Be sure to report earned interest on tax form

To get lower tax rates in 1988 and a more equitable tax system, we had to give up some of our tax breaks. One — the elimination of the $1,000 investment income deduction — will affect virtually every Canadian worker.

This is the deduction that allowed most Canadians to ignore the interest they received on their bank accounts or GICs or even Canada Savings Bonds when they filled out their tax returns. Until the end of 1987, up to $1,000 of Canadian interest and dividends could be received tax-free. But that changes this year.

For example, if you earn $200 of interest on your savings or chequing account in 1988, it is taxable. That means you could pay about $80 tax on that interest — $80 that you did not have to pay in 1987. This assumes that you are in the middle tax bracket (income above $27,500) so that your combined federal and provincial tax rate is about 40 per cent.

If you bought, say, $5,000 of Canada Savings Bonds last year, the $450 in interest (9 per cent on $5,000) is fully taxable. This means that your tax bill will be $180 higher than you may have expected (40 per cent of $450).

All interest income that you receive in 1988 is taxable, including interest on term deposits, on T-Bills or other government or corporate bonds, on the mortgage you may have taken back when you sold your house, and the interest that you earn on your mutual fund investments. Even the interest paid by the government on the tax refund that you were late in receiving is taxable.

Reporting woes

And to add to your woes, you may not receive a T5 slip for smaller amounts of interest earned. The T5 is the slip you would file with your tax return reporting the amount of interest inome earned.

T5s are not required to be issued if the interest earned is below a certain amount ($100 earlier this year).

Thus to obey the law, you may have to add up your interest income from your bank statements or pass books and include it in your income tax return.

There are fairly severe penalties for not reporting this interest and paying the appropriate amount of tax. And bear in mind that ignorance of the tax law is no excuse for not reporting the interest.

If both you and your spouse are earning interest income, you will be hit doubly hard by the new regime. Suppose that each of you earn $1,000 of interest and your tax rate is 40 per cent. You could be paying as much as $800 extra tax in 1988 (40 per cent of $1,000 plus $1,000).

Spouse taxable

Even if your spouse is not taxable because his or her income is too low, you will be affected. For example, assume that your spouse earns $1,500, $1,000 of which is interest income. In 1987, you could transfer the $1,000 investment income deduction to your tax return and there would, in effect, be no tax on that interest.

In 1988, there is no deduction to transfer. The married status tax credit to which you are entitled will be reduced because your spouse has earned more than $500 — in this case $1,000 more.

You don't have to sit back and meekly accept this new tax on your income. There are several ways of rearranging your financial affairs to reduce or even eliminate the impact of the tax. These techniques should also improve your overall financial health.

EDITOR'S NOTE: This column is provided by Don Zelisko, manager of Standard Trust in Markham.

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