When you Owe Money to the CRA

By now, everyone who is required to file a tax return for the 2009 tax year has likely done so, and nearly all will have received a Notice of Assessment from the Canada Revenue Agency (CRA) relating to that 2009 tax return. In most cases, those Notices of Assessment will simply confirm the income amounts reported and tax calculated by the taxpayer on the return. Some fortunate taxpayers may receive an unexpected refund. Others, however, may be surprised by a Notice of Assessment indicating that they owe more money to the CRA.

Most taxpayers, assuming that they agree with the CRA's assessment of their tax liability, pay up promptly, if not cheerfully. However, for those who don't, the CRA has a very broad range of options at their disposal to compel payment, and a very long period of time in which to use them. As well, interest is levied from the original due date until full payment is made, and accumulated interest costs can be significant.

The interest rate charged by the CRA on overdue or insufficient tax payments is set quarterly. For each quarter, the interest rate charged on taxes owing is equal to the average Treasury bill rate in effect during the first month of the previous quarter, *plus four percent.* For the fourth quarter of 2010, therefore, covering the months of October, November, and December, the interest rate charged on taxes owing is 5 percent. In addition, any interest charged by the CRA is compounded *daily,* meaning that on each successive day, interest is being levied on the interest charged the day before. Not surprisingly, interest costs can add up quickly.

Where a balance owing isn't paid within 30 days of the date on the Notice of Assessment, the CRA will usually contact the taxpayer, by phone or by mail, with a second request for payment. If, following that second contact, the taxpayer does not remit the amount owed or at least contact the CRA to discuss his or her options, the Agency will send a final letter. That final letter will inform the taxpayer that legal action may be taken by the CRA if, within the next 90 days, no payment is forthcoming or at least some payment arrangement is made.

If the CRA does determine that further action is necessary to compel payment, it has a great number of options. First, it can redirect other amounts which may be owed by the federal government to the taxpayer (for example, a Canada Pension Plan payment, or goods and services tax credit) and apply that credit to the amount owed by the taxpayer. The CRA can also intercept (or garnish) money which may be owing to the taxpayer from a third party, like an employer and, as a last resort, can direct that the taxpayer's assets be seized and sold to satisfy the tax debt.

It's relatively rare for a tax debt to reach the stage of litigation or garnishment, as it's in everyone's interest to resolve matters before things reach that point. And, perhaps contrary to popular belief, the CRA has some flexibility. Where the taxpayer just doesn't have and can't obtain the funds required to make immediate payment in full, the CRA is generally amenable to entering into some type of payment arrangement based on the taxpayer's ability to pay. Before such an arrangement is agreed to, the CRA will have to be satisfied that the taxpayer has exhausted all other reasonable avenues to obtain the funds. It will also be necessary for the taxpayer to disclose his or her income, living expenses, assets, and liabilities to the CRA, and to allow the CRA to verify those amounts before a payment arrangement will be entered into. And, of course, entering into a payment arrangement doesn't stop the interest clock from running – interest continues to be assessed at the current rate, and compounded daily.

While it's best, of course, not to get into a situation in which the CRA becomes your creditor, paying the debt off as soon as possible is the second best option. Given the CRA's punitive interest assessment practices, a taxpayer who doesn't have the funds needed to pay taxes owing can be better off borrowing the amount owed from a third party and paying the CRA in full as soon as possible. Especially where the taxpayer can provide some security – like in the equity in a home - it may be possible to borrow funds at considerably less than the 5% interest rate currently being charged by the CRA on overdue tax amounts. One final blow: interest paid on tax debts, whether paid to the CRA or to a third party lender, is not deductible from income.