
Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

# What to do with your tax refund

## Strategies to optimize the use of your income tax refund

As a result of RRSP contributions, interest expenses, tax shelter deductions or various other tax deductions and credits, you may be expecting, or have recently received, an income tax refund from the Canada Revenue Agency (CRA). If you receive a tax refund, it may be a good opportunity to determine if you can use some or all of it to improve your financial well-being. This article discusses some strategies that may help you use your income tax refund wisely and assist you in meeting your financial goals.

Please contact us for more information about the topics discussed in this article.

### Saving for your future

You may be tempted to spend your refund on things like a well-deserved vacation or doing a minor renovation to your home. In some cases, this is an appropriate use of the money, depending on your need at the time. You might also consider saving all or a portion of your refund for your future financial security. The "compounding" effect helps even small savings grow significantly over the long term, helping you achieve the financial lifestyle you want.

### Improve your financial well-being

Has an RBC advisor recently prepared a financial plan for you? If so, review the recommendations in the financial plan. You can then consider the areas that need improvement and prioritize what's most important to you. The receipt of an income tax refund can be a great catalyst for you to implement some of the strategies in your financial plan.

You can use your tax refund to prepare your Will or Power of Attorney, set up your emergency fund or put adequate disability or life insurance in place. Of course, saving the refund in an RRSP, RESP, a TFSA or paying down debt are all financially wise saving strategies for the funds as well.

The following are some common financial planning recommendations that you may want to address with your tax refund.

#### Risk management strategies

When it comes to managing your finances, you probably understand the benefits of saving on a regular basis. At the same time, it's equally important to ensure that you and your family are taken care of in the event that something unexpected or tragic takes place and you pass away or become disabled. Consider the following three common risk management strategies:

If you plan to help your children or grandchildren with their education costs, you may want to use your income tax refund to contribute to a Registered Education Savings Plan (RESP).

1. Consult a lawyer to have a Will and a Power of Attorney prepared or reviewed.

2. Ensure you have adequate disability and critical illness insurance.

3. Ensure you have adequate life insurance.

## Education savings

If you plan to help your children or grandchildren with their education costs, you may want to use your income tax refund to contribute to a Registered Education Savings Plan (RESP). Keep in mind that the first $2,500 of RESP contributions attracts a federal government grant of $500 to $600, depending on your family income. If you haven't opened an RESP for your children, you may wish to use your tax refund to start making contributions.

## Reduce non-deductible debt

Consider paying down an outstanding non-deductible debt that's subject to a high interest rate. Non-deductible debt includes: credit card debt, a personal-use car loan, a line of credit used for personal purposes or the mortgage on your home. As the interest on a loan used for personal purposes is not deductible for income tax purposes, you're paying the interest on the loan with after-tax dollars. The higher the interest rate on the loan or the higher your marginal tax rate, the more income you'll have to earn to pay the interest on this loan. This makes it more beneficial to pay down this debt.

## RRSP or non-registered savings

If you don't have high interest non-deductible debt, another option is to save your income tax refund in an RRSP or a non-registered account. Whether you should save your refund in an RRSP or a non-registered account depends on your specific circumstances and several financial assumptions. Here's some general guidance that may help with this decision:

- If you expect your marginal tax rate in retirement to be the same or lower than your marginal tax rate today, consider contributing to your RRSP;

- If you want to invest in securities that produce Canadian source dividends and capital gains and you're in a low tax bracket today but expect to be in a higher tax bracket in retirement, you're generally better off saving outside an RRSP.

Speak to an RBC advisor about whether you should contribute your tax refund to a registered account or save it in a non-registered account. RBC advisors have access to tools that can help you decide which option is best for you.

## Contribute to a Tax-Free Savings Account (TFSA)

The TFSA provides a further option for investing your tax refund. The TFSA allows you to make a $6,000 (for 2019) annual maximum contribution. All growth, income and withdrawals are tax-free. You can also gift money to your spouse to invest in a TFSA without being subject to the income attribution rules.

Should you invest your tax refund in an RRSP or a TFSA, if you're unable to do both? The following general guidelines may help you make the decision:

- Choose the TFSA if your expected marginal tax rate in retirement is going to be higher than your marginal tax rate today.

- Choose the RRSP if your expected marginal tax rate in retirement is going to be lower than your marginal tax rate today.

## Emergency fund

A fundamental financial planning strategy is to set aside some money

If you don't want to direct your income tax refund to a savings vehicle that may earn little interest, consider obtaining or increasing your line of credit for emergency purposes only.

for unexpected expenses or a job loss. In general, consider keeping approximately three to six months' worth of living expenses within a liquid emergency fund. If you don't have an adequate emergency fund, you may want to direct some or all of your tax refund towards creating one.

If you don't want to direct your income tax refund to a savings vehicle that may earn little interest, consider obtaining or increasing your line of credit for emergency purposes only.

## Receive your tax refund earlier

Ensure that the information you provide to your employer about your personal tax credits is up-to-date. If your personal or family situation has changed since last year, you may be entitled to claim credits you haven't claimed before, such as the pension income tax credit, spouse or common-law partner amount, caregiver amount and disability amount. If you advise your employer of these additional credits, this may lower your income tax deductions at source, so you won't have to wait until your tax return is assessed to receive your refund.

If you don't want to wait until after you file your income tax return to receive your tax refund and you have regular tax deductions such as RRSP contributions, child care expenses and deductible support payments, talk to a qualified tax professional about making a request to the CRA to reduce your tax deductions at source. If the CRA accepts your request, they will authorize your employer to reduce the income tax withheld from your pay during the year, thereby increasing your net pay. This means you'll have more funds in your pocket throughout the year rather than waiting for a lump-sum tax refund after you file your income tax return.

## Conclusion

There are numerous ways you may choose to use a tax refund. Your choice will depend upon your priorities and your personal financial situation. You can use your refund for many purposes including: saving for education or retirement, reducing non-deductible debt, building an emergency fund or simply for fun and relaxation. Whatever you decide, consider what matters most to you and obtain professional advice if you have questions about your options.

*This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.*

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