How to calculate installment payments cra

Under the Income Tax Act, quarterly tax instalments are required for this tax year if a taxpayer’s “net tax owing” for 2021 will be more than $3,000, and they also owed more than $3,000 in either 2020 or 2019. (For tax filers in Quebec, the threshold is $1,800 owing.) The definition of net tax owing is somewhat complex, but it essentially refers to net federal and provincial taxes, less income tax withheld at source, plus any Canada Pension Plan contributions and employment insurance premiums on self-employment earnings (if applicable), as well as adjustments for certain credits and social benefit repayments. There are three options that may be used to determine how much taxpayers need to pay each quarter: the no-calculation option, the prior-year option and the current-year option. Clients can choose the option that results in the lowest payments. Under the no-calculation option, the CRA calculated the March 2021 and June 2021 instalments based on 25% of the net tax owing on the 2019 assessed return. The Sept. 15 and Dec. 15 instalments will then be calculated based on the net tax owing from the recently filed 2020 return, less the March and June instalments already paid. By contrast, the prior-year option is based solely on last year’s (2020) income. The 2021 instalments are based on the 2020 tax owing, and taxpayers simply need to pay one-quarter of the amount on each instalment date. This option is best if the individual’s 2021 income, deductions and credits will be similar to 2020 but significantly different from 2019, perhaps because they sold securities in 2019 and reported significant capital gains. This option may also suit self-employed workers whose income dropped in 2020 due to the Covid-19 pandemic, and who continue to be affected this year. Finally, under the current-year method, taxpayers simply base their 2021 instalments on the estimated amount of tax owing for this year and pay one-quarter of that estimated amount on each instalment date. This option is useful if the taxpayer’s 2021 income will be significantly less than 2020 (perhaps due to Covid or sales of securities in 2020, for example). Provided taxpayers make the required instalments and they are remitted on time, no interest or penalties will be assessed. Taxpayers who ignore the instalment reminders could be charged instalment interest and, in some cases, an instalment penalty. Instalment interest is compounded daily at the prescribed interest rate, which is currently 5% for overdue taxes. The instalment interest clock starts ticking from the day the instalment was due until it’s paid (or, if unpaid, until April 30, 2022). Fortunately, the government chooses the instalment option that results in the least amount of interest. And, if clients pay future instalments early, they may be able to offset interest on other instalments that were paid late. An instalment penalty may also apply if the instalment interest is more than $1,000. The penalty is calculated by subtracting from the instalment interest the greater of either $1,000 or 25% of the instalment interest calculated if no instalment payments had been made for the year. Half of this difference is the amount of the penalty. Financial advisors can play an important role when it comes to instalments, both in discussing instalment requirements for 2021 that may be based on isolated high-income events (like the sale of stock), as well as by ensuring clients have sufficient cash or liquidity on each instalment date to make the required payments on time. Jamie Golombek, CA, CPA, CFP, CLU, TEP, is managing director, tax and estate planning, at CIBC Private Wealth Management in Toronto You have 3 options to calculate your instalment payments which could help reduce or eliminate the amounts you need to pay. On this page Decide which option to use No-calculation option This option is best if your income, deductions, and credits stay about the same from year to year. The CRA determines the amount of your instalment payments based on the information from your latest assessed tax return. The amount for the no-calculation option will be indicated on the instalment reminders that we send you. Prior-year option This option is best if your 2021 income, deductions, and credits will be similar to your 2020 amount, but significantly different from those in 2019. You determine the amount of your instalment payments based on the information from your tax return for the 2020 tax year. Use the calculation chart for instalment payments for 2021 (PDF) to help you calculate your total instalment amount due. If you make your payments in full by the 2021 due dates, we will not charge instalment interest or a penalty, unless your estimated instalment amounts are too low. Current-year option This option is best if your 2021 income, deductions, and credits will be significantly different from those in 2020 and 2019. You determine the amount of your instalment payments based on your estimated current year (2021): net tax owing CPP contributions payable voluntary EI premiums Use the calculation chart for instalment payments for 2021 (PDF) to help you calculate your total instalment amount due. If you make your payments in full by the 2021 due dates, we will not charge instalment interest or a penalty, unless your estimated instalment amounts are too low. Reduce or eliminate tax instalment payments You can reduce or eliminate your instalment payments by having tax withheld or increasing the amount of tax deducted from these sources: Old age security Use Request for Voluntary Federal Income Tax Deductions (form ISP3520OAS) and send to a Service Canada office Canada Pension Plan benefits Use Request for Income Tax Deductions (form ISP3520CPP) and send to a Service Canada office Quebec Pension Plan benefits For details: Retraite Québec EI or pension benefits (employer-sponsored pension plan) Use 2021 Personal Tax Credits Return (form TD1), and send to your employer or pension plan administrator Income tax cannot be withheld from certain types of income, such as self-employment, investment, rental income, and capital gains. Example – How to eliminate the amount of your instalment payments Hugh is a resident of Alberta and pays his tax by instalments. His net tax owing has been $3,500 for several years and he expects it will stay the same in 2021. He decides to have more tax withheld from his income in 2021. In January 2021, Hugh filled out Form TD1 to ask his pension plan administrator to withhold an extra $250 each month from his pension income. Hugh now estimates his net tax owing will be $500 for 2021. Based on his estimate, he does not have to make instalment payments in 2021 because his net tax owing will not be over $3,000 for 2021. Hugh would disregard the instalment reminders he gets for 2021. Thank you for your feedback Tax Matters Jamie Golombek Clients can minimize payments by choosing the calculation method that best suits them By: Jamie Golombek September 25, 2020 September 25, 202015:27 Over the summer, the Canada Revenue agency extended the deadline for individuals, corporations and trusts to make tax payments, including instalment payments, to Sept. 30, 2020. For individuals, the extension applies to amounts owing on 2019 returns and instalments otherwise due on June 15 and September 15. When are instalments required? Under the Income Tax Act, quarterly tax instalments are required for 2020 if an individual’s “net tax owing” this year will be more than $3,000 ($1,800 for Quebec tax filers) and was also greater than $3,000 ($1,800 for Quebec) in either 2019 or 2018. The definition of net tax owing is complex, but essentially refers to an individual’s net federal and provincial taxes, less income tax withheld at source, plus any CPP contribution and EI premiums on self-employment earnings (if applicable), as well as adjustments for certain other credits and social benefit repayments. There are three methods used to determine how much an individual needs to pay each quarter: the no-calculation method, the prior-year method and the current-year method. Individuals can choose the one that results in the lowest payments. No-calculation option Under the no-calculation option, the CRA calculates the March and June instalments based on 25% of the net tax owing on the taxpayer’s 2018 assessed return. The Sept. 15 and Dec. 15 instalments are then calculated based on the net tax owing from the 2019 return, less the March and June instalments already paid. Provided the taxpayer sticks to the amounts the CRA tells them to pay and the instalments are remitted on time, no interest or penalties will be assessed, even if the taxpayer does end up owing some additional tax when they file the 2020 tax return next spring. If one’s income, deductions and credits don’t vary much from year to year, this is the simplest option. Prior-year option By contrast, the prior-year option bases the calculation solely on last year’s (2019) income. The 2020 instalments are based on the 2019 tax owing and the individual simply pays 25% of the amount on each instalment date. This option is best if 2020 income, deductions and credits will be similar to 2019, but significantly different than 2018. When instalment payments are made by their due dates, no instalment interest or penalties are charged unless the total instalment amount that was calculated is too low. Current-year method Finally, under the current-year method, taxpayers can simply base their 2020 instalments on the amount of estimated tax they think they will owe for this year. Individuals simply pay one-quarter of the estimated amount on each of the four instalment dates. This option is useful if the income source that gave rise to instalments in a prior year no longer applies. For example, if your client had a one-time sale of some securities last year but expects all 2020 income to have deductions taken at source, they may not need to make any 2020 instalments, despite receiving an instalment reminder from the CRA. This method can be risky because if it’s inaccurate and instalments made are lower than the no-calculation option above, arrears interest could be charged. Action required If you’re aware of significant capital gains (or losses) that a client triggered in 2019 or 2020 that could impact the upcoming instalments, consider being proactive and reaching out to your clients to remind them that they have several options when it comes to making the upcoming instalments. 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