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# TAX FACTS

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## SMART AT AVOIDING INTEREST ON TAX

This article discusses the administration of the Canadian Income Tax Act. It is about interest the Government charges on overdue tax payments.

**Why the Government Charges Interest**

A few years ago, individuals who had outstanding debt on which they made non-deductible interest payments could finance it at the expense of the Government. They could do this because the amount of interest charged by the Government on outstanding taxes was generally lower than rates obtainable elsewhere. Therefore taxpayers made sure they paid their debts before paying their taxes.

**When Tax Payments are Supposed to be Made**

When tax is withheld from three-quarters or more of your income for a year, you must pay the balance of your taxes owing by April 30 of the following year. If this is not the case, you must generally make instalment payments on or before March 15, June 15, September 15 and December 15 in the taxation year in which the income arises. Instalment payments need not be made where you owe less than \$1000 in taxes for the year or for the immediately preceding year. The amount of instalments that you must pay may be calculated based on either the amount of taxes that you had to pay last year or your estimate of taxes for this year.

**You Have to Pay Interest When**

The Receiver General charges you interest on unpaid taxes from the day the payments are due. To determine interest on instalments he bases this calculations on the amount of tax payable for the previous year or the amount owed for the year in question, whichever is less.

He will charge interest on instalment payments from the day they are due until either the time they are paid or April 30 of the following year. From April 30 onward he charges interest on the balance of any tax owing for the year. The interest charges are compounded daily, and

even though the Government stops charging interest on instalments as of April 30 of the following year, if the debt remains outstanding, it continues to charge interest on any unpaid interest.

**The Prescribed Rate Plus**

Interest is charged at the prescribed rate. The rate is based on the average equivalent yields of Government of Canada treasury bills sold at weekly auction during the first month of the preceding quarter. Once the rate is determined, it is increased by 2%. Therefore, if the average equivalent yield on the bills is 10% for the month of January, the prescribed rate for the quarter from April to June will be 12%.

Unfortunately, the Government decided the additional 2% increase in the prescribed rate was not enough to ensure that people pay their instalments on time. To make non-payment more expensive, they decided to charge a penalty of an additional 50% of the interest otherwise owing on unpaid instalments. Where, for example, you did not pay your instalments on time and the prescribed rate was 12%, you would have to pay a total of 18% interest on the unpaid amounts. The penalty is only charged on the interest exceeding the greater of \$1000 and 25% of the interest that you would have had to pay if you made no instalments for the year. Of course neither the interest nor the penalty owing with regard to the tax payments is tax deductible.

The lesson in this is clear. It is no longer worthwhile to postpone paying instalments or even balance of tax payments. Taxpayers are better off borrowing funds at lower rates to pay off their debt to the Government on time. Now if we could only get the Government to be as punctual in paying off its debts...

The implementation of any tax saving strategy is based on your personal financial situation. Professional advice should be obtained before implementing any of the suggestions contained herein.

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