Unexpected tax bill? How to work it out with the CRA

By Gail Johnson | Pay Day – Wed, 21 May, 2014 1:36 PM EDT

What a relief that tax season is over — unless you received a notice of assessment and owe the government more money than you anticipated.

Getting an unexpected tax bill can really sting. Before figuring out how to pay it, it's crucial to get a sense of how it came about in the first place.

"It's important to understand why so you can plan better and ensure it does not happen again in the future," says Vancouver Money Coach Melanie Buffel. A few scenarios could explain the hit:

A withdrawal from your Registered Retirement Savings Plan (RRSP)
Most withdrawals from an RRSP will result in a tax liability at your marginal tax rate. "When you make the withdrawal the bank will hold back up to 10, 20 or 30 per cent of the amount depending on the size of the withdrawal and submit it to CRA," Buffel explains.

"However if your marginal tax rate is higher, then you will still owe additional taxes. For example, in B.C. if your income is $60,000 your marginal tax rate is 29.7 per cent. If you withdraw $10,000 the bank will hold back 20 per cent and you will still need to save 9.7 per cent to cover the additional tax liability."

Working two or more separate jobs
It's possible the amount of tax deducted from your pay cheques is less than what you owe based on your total income. "You can avoid this by asking one of your employers to withhold more taxes each paycheque so you do not receive such a large bill at tax time," Buffel says.

Being self-employed
If you're not accurately tracking income and expenses, or setting aside money to cover income taxes and GST/HST, than you may get an unpleasant surprise come tax time.

"This can result in a big shock when you must pay your entire tax bill all at once if you have not planned for it," Buffel says. "For the future you would need to set up a system whereby you set aside the full GST/HST plus a percentage of your revenue into a separate savings account labeled 'taxes' so that when tax time rolls around you have the money to cover the bill."

The percentage you use should reflect your effective tax rate, and 20 to 30 per cent is a great place to start saving depending on your level of income.

Don't wait to contact the CRA

So if you owe money to the Canada Revenue Agency, which currently has an interest rate of 5 per cent but you're also dealing with consumer debt, say credit cards charging around 19 per cent, does the line of thinking to pay off high-interest debts first still apply?

Nope.

“The CRA does not appreciate the role of creditor, and it’s far more impatient for you to pay your tax bill,” Buffel says. “The first steps include developing a clear monthly cash flow plan to determine how much money you have available to pay the CRA monthly and negotiate a manageable payment plan with them. Depending on the patience of the CRA collection agent you will most likely need to clear that tax bill within the year, or sooner if they believe you could borrow the money elsewhere to pay off your tax debt."

Your credit cards will be happy to receive a minimum payment while you deal with your tax debt as quickly as you can.

And if you decide to ignore your tax bill?

"The CRA can initiate legal collection actions which could include wage garnishment, bank account seizure, and/or home or other personal property liens,” says fee-for-service financial planner Stevan Dostanic of Ottawa’s Astrolabe Financial Group.

Dostanic also advises speaking to an accountant, especially if you completed and filed your own tax return.

“It may be worth the cost to have your return and the reassessment reviewed be a qualified accountant,” he says. “This will both validate CRA’s reassessment as being correct and confirm that errors were not made by either the CRA during the reassessment or by yourself during the initial filing.”

Payment plans

When it comes to setting up a payment plan — which would allow for more manageable monthly payments rather a big lump sum, especially if you are servicing other debt — it may also be worth consulting a professional.

“It may be worthwhile to seek legal advice prior to initiating discussions with CRA or have a qualified tax lawyer negotiate on your behalf,” Dostanic notes.

In extreme cases, the taxpayer relief provision may apply.

“The tax payer relief provision will not allow you to eliminate the debt owing to the CRA; however, it may allow you to have penalties and interest cancelled or waived,” Dostanic says. “Some of the instances where this provision may apply are extraordinary circumstances, inability to pay, or financial hardship.”

From there, come up with a plan to get out of consumer debt as fast as possible, Buffel says.

“A clear spending plan and a monthly cash-flow system will ensure that you always know what you can afford to spend so you do not continue to incur debt on an ongoing basis,” she says. “If you’ve been living in denial then it can be scary to see your financial situation with such clarity but the long term solution that comes from a clear plan will show you the light at the end of that tunnel of debt. That should help you release the debt stress and sleep better at night.”