

How To Respond to an Instalment Reminder from the CRA

August is the month in which millions of Canadian taxpayers receive Instalment Reminders from the Canada Revenue Agency (CRA). For taxpayers who have received many such notices in the past the Reminder and the tax instalment process are familiar, although not necessarily welcome. For those who are receiving one for the first time, however, both the Reminder itself and figuring out how to deal with it can be baffling.

Most Canadians — certainly those who are employed — have income tax deducted “at source”, meaning that their employer deducts an amount for income tax from their paycheques and remits it to the CRA on their behalf. However, for those who are self-employed or, frequently, for those who are retired, no such deduction is automatically made from their income, in which case the CRA may issue an Instalment Reminder.

The receipt of such a Reminder may be particularly puzzling to the newly retired, who have been accustomed to having tax deducted at source from their paycheques throughout their entire working life. However, no matter the source of one’s income or the reason that tax has not been deducted at source, the options available to a taxpayer who receives such a Reminder are the same.

Canadian tax rules provide that where the amount of tax owed when a return is filed by a taxpayer is more than \$3,000 in the current year and either of the two previous years, that taxpayer may be required to pay income tax by instalments. Such instalment payments of tax are due on March 15, June 15, September 15, and December 15 of each year.

An Instalment Reminder issued by the CRA in August 2009 will specify two amounts, one to be paid by September 15 and the other due by December 15. Those amounts represent the CRA's best estimate, based on the taxpayer’s returns filed for the 2008 and previous years, of the net tax that will be payable by the taxpayer for 2009. The taxpayer then has the following three options.

First, the taxpayer can pay the amounts specified on the Reminder by the respective due dates of September 15 and December 15. A taxpayer who does so can be certain that he or she will not face any interest or penalty charges, even if the amount paid turns out to be less than the amount actually owed for the 2009 tax year. (If the instalments paid turn out to be more than the taxpayer’s tax liability for 2009, he or she will, of course, receive a refund on filing.)

Second, the taxpayer can make instalment payments based on the amount of tax that was owed for the 2008 tax year. Where a taxpayer’s income has not changed between 2008 and 2009, and his or her available deductions and credits remain the same, the likelihood is that total tax liability for 2009 will be the same or slightly less than it was in 2008, owing to the indexation of tax brackets.

Third, the taxpayer can estimate the amount of tax that he or she will owe for 2009 and can pay instalments based on that estimate. Where a taxpayer’s income has dropped from 2008 to 2009 and there will, consequently, be a reduction in tax payable, this option may be worth considering. Taxpayers who wish to pursue this avenue can obtain the information needed to estimate current-year taxes (provincial and federal tax rates and brackets) on the CRA Web site at <http://www.cra-arc.gc.ca/tx/ndvdl/fq/txrts-eng.html>.

A taxpayer who elects to follow the second or third options outlined above will not face any interest or penalty charges where there is no tax payable when the return for the 2009 tax year is filed in the spring of 2010. However, should instalments paid have been late or insufficient, the CRA can impose interest charges, at rates that are higher than current commercial rates. As well, where interest charges are levied, such interest is compounded daily, meaning that on each successive day, interest is levied on the previous day's interest. It is also possible for the CRA to impose penalties, but this is typically done only where the amount of instalment interest charged for the year is more than \$1,000.

Most Canadian taxpayers are understandably disinclined to pay their taxes any sooner than absolutely necessary. However, ignoring an Instalment Reminder is never in the taxpayer's best interests. Those who don't wish to involve themselves in the intricacies of tax calculations can simply pay the amounts specified in the Reminder. The more technical-minded (or those who want to ensure that they are paying no more than absolutely required and are willing to take the risk of having to pay interest on any shortfall) can avail themselves of the second or third options outlined above.