So, You Got a Tax Refund

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According to the Minister of National Revenue, the average tax refund is over $1,500 for the 2011 tax year. Surprisingly, many Canadians are thrilled about getting a big refund. While certain situations can lead to an unusual tax refund, far too many Canadians lend large sums of money to the government at 0% interest year after year. Two things you can do to make your refunds smaller are:

File a new TD1 - When Ben started his new job several years ago, he completed a TD1 form with his employer. This form tells Ben's boss how much to deduct from his income for taxes. He has since married and had two children. Ben should complete a new TD1 form that better reflects his situation today. These life changing events provide Ben with more tax lowering opportunities and, rather than getting a large refund, he prefers to have less deducted from his paycheques.

File a T1213 - Cheryl makes RRSP deposits on a monthly basis by automatic bank withdrawal. By completing a T1213 'Request to Reduce Tax Deductions at Source' form, her employer can reduce her monthly salary by the RRSP deposit before calculating tax deductions. This gives Cheryl an instant tax break rather than a big refund.

Mike was laid off for a few months. Julie had some unusual medical bills. Doug and Mary started their twins in daycare. These events resulted in tax refunds that were not normal. Then again, many plan on getting refunds each year. What can you do with your income tax refund? Here are some ideas:

Start an emergency fund - Like many, Mike didn't expect to get laid off. It took almost six weeks to receive his first Employment Insurance payment. Mike deposited $5,500 of his refund in a Tax-Free Savings Account (TFSA). Next time there is an employment interruption, he can dip into his TFSA to help get him through. Any withdrawals he makes get added back to his contribution room the following year, so he can replenish his emergency funds.

Pay down high interest debts - Julie had incurred some unusual expenses and some went on her credit cards. Most bank credit cards charge about 19% annual interest on outstanding balances. Any new charges to the cards attract the same interest until the balance is paid off. Julie used her refund to pay down her credit card balances and save on interest costs.

Pay down the mortgage - Doug and Mary have $250,000 left on their 3.5% mortgage. They have twenty years left to pay on the current amortization schedule. If left as is, they will pay over $97,000 in mortgage interest over the next twenty years, assuming the same interest rate throughout. Let's say they will be getting a $2,500 tax refund every year and apply it to the principal. Doug and Mary will reduce the interest paid on their mortgage by over $17,000 and pay it off about 3 years sooner.

It can be tempting to view a tax refund as found money and blow it on consumer items. A little bit of financial discipline now can make a very real difference in your long-term financial situation. After all, do you really want to lend your money for free?

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