



Intoxication: Why getting a tax refund may be a sign of poor financial planning

April 2021

Jamie Golombek

Managing Director, Tax and Estate Planning, CIBC Private Wealth Management

In-tax-i-ca-tion [in-tak-si-KEY-shuh n] (noun) – The short-term euphoria associated with a tax refund that fades when you realize you are getting your own money back, interest-free, over a year later.

Many Canadians who expect a tax refund often plan to use it to pay down debts or build up their savings. While Canadians may be focused on getting their financial house in order, getting a tax refund each year may actually be a sign of poor tax and financial planning, as Canadians might be better off either paying down debt and/or investing their tax “refund” with every paycheck.

Canadians expecting a tax refund should be aware of the heavy price associated with the instant cash-back option available with some tax-preparation services. While the maximum fees charged are legislated by the government, the amounts can still be high. For example, under federal rules, you may only receive 85% on the first \$300 of your refund and 95% on any amount above.

Refunds are a sign of poor tax planning

Contrary to popular belief, getting a tax refund may be a sign of poor tax planning. After all, you’ve loaned your hard-earned money to the government, interest-free, for a year (or more!) A tax refund typically arises when the amount of tax owing on your return is less than the amount of tax withheld from your income during the year.

Employment income is the most common type of income from which tax is deducted at source. The amount of tax withheld by your employer is calculated without taking into account various deductions normally claimed, such as RRSP contributions or child-care expenses, which reduce your taxes payable.

For employees, there are two ways in which your taxes at source can be reduced. The first is by making sure that the credits your employer uses to calculate your payroll deductions are up to date (the “TD1 Return”) and the second is to apply annually for a reduction of tax at source (the “T1213 Form.”).

TD1 – Personal tax credits return

The “TD1 Personal Tax Credits Return”¹ sets out the personal tax credits you intend to claim when filing your tax return, and helps determine how much tax is deducted each pay period. If your entitlement to personal tax credits such as the spouse or common-law partner amount, the disability amount or tuition has changed from the time you were hired, you should re-submit the form so that taxes withheld at source can be adjusted for tax credits beyond the basic personal exemption. Note that you must submit both the federal and provincial TD1 forms, which can be found on the Canada Revenue Agency (CRA) website².

¹ Quebec employees must also complete the Quebec form, “Source Deductions Return” (TP-1015.3-V).

² See: [canada.ca/en/revenue-agency.html](https://canada.ca/en/revenue-agency/html)

Commissioned employees who are able to claim expenses may complete the “TD1X, Statement of Commission Income and Expenses for Payroll Tax Deductions”³ so that their expenses can be taken into consideration in the calculation of the income taxes deducted from their commission income. These forms (both federal and provincial) should be reviewed and, where appropriate, refiled annually to reduce taxes withheld at source.

Form T1213 – “Request to reduce tax deductions at source”

It’s possible to get your taxes reduced throughout the year, on every paycheque, instead of waiting until your return is filed the following spring to get a refund. To apply, you simply complete CRA’s one-page form, T1213 “Request to Reduce Tax Deductions at Source”⁴. On this form, you indicate the various deductions or credits that, if not taken into account, would otherwise result in a tax refund for the year.

This form is then sent to your local CRA tax services office for approval. Once approved, the CRA will send you a letter of authority, which must be given to your employer who can then reduce tax at source.

Let’s review an example of how the monthly reduction of tax at source can boost your savings by directly investing in a Tax Free Savings Account (TFSA).

Example – Savings in a TFSA (monthly)

Kareem will earn \$72,000 in 2021 and plans to contribute \$9,000 to his RRSP. Based on 2021 Ontario tax rates, he would be eligible for a reduced tax withholding of about \$222 per month.

If this \$222 monthly savings is automatically redirected from Kareem’s paycheque into a regular investment program in his Tax Free Saving Account (TFSA), he won’t miss the money on a monthly basis because his net pay will remain constant. The automatic savings means he will have accumulated \$2,664 over the year and by saving it monthly, he may be less tempted to spend it versus if he received it as a single lump sum refund the next year.

Over a working career of 30 years, at a 5% annual compounded growth rate in a balanced portfolio, Kareem’s TFSA could grow to nearly \$185,000, representing approximately \$105,000 in tax-free growth on the monthly contributions.

What is your number one priority for your refund?

If you do end up getting a refund, let’s take a look at some examples of how a tax refund might be used. Debt repayment and investing seem to be Canadians’ top priorities.

Example 1 – Pay down debt

Lisa and Harvey just took out a mortgage of \$300,000 at 3%, compounded semi-annually, with a 25-year amortization. If they were to contribute their annual combined tax refunds of \$5,000 to make an extra payment on their mortgage each year, their mortgage would be paid off 8 years sooner and the couple would save over \$42,000 in interest over the 25 year mortgage.⁵

Example 2 – Fund a Registered Education Savings Plan (RESP)

Jacques and Jeanne have two kids, and Jacques, who is in a 40% tax bracket, contributes \$12,500 to his RRSP annually, resulting in a tax refund of \$5,000. By contributing his tax refund to an RESP established for both of their kids, the RESP will receive the matching Canada Education Savings Grants (CESG) of 20%, or an additional \$1,000. If this is repeated for the next 12 years and the funds are invested in a balanced portfolio with a 5% return, the RESP will be worth over \$100,000.

³ Quebec employees must also complete the Quebec form, “Statement of Commissions and Expenses for Source Deduction Purposes” (TP-1015.R.13.1-V)

⁴ Quebec residents must also complete Québec Form "Application for a Reduction in Source Deductions of Income Tax" (TP-1016-V).

⁵ Calculated using CIBC’s online mortgage payment calculator, which is available online at [cibc.com/en/personal-banking/mortgages/calculators/payment-calculator.html](https://www.cibc.com/en/personal-banking/mortgages/calculators/payment-calculator.html).

Example 3 – Fund a Registered Disability Savings Plan (RDSP)

Aisha's son who is twenty years old, has no income and a disability that qualifies him for the disability tax credit. Aisha earns \$45,000 annually and is expecting a tax refund of \$1,500. By contributing this \$1,500 tax refund into an RDSP for her son, the RDSP will be entitled to receive \$3,500 in Canada Disability Savings Grants and \$1,000 in Canada Disability Savings Bonds for a total of \$6,000, before any growth in the plan.

If Aisha continues to invest her \$1,500 tax refund annually in the RDSP, in 15 years, assuming the same levels of government contributions and a growth rate of 5% in a balanced portfolio, the RDSP will be worth over \$130,000.

Plan to use your tax refund wisely... or avoid a refund entirely

As you can see, there are a number of ways to either use your tax refund to your advantage or, even better, arrange it so that next year, your tax refund is eliminated or reduced and the taxes saved are used throughout the entire year to your benefit rather than accumulating interest-free in the hands of the CRA.

Jamie Golombek, CPA, CA, CFP, CLU, TEP is the Managing Director, Tax & Estate Planning with CIBC Private Wealth Management in Toronto.

jamie.golombek@cibc.com

This report is published by CIBC with information that is believed to be accurate at the time of publishing. CIBC and its subsidiaries and affiliates are not liable for any errors or omissions. This report is intended to provide general information and should not be construed as specific legal, lending, or tax advice. Individual circumstances and current events are critical to sound planning; anyone wishing to act on the information in this report should consult with their financial, tax and legal advisors.

The CIBC logo is a trademark of CIBC.