

# Assumptions and Effects of the Detailed Tax Method

## Functions addressed in this document:

- What is the difference between the Average Tax method and the Detailed method?
- Where is the Detailed Tax method selected?
- When using Detailed Tax, how does NaviPlan determine and apply the tax rates?
- When using Detailed Tax, how does NaviPlan treat deductions and credits?
- When using Detailed Tax, how does NaviPlan handle alternative minimum tax (AMT)?

**Important!** NaviPlan does not offer comprehensive tax planning, the use of these methods should not replace professional tax-planning advice.

### What is the difference between the Average Tax method and the Detailed Tax method?

NaviPlan offers two income tax methods: average and detailed. Both methods approximate real life taxes, but in different ways and in different levels of detail. **Average Tax** uses flat tax rates that are chosen by the user, whereas **Detailed Tax** uses bracketed tax rates that are based on government legislation. Both methods include several tax deductions, but only **Detailed Tax** provides tax credits and support for alternative minimum tax (AMT). **Detailed Tax** also offers provincial tax calculations.

Select **Average Tax** method in a Level 1 or Level 2 Plan to apply the average tax rates, defined by the user for the pre-retirement, retirement, and year of death time frames (entered under **Tax Rates** on the **General** page, accessible from the **Plan Management** section – **Assumptions** page), and to offer an **Income Tax Summary** report (**Quick Actions** menu – **Reports** – **Income Tax**) that provides a general breakdown of taxable income and applicable deductions.

Select **Detailed Tax method** in a Level 1 or Level 2 Plan to automatically apply bracketed federal and provincial taxes, and to also consider an extensive number of deductions and credits. The appropriate rates are automatically applied based on your clients' annual income levels throughout the planning period.

The following table shows which tax rates, deductions, and credits are applied in which tax method:

Tax Rates, Deductions, and Credits Applied	Average Tax method	Detailed Tax method
User-defined federal flat tax rates	<input checked="" type="checkbox"/>	
User-defined provincial flat tax rates	<input checked="" type="checkbox"/>	
Bracketed federal tax rates		<input checked="" type="checkbox"/>
Bracketed provincial tax rates		<input checked="" type="checkbox"/>
Federal tax deductions	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Federal tax credits		<input checked="" type="checkbox"/>
Federal AMT		<input checked="" type="checkbox"/>
Provincial tax credits	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Provincial tax reductions	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Miscellaneous credits and deductions		<input checked="" type="checkbox"/>

The remainder of this document focuses on the **Detailed Tax** method in a **Level 2 Plan**.

## Where is the Detailed Tax method selected?

In the **Plan Creation** screen, click either **Average Tax** or **Detailed Tax** during the **Income Tax Method** stage.

### Income Tax Method

Average Tax

Detailed Tax

Plan Creation

NaviPlan also allows you to easily transition an existing plan from **Average Tax** method to the **Detailed Tax** method (but not the other way around). On the **Modules** page, users with appropriate permissions can convert a plan by clicking **Convert to Detailed Income Tax**.

## Modules

Modules << >>

Plan Name *	Plan Year
<input type="text" value="Plan"/>	2019

Base the plan calculations on the following date:

**Plan Analysis Date**  
Mar 22 2019  Use today's date

Enabled modules are checked. Click **Select Modules** to change the available modules in this plan.

### Modules

- Asset Allocation
- Retirement
- Education
- Major Purchase
- Emergency Fund
- Survivor Income
- Human Life Value
- Disability Income
- Long-term Care

Plan Management — Modules

Once a plan has been converted to **Detailed Tax** method, you cannot revert back to **Average Tax** method.

**DID YOU KNOW?** The **Average Tax** method is the default income tax method, but (with appropriate permissions) the default method can be changed for all future plans to **Detailed Tax** method from the **User Preferences** menu – **Plan Settings** – **General** tab.

## When using Detailed Tax, how does NaviPlan determine and apply the tax rates?

As taxes affect many aspects of a financial plan, when using **Detailed Tax** method it is important to realize the following:

- NaviPlan uses bracketed rates in most tax-related calculations, and also considers deductions, credits, and thresholds. Tax rates are applied on a year-by-year basis, based on the income tax brackets for the year in question. NaviPlan uses separate definitions for the calculation of federal versus provincial taxes.
- To calculate federal taxes:
  - First, an analysis is done to determine marital status and how clients file their taxes (e.g., single, married, common-law relationship).
  - For each taxpayer, all sources of income are aggregated to come up with the gross income amount.

- Federal deductions from **Total Income** are calculated (including those entered on the **Financial Picture** section - **Tax Details**), and subsequently deducted to arrive at **Net Income**.
- Federal deductions from **Net Income** are calculated (including those entered under **Tax Details**), and subsequently divided to arrive at **Taxable Income** (line 260 on CRA form T1 General).
- Federal tax is then calculated using the commonly applicable rules for CRA form Schedule 1. NaviPlan includes the calculations for AMT at this time.
- Provincial income taxes are determined, using each province's own form, which has its own set of bracketed tax rates and tax credits. Most provinces are based off of the federal Net Income amount, but have their own set of tax credits and tax reductions.
- All applicable income taxes are totaled to arrive at the final **Total Tax** amount.

For the items listed above, not all nuances of the income tax codes (federal and provincial) are implemented. However, NaviPlan supports the rules that apply in most common situations.

To assist both clients and advisors with reconciling the tax details, the **Income Tax Details** report (accessed from the **Quick Actions** menu – **Reports** – **Income Tax** – **Income Tax Details**, when using **Detailed Tax**) uses a format similar to the CRA form T1 General.

Inflation is applied to tax calculations as follows:

- For the years when amounts are known (i.e., already legislated), NaviPlan uses the legislated amounts. This includes various rates (i.e., percentages), limits, thresholds, and other amounts, such as personal exemption amounts.
- Legislated amounts are typically known for the current calendar year and previous calendar years (needed for plans created in those years), but in some cases future year amounts will also be legislated.
- For calculating income taxes for future years (when NaviPlan projects a plan into the future), NaviPlan will use the future year legislated amounts when they are available. Otherwise, NaviPlan indexes them using the plan's inflation rate and the legislated rules for how each number is typically indexed to inflation (e.g., rounded to the nearest \$50).

## When using Detailed Tax, how does NaviPlan treat deductions and credits?

In addition to using bracketed tax rates, NaviPlan automatically considers and calculates an extensive number of deductions and credits, and allows for the entry of additional deductions and credits.

To further understand the benefits of using **Detailed Tax** method, we will look at a plan for David and Susan.

### Example:

David and Susan have two children and their tax filing status is married. David earns \$50,000, while Susan is self-employed and earns \$60,000. In addition, they have a home mortgage with tax-deductible interest, and David contributes to an RRSP.

Income Tax Details for David		
Smith		
Marital Status: Married		
Plan (2019)		
<b>Regular Tax Calculation</b>		
<b>Calculation of Total Income</b>		
Employment	\$50,000	
<b>Total Income</b>		\$50,000
<b>Deductions from Total Income</b>		
RRSP Contributions	\$2,500	
Carrying Charges & Interest	\$3,050	
Employment CPP/QPP Contributions	\$70	
<b>Total</b>		\$5,620
<b>Net Income</b>		\$44,380
<b>Deductions from Net Income</b>		
<b>Total</b>		\$0
<b>Taxable Income</b>		\$44,380
<b>Regular Federal Tax Calculations</b>		
Federal Tax on Taxable Income		\$6,657
<b>Tax Credits (Non-Refundable)</b>		
Personal Credit	\$1,810	
Canada Employment Credit	\$183	
CPP/QPP (employment)	\$345	
Employment Insurance	\$122	
<b>Total</b>		\$2,460
<b>Regular Federal Tax (A)</b>		\$4,197

Report — Income Tax Details

Looking at the **Income Tax Details for David** report, we can see that when using **Detailed Tax** method, NaviPlan has considered numerous deductions and credits. In particular, we can see that NaviPlan has taken into consideration the RRSP contribution and the child care expenses deduction. Non-refundable tax credits, such as the Canada Employment Credit, are displayed under Tax Credits (Non-Refundable). AMT has also been automatically calculated, but does not apply in this case.

As shown in the **Income Tax Details** report, NaviPlan includes several deductions and credits by default, because deductions and credits can significantly affect a client's annual income tax bill. The **Tax Details** page (**Enter Financial Data** section – **Tax Details** category) allows for the entry of additional credits and deductions. In addition, separate reports are available from the **Quick Actions** menu – **Reports**, to help ensure that all applicable deductions and credits are considered. We will use the following reports for David and Susan's plan to examine the deductions and credits, and we will look at the **Tax Details** page (**Enter Financial Data** section – **Tax Details** category) in the application.

Since they have recently purchased a hybrid vehicle, they are also eligible for a non-refundable tax credit of \$2,200. NaviPlan does not directly support this, but allows the user to enter it on the **Tax Details** page under **Misc. Tax Credits**.



Misc. Tax Credits

Description *	Owner	Type	Amount	Start Date	End Date
Non-Refundable (Hybrid)	David	Refundable Tax Credit	\$2,200	Jan 1 2019	Death (Owner)

Enter Financial Data — Tax Details — Tax Details

**Tax Credits**  
Smith  
Plan (2019)

	David	Susan	Matthew	Jon	Family
Basic Personal Credit	\$1,810.35	\$1,810.35	\$1,810.35	\$1,810.35	\$7,241.40
Age Credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Basic Married Credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Canada Employment Credit	\$183.30	\$0.00	\$0.00	\$0.00	\$183.30
Child Tax Credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Amounts for dependent children	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
CPP/QPP Contributions	\$345.26	\$0.00	\$0.00	\$0.00	\$345.26
CPP/QPP Contributions (self employed)	\$0.00	\$400.21	\$0.00	\$0.00	\$400.21
Employment Insurance premiums	\$121.50	\$0.00	\$0.00	\$0.00	\$121.50
Pension credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Disability Credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Tuition fees	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Education amount	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Transfer Credits from Dependents	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Transfer Credits	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Medical Expense Credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Charitable Donations	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Family Tax Cut	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Dividend Credit	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Quebec Abatement	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Other Refundable Tax Credits	\$2,200.00	\$0.00	\$0.00	\$0.00	\$2,200.00
Other Non-Refundable Tax Credits	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
<b>Total</b>	<b>\$4,660.41</b>	<b>\$2,210.56</b>	<b>\$1,810.35</b>	<b>\$1,810.35</b>	<b>\$10,491.67</b>

Report — Tax Credits

After entering this nonrefundable tax credit (as shown above) and then regenerating the **Tax Credits** report for David and Susan, we can see that NaviPlan now considers this amount for tax purposes.

Using the **Tax Deductions** report, we can see the deductions and personal exemptions that NaviPlan has automatically calculated.

<b>Tax Deductions</b>					
Smith					
Plan (2019)					
	David	Susan	Matthew	Jon	Family
Carrying charges and interest expenses	\$3,050.46	\$3,050.46	\$0.00	\$0.00	\$6,100.93
Net capital losses of other years	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Capital gains deduction	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Annual union, professional or like dues	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Registered Pension Plan Contributions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Registered Retirement Savings Plan Contributions	\$2,500.00	\$0.00	\$0.00	\$0.00	\$2,500.00
RRSP retirement rollover	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Spousal RRSP retirement rollover	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Child care expenses	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Spousal Support Payments	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Moving Expenses	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Clawback Payments for Social Benefits	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Other Deductions from Total Income	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Other Deductions from Net Income	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Employment CPP/QPP Contributions	\$69.75	\$0.00	\$0.00	\$0.00	\$69.75
Self-Employment CPP/QPP Contributions	\$0.00	\$2,829.75	\$0.00	\$0.00	\$2,829.75
<b>Total</b>	<b>\$5,620.21</b>	<b>\$5,880.21</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$11,500.43</b>

Report — Tax Deductions

**DID YOU KNOW?** When calculating personal exemptions, the **Average Tax** method uses an absolute approach where no partial exemptions are calculated. In contrast, the **Detailed Tax** method calculates partial exemptions when applicable.

### When using Detailed Tax, how does NaviPlan handle alternative minimum tax (AMT)?

When using the **Detailed Tax** method, NaviPlan reports on AMT by providing a single-year analysis in the **Income Tax Details** report and a multi-year analysis in the **Projected Income Tax Details** report.

In both these reports, the **Alternative Minimum Tax** section displays a list of the adjustments and preferences that need to be included as part of the alternative minimum taxable income, such as taxes paid and itemized expenses. After calculating the alternative minimum taxable income, NaviPlan uses the rate applicable for this increased level of income to perform another round of calculations. The **Alternative Minimum Tax** row displays the amount in addition to the **Regular Federal Tax** amount that needs to be paid.

In cases where the timing of a tax-applicable transaction can be selected, such as the exercise date of a stock option or the claiming of a tax credit, using either the **Projected Income Tax Details for <client>** report or the **Income Tax Details for <client>** report is often beneficial.