INVESTMENT EXECUTIVE

# Helping clients manage their tax instalments

The instalment system can be complicated, so clients need help figuring out which one of the three methods to pay their taxes makes the most sense

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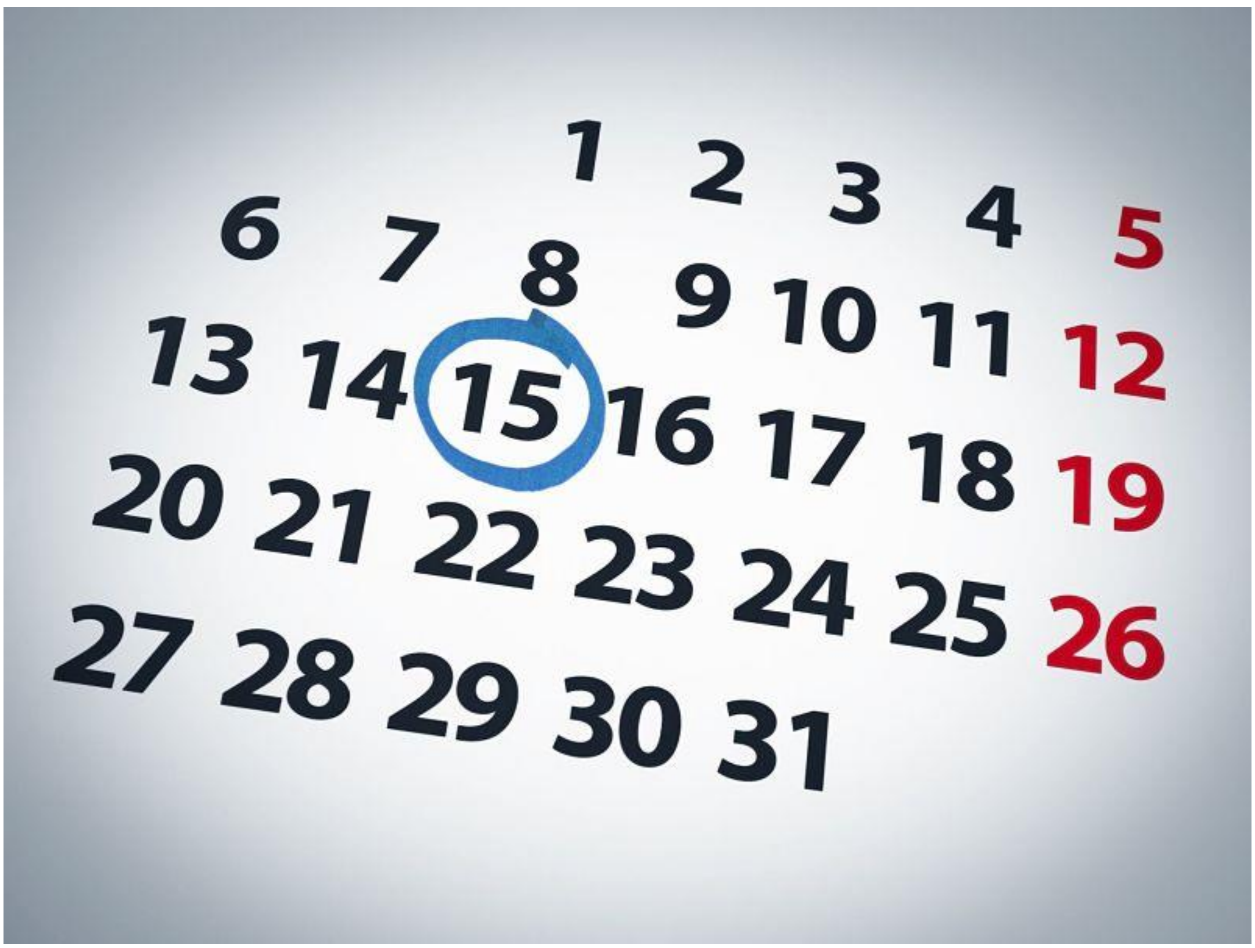


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You may have noticed that some of your clients may have requested a large withdrawal of cash from their accounts around mid-September. If those clients are self-employed, chances are these monies were withdrawn to pay their quarterly tax instalment for the third quarter, which was due on Sept. 17 (the normal 15th due date fell on a Saturday).

The instalment system can be complicated and, as such, it's worth taking a fresh look at the rules surrounding instalments to see when clients need to make these payments and how they're calculated.

As a general rule, most employees whose employment income is their main, if not only, source of income, likely don't have an obligation to make quarterly instalments. But, for others who earn self-employment income, net rental income, investment income or realize capital gains in their non-registered accounts, they may have an obligation to pay taxes by instalments. Failure to do so can result in arrears interest and, in some cases, instalment penalties.

Under the technical tax rules, quarterly tax instalments (due March 15, June 15, Sept. 15 and Dec. 15) are required for the current year if the "net tax owing" during that year will be more than $3,000 ($1,800 for Quebec tax filers) and also was greater than $3,000 in either of the previous two taxation years. The definition of net tax owing is, effectively, the net federal and provincial taxes, less income taxes withheld at source. If someone is self-employed, the instalments must include any Canada Pension Plan contributions and voluntary Employment Insurance premiums.

There are three methods to determine how much must be paid each quarter: the no-calculation method, the prior-year method and the current-year method. Taxpayers can choose the one that results in the lowest payments.

Under the no-calculation option, the Canada Revenue Agency (CRA) calculates the March and June instalments based on 25% of the net tax owing on the taxpayer's assessed return from two years ago. In this case, that would be 2016. The Sept. 15 and Dec. 15 instalments are then calculated based on the net tax owing from the 2017 return, minus the March and June instalments already paid.

Provided that taxpayers stick to the amounts that the CRA tells them to pay and the amounts are remitted on time, the CRA will not assess any interest or penalties, even if there are additional taxes owing when the 2018 tax return is filed next spring. If an individual’s income, deductions and credits don’t vary much from year to year, this is the simplest option.

By contrast, the prior-year option bases the calculation solely on last year’s (2017) income. The 2018 instalments are based on the 2017 taxes owing, and 25% of the amount is due on each instalment date. Taxpayers should choose this option if they estimate that their 2018 income, deductions and credits will be very similar to 2017, but significantly different than 2016.

Finally, under the current-year method, taxpayers can simply base their 2018 instalments on the amount of estimated taxes they think they will owe in 2018. They would 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 did a major non-registered portfolio rebalancing in 2017, triggering significant capital gains, and doesn’t expect to have significant income not subject to deductions at source, they may not need to make any 2018 instalments, despite receiving an instalment reminder from the CRA.