How to deal with an instalment reminder from the CRA (February 2011)

February is the month in which millions of Canadian taxpayers receive an Instalment Reminder from the Canada Revenue Agency (CRA). For many of the taxpayers who have received 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, those who are retired, no such deduction is automatically made from their income, and the issuance of an Instalment Reminder by the CRA may be the result.

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 what 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 a taxpayer may be required to pay income tax by instalments where the amount of tax owing on filing is more than $3,000 in the current year (2011) and either of the two previous years (2009 or 2010). Essentially, the requirement to pay by instalments will be triggered where the amount of tax withheld from the taxpayer's income is at least $3,000 less than their total tax liability for the current and either of the two previous years. 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 February 2011 will specify two amounts: one to be paid by March 15, and the other due by June 15. Those amounts represent the Agency's best estimate, based on the taxpayer's return filed for the 2009 taxation year, of the net tax which will be payable by the taxpayer for 2011. 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 March 15 and June 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 taxes actually payable for the 2011 tax year. (If the instalments paid turn out to be more than the taxpayer's net tax liability for 2011, 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 2010 tax year. Where a taxpayer's income has not changed between 2010 and 2011 and his or her available deductions and credits remain the same, the likelihood is that total tax liability for 2011 will be slightly less than it was in 2010, owing to the indexation of tax brackets and personal tax credit amounts.

Third, the taxpayer can estimate the amount of tax that he or she will owe for 2011 and can pay instalments based on that estimate. Where a taxpayer's income will decrease from 2010 to 2011 and there will consequently be a reduction in tax payable, this option may be worth considering.

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 2011 tax year is filed in the spring of 2012. However, should instalments paid have been late or insufficient, the CRA can impose interest charges at rates which are higher than current commercial rates. (The rate charged for the first quarter of 2011—until March 31, 2011—is 5%.) 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.