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Don't blow your bonus

By [Jim Middlemiss](#) • Bankrate.com

When it comes to work, most people are paid a salary or compensated by the hour or on commission. The lucky ones might also see a bonus paid out, often near year's end.

Jeff Llewellyn, an accountant at Myers Norris Penney LLP in Calgary, says in some jobs, a bonus is considered part of the compensation scheme and is expected by employees every year. "It's not a big deal, but for others it's a real surprise," he says.

However, much of that hard-earned bonus could find its way into the taxman's hand if you aren't careful. That's because a bonus is taxed as income at your marginal rate. Llewellyn says the top marginal tax rates range between 39 percent in Alberta to a high of 46.4 percent in Ontario. That means someone in Ontario in the highest tax bracket who earns a \$10,000 bonus would lose \$4,640 right off the top in taxes.

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Don't despair -- there are strategies you can use to keep more of your hard-earned money. But it will depend on the flexibility of your employer and your willingness to invest it in your RRSP.

Talk to your employer

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David Bruce, associate director and a senior investment adviser at ScotiaMcLeod in Toronto, says the most tax-efficient way of using your bonus is putting it into your RRSP.

That can usually be done in two ways:

"You could have your employer do it or just do it yourself," he says.

However, there's a difference in the net effect. An employer can transfer your bonus to your RRSP without taking off any income tax, meaning most of it will end up in your tax-sheltered plan. You will still have to include the bonus on your taxes, but you will also have the contribution you can apply against the income.

If you wanted to do it yourself, you would receive your bonus, less taxes, and then invest it in your RRSP and get a refund for the contribution the following spring when you file your taxes. You could then take that refund and top up your RRSP.

Having your employer contribute it directly to your RRSP is the best strategy, say accountants, because it gets the full amount of your bonus working for you earlier. Doing it yourself means having to wait for your refund to top up the contribution, and it can be tempting to spend that money, rather than invest it.

However, Llewellyn says there's one hitch to that. The employee has to get the Canada Revenue Agency's blessing, giving the employer the OK not to deduct tax. "You need a little bit of lead time. It depends on how quickly the district office can deal with it," he says.

Know your limits

In either case, a bonus can only be put into an RRSP if the employee has eligible contribution room. Statistics Canada figures suggest most Canadians have unused room. More than \$300 billion in unused contribution room has accumulated since 1991, the year the government allowed Canadians to carry forward missed RRSP payments.

Nonetheless, you have to be careful. "You really don't want to overcontribute," says Bruce, because that draws a penalty of 1 per cent per month, which can add up.

Overcontributing can be a problem if the bonus comes in December and you have already made your contribution for the year. You can still make the contribution, but you will only pay one month's worth of penalty. That's because on Jan. 1 of each year, your contribution room expands based on the income you earned the previous year.

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Michel Matifat, a chartered accountant and head of the private client advisory group at KPMG LLP in Vancouver, says you can ask your employer to defer the bonus until early January. "It all depends on the company's policies," he says.

If you wait until 2006, you get another year under your belt, he says, and could be eligible for as much as an \$18,000 RRSP contribution in 2006. Deferring till the new year is also appealing, "for someone who knows their income tax rate might be lower in the following year." In that case, the tax hit on the bonus could be lessened.

Of course, contributing to your RRSP is only one way to use your bonus. If you are looking to lower your taxes, Bruce says you could also buy some sort of tax shelter. Things like flow-through shares, usually issued by mining and exploration companies, or [labour-sponsored funds](#) provide incentives to investors that reduce their tax burden. However, he says, there's "investment risk. Each one has to be looked at carefully."

Pay down debt

A better route, he says, is to use the bonus to pay down nontax-deductible debt, such as mortgages, lines of credit and credit cards. He notes that interest rates are rising and are expected to go higher. "People are finding it very easy to borrow. As rates go up, it's not quite as easy to carry (those loans)."

Or you may want to use your bonus to start a savings plan, Bruce says, noting "the savings rate is fairly low." In fact, Canadians spend about \$1.16 for every dollar we earn, according to recent government figures.

Above all, Bruce says, don't let charlatans make off with hard-earned bonus with offers of making money in real estate with no money down or offers to pay unbelievably high interest rates on investments. Those are gimmicks, he says. "You're better off not investing. Be astute with your bonus money. At the end of the day, there is no free lunch."

Jim Middlemiss is a freelance writer and lawyer based in Toronto. He's a frequent contributor to the National Post, Investment Executive and Lawyers Weekly.

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