as long as they're reasonable in amount.

Take a look at lines 13499 and 13699 (business or professional income) on your tax return. Any figures there? If not, you're missing an opportunity to claim a deduction for costs you're likely paying for anyway. Things such as a portion of rent, mortgage interest, property taxes, repairs on your home, vehicle costs and more. Make 2022 the year you start a home-based business to earn a little income and create tax savings.

Avoid loans to the taxman

If the taxman sent you the following letter, how would you reply? "Dear Taxpayer: Thank you for filing your tax return last year. Since you have sufficient income, we would like to ask you to lend us $1,200 on an interest-free basis. Please contact us within 30 days to let us know whether you would like to participate in this program."

Uh, count me out. Yet, if you're receiving a tax refund each year, you're effectively lending money to the taxman without interest. Check Line 48400 (Refund) on your tax return. If there's a meaningful balance there, you may be able to fix this by filing Form T1213 with the Canada Revenue Agency. This is an application to have the tax deducted from your pay reduced so that you avoid large refunds each year. It's best to file this in November each year for the coming tax year, but you can still apply for 2022. Better late than never.

Refine your asset location

Are you paying too much tax on your investment returns? Check out lines 12000 (eligible and ineligible dividends), 12010 (ineligible dividends), 12100 (interest and other investment income), and 12700 (taxable capital gains). If you have interest income on Line 12100 but you also have an RRSP or TFSA, you should be earning that interest in those tax-sheltered registered plans to the extent you can because interest is the most highly taxed type of investment income.

If you're going to earn investment income outside your registered plans, you'd be better off earning capital gains, or Canadian dividends. But always keep in mind the amount of risk in your portfolio. Don't take on more risk than you should just because you might save taxes.

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