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THE SMALL BIZ PROS

# WHAT TO DO IF YOU ARE BEHIND ON YOUR TAXES



OBSERVATIONS FROM A TAX PREPARER

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## CHAPTER 1

### INTRODUCTION



**T**he Canada Revenue Agency (i.e. CRA) is Canada's tax collection agency. Their sole purpose is to ensure that individuals and corporations in Canada that have income from any source file income tax returns and pay their share of

the nation's tax burden. This is a pretty big challenge if you consider that about 23 million people in Canada fall into this category. So it is not surprising that you may have not filed income taxes returns for a few years and have never heard from the CRA.

So why does a person file an income tax return after so many years of not filing?

The reasons that I have seen for late filers coming forward is:

- a) They want to secure a mortgage from a bank and are required to provide a Notice of Assessment to show that taxes are paid up.
- b) To appease a loved one's wishes to come clean.
- c) They feel guilty.

If you are reading this E-Book, my guess is that you fall into one of the above three categories.

### **So am I in trouble?**

You may have the following questions:

- a) Does the CRA prosecute people for not filing tax returns?
- b) Is the CRA going to drag me in front of a judge and put me in jail?

The answers to these questions are not nearly as dramatic as you may think.

There are laws in Canada that make it a criminal offense not to file an income tax return. Typically, the offender is fined \$1000 for each corporate or personal tax return that is outstanding. The offending parties always are required to file the missing returns even after paying the fine. The reality is that there are about 500 people a year that are prosecuted for this offence. Prosecution under this law seems to be reserved for the real bad offenders.

So what does a person do if you haven't filed for years? The answer to that is a two part answer. The reality of the situation is that there are **two** different departments of the CRA that deal with two different goals. One department deals with *ensuring that people have filed their income tax returns*. The second department deals with *ensuring that people pay their taxes*. Each of these departments operates with their own agenda, methods and punishments. Therefore, each of them has to be dealt with in a different manner.

I think it is also worth mentioning that this division of labour exists in all aspects of the government tax system. So the divisions exist in the areas of GST/HST, corporate taxes, and personal taxes. The strategy that we are going to discuss here applies to all of these areas. The only exception is payroll source deductions.

**So what does this mean?**

What this means is that there are two tasks that need to be achieved when you are offside in tax reporting to the federal government of Canada. The first task is to file all missing documentation. The second task is to pay the tax bill. Each of these tasks requires different strategies.

It should be noted that while it is a criminal offense not to file a tax return in Canada, it is not a criminal offense to owe money for taxes. So it is always best to file the returns on time and then deal with the tax bill.

## CHAPTER 2

### FILING THE MISSING DOCUMENTATION



You haven't filed some sort of government tax form and now you are getting letters requesting that the documents be filed. You don't even know for sure how much you owe. **So your first step is to get the forms filed.**

Filing tax forms late will always result in a monetary penalty. The penalties vary depending on what tax form was not filed but in general the penalty is 5% of the taxes owing for the first month late and 1% for every month after that to a maximum of 12 months. That means on the first occurrence, the government is going to charge you an additional 17% of the amount of the taxes owing for that late filing if you are overdue by one year or more. A second late filing results in a much larger penalty. A second late return can result in up to a 50% penalty if it is over 20 months late. So you need to be prepared for some large penalties if you have not filed for a long time.

### **What do you need to do?**

You need to file your missing tax returns as quickly as possible. It is sort of like sitting in a taxi cab that is stuck in slow moving traffic. The longer you sit there doing nothing, the more your penalty will be and the bigger the financial hole you will be in. So you need to get it done.

Some people ask “What if I don’t know how much income I made?” Maybe you have lost your financial documents in a flood or fire. Maybe you moved six times in three years and the slips got lost. These cases are tough but still do not excuse you from filing tax returns. If you are an employee, this will mean going back to your employers and asking for the documents. The alternative to this is to call the CRA directly and ask them for the T4 information. If you are a small business owner, then hopefully you will have had one bank account for the time in question. If you have, then you can get the bank statements from the bank and create a pretty good taxable income number from there. If you don’t, you are then best to estimate what your tax burden is and submit that. Remember, the government expects you to have the documents to support your claim so this is really only an option when there is no other way. You are, though, better off to estimate and submit then not submit. Remember, the penalty meter is running.

## CHAPTER 3

### DEALING WITH THE TAXES OWED

So you have now filed all your income tax returns, good for you. Now you owe money to the government. If you are lucky, the amount is small and you can simply write a cheque to pay it. If you are not lucky, you may be looking at an amount that is larger than the mortgage on your house. It is unfortunate how sometimes life's little challenges get in our way and eventually get us in trouble. But the good news is that you now know how much you owe because you filed the tax forms.

The first thing to understand is that just because you owe taxes, it does not mean that you are going to get a call tomorrow from a collections agent. It does not mean that the CRA SWAT team is going to storm the front door of your home and drag you off to prison. Instead, you may not hear from the CRA for some time.



If you owe amounts for payroll source deductions, you will hear from the government in the first month. If you owe GST amounts, you will hear from collections within the first three months. If you owe personal or corporate taxes you may not be contacted for a year.

In my experience, you need to start to feed the beast. In other words, you need to start sending money into the government in order to remain at least partially on side. Even small amounts on a huge tax bill can go a long way to help keep the monster at bay. We have found that sending in a large number of post-dated cheques can go a long way with the government.

The other thing to note is that there is a hierarchy to the tax collection world. The collection of certain types of taxes is a priority to the government where the collection of other types of taxes is of lesser concern. The collection of payroll source deductions is a priority. Failure to pay these amounts in a timely basis will pretty much guarantee a review (i.e. audit) by the government of Canada. The next priority is GST/HST amounts outstanding.

After that, the Alberta tax group for corporations needs to be paid. Then there is the personal taxes and federal corporate taxes. So if you owe GST and corporate taxes, you are better off paying out the GST amount and working out a payment plan for the corporate taxes. If you owe payroll source deductions and GST, you need to pay the payroll source deductions first. This gives you an idea of where to focus your payment strategy.

The other point to know is that the government's approach to dealing with overdue taxes works like this. Their first step is to determine if a person can pay their taxes immediately. If they cannot, they then try to work out a payment plan where they get their money over a longer period of time (i.e. a six month period). Failing this, they will usually try to determine where the bank accounts are for the individual/corporation and send a demand notice that locks up the bank account until payment is made. If this does not work, then they garnishee wages or accounts receivable. And if this fails, then they try to find real estate or large equipment somewhere so that they can lien the property. In my experience, the last step is only done in cases where full payment is doubtful.

The point of all of this is that an individual that owes money to the government is better off making small payments then waiting for the embarrassment of having to explain to their bank, or employer the reasons for the government demand notices. Again, feeding the beast is the solution.

### **Penalty Forgiveness**

Many people that have not filed income tax documents will have very good reasons for not filing. Maybe a significant loved one passed away suddenly and it has taken a few years to recover. Maybe a major illness has made it difficult to comply. The government will, at times, take these factors into account in forgiving the penalties.

There are two approaches that one can use to make the government consider these factors. One is the voluntary disclosure program. The other is the fairness committee. Both of these departments or programs have very different mandates and approaches.

The voluntary disclosure program is designed to encourage non-filers to comply with the law. This program is similar to being granted amnesty in that all is forgiven if you come forward on your own accord and try to make things right. People using this system complete their tax returns and then submit them to the voluntary disclosure program. Our experience with this program has been that you need to have a good reason in order to be considered. Saying that you forgot or that the dog ate the receipts is not going to cut it. You also need to never have been contacted by the government asking for the missing tax forms to be submitted. So even if you received a computer generated letter asking that documents be filed, you are now disqualified from this program. Also remember that this group can only forgive penalties and interest owing. It cannot forgive tax amounts owing. Our success with this program has been mixed.

The other body that can provide some relief is the CRA Fairness committee. This group is tasked with hearing and addressing any unfairness within the tax system. This is the office of last resort for many desperate people.

Appeals are sent to this group once all of the documents have been filed and the notice of assessments have been issued. Our experience with this group has been mixed.

So in summary:

**Step 1:** File the required documents.

**Step 2:** Work out a payment plan with the government.

If you can do this, then you will be able to dig yourself out of the hole that you are presently in.