Canada Revenue Agency/Ontario Government Implement Personal Tax Increases Retroactive to January 1, 2014 for Employees Earning over $150,000

Key Points

- **Increased taxes for employees earning more than $150,000 to be implemented through higher payroll tax deductions from September to December and/or on 2014 tax returns**
- **CRA publishes revised Ontario tax tables to implement retroactive Ontario tax increases for employees earning over $150,000**
- **CRA agrees to no penalty approach for employers**
- **Discussion points for payroll staff and management: Who will be impacted and how?**
- **Next Steps for Payroll Staff**

Most employees earning over $150,000 will have a 3% or 6% increase in their Ontario taxes on regular pay from September to December, 2014.

Background

Increased taxes for employees earning more than $150,000 to be implemented through higher payroll tax deductions from September to December and/or on 2014 personal tax returns

On May 1, 2014 the Ontario government tabled a provincial budget that introduced higher personal income tax rates for individuals earning over $150,000. These tax increases were to be retroactive to January 1, 2014. This budget was defeated, triggering a provincial election. The current Liberal government was elected with a majority on June 12, 2014 and re-introduced the budget which passed July 24, 2014 with the same tax rate changes and retroactivity to January 1, 2014.

Current 2014 Ontario tax rates and income thresholds	
Annual taxable income ($) From – To	**Provincial tax rate (%)**
0 to 40,120	5.05%
40,120 to 80,242	9.15%
80,242 to 514,090	11.16%
514,090 and over	13.16%

New 2014 Ontario tax rates and income thresholds	
Annual taxable income ($) From – To	**Provincial tax rate (%)**
0 to 40,120	5.05%
40,120 to 80,242	9.15%
80,242 to 150,000	11.16%
150,000 to 220,000	12.16%
220,000 and over	13.16%

Prior to the Ontario Government's July budget, the Canadian Payroll Association (CPA) had been discussing various implementation scenarios for these proposed income tax rate and threshold changes with the Canada Revenue Agency (CRA) and the Ontario Ministry of Finance.

The purpose of our discussions was to advise government officials on the efficiency and compliance implications for employers and payroll systems providers of mid-year changes and the complications with retroactive adjustments in particular. While January 1 and July 1 income tax table updates are expected and planned for, income tax changes at other dates require additional resources and processes. Most government budgets are tabled in the spring, and the CRA and provinces have a tax collection protocol that results in these changes being made using a July 1 tax table release. The CPA has advocated strongly that these dates be honoured to provide employers, payroll service and software providers, as well as governments, sufficient time to program payroll systems, then test and implement changes to support compliance and efficiency. Because the Ontario budget was re-introduced and passed on July 24, 2014, a July 1 income tax table change and resulting processes are no longer possible.

The CPA made a number of suggestions to the CRA and the Ontario Ministry of Finance on how employers could implement and comply with these unusual changes in an efficient and effective manner while being fair to affected employees and protecting employers from compliance problems and penalties. Suggestions included waiting to implement the tax rate changes until January 2015 or enabling those affected to pay the retroactive amounts when filing their 2014 T1 personal tax return.

The Ontario government stood to forego $635 million in tax revenue by delaying the tax increases until 2015, and advised of the need to proceed with implementing the personal tax increases retroactive to January 1, 2014. As a result, the CRA needed to determine how best to administer the rate increases within the context of the Federal/Provincial Tax Collection Agreement that has been in place for decades. The CRA has decided that it must apply the new tax rate by implementing a higher tax rate in payroll deductions from September 1 to December 2014 to capture the amount of tax due from January 1, 2014.

The majority of payroll service providers and software companies have a contractual obligation to use the most current tax tables for their clients (employers) payroll processes.

Impact on Net Pay

CRA publishes revised tax tables to implement retroactive Ontario tax increases

The personal tax rate increases in the Ontario budget is 1% for earnings of $150,000 to $220,000 and 2% for $220,000 to $514,090. Because the tax increases are effective January 2014 but implemented for only the last 4 months of 2014, the new CRA tax tables will result in many of these employees having a 3% or 6% increase in their Ontario tax deduction on regular pay from September to December 2014.

Employees earning over $514,090 will also have a retroactive tax increase from September to December, 2014 since their earnings between $150,000 and $514,090 would have been taxed at the lower rates from January to August 2014.

The CPA is advising members and stakeholders that within this context, the CRA has agreed to some of the CPA’s implementation suggestions and has posted the following on its website under “What’s new for payroll”.

Message on “What’s new for payroll” webpage
http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/whtsnw-eng.html

Payroll tables

The Canada Revenue Agency (CRA) will publish a September 1, 2014 version of the Ontario payroll tables to incorporate proposed increases to personal income tax rates tabled in the Ontario budget on July 14, 2014. As the proposed changes are retroactive to January 1, 2014, the revised tables will reflect the necessary prorated tax rates to allow employers to withhold the correct additional amounts from employees between September and the final pay of 2014. The changes to the tables apply to employees who earn more than $150,000 in 2014.

The September 1, 2014, version of Guide T4127, Payroll Deductions Formulas for Computer Programs is now available on the CRA website.

The updated payroll deductions online calculator and the electronic version of the T4008 Payroll Deductions Supplementary Tables and T4032 Payroll Deductions Tables for Ontario will be available on our website by mid-August.

The paper and CD version of the T4032 will be available by the end of August.

Message on “T4127, Payroll Deductions Formulas for Computer Programs” webpage
http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/t4127/menu-eng.html

Notice to the reader

The September 1, 2014, version of Guide T4127, Payroll Deductions Formulas for Computer Programs, contains adjustments for proposed increases to personal income tax rates tabled in the Ontario budget on July 14, 2014. The proposed changes are retroactive to January 1, 2014, and the revised tables reflect prorated tax rates to allow employers to withhold the correct additional amounts from affected employees between September and the final pay of 2014. The changes to the tables apply to employees who earn more than $150,000 in 2014.

The CRA normally requires employers to withhold and remit income taxes in line with current rates, but because of the complexities and timing of the Ontario budget measures it is recognized that these income tax changes will be implemented on a best-effort basis where practical, in full appreciation of the different payroll systems and administrative capacities of employers. Employers will not face penalties for failing to withhold as a result of the Ontario budget measures introduced on July 14, 2014.

Employees whose employers are unable to change their payroll systems or processes on time can ask their employers to increase withholdings from September to December 2014. This could reduce the amount the employees owe when they file their 2014 income tax and benefit return.

Employers are encouraged to discuss these changes with affected employees.

Implications/Points for Discussion between Payroll Staff and Management

Who will be impacted and how? Is the system change possible for September? What are the next steps for payroll deductions?

The CPA's advocacy goal is to increase the efficiency and effectiveness of payroll related legislation and administration for all stakeholders - it does not advocate for higher or lower taxes. The majority of payroll service and software providers have advised the CPA they will make the programming changes required by September 1, 2014 to enable employers and Ontario employees affected to comply with the higher tax rate.

The new tax table's catch-up rate will deduct, in payroll processing, most of the additional tax liability (approximately $485 million collectively) for those affected. A reduction in net pay ─ due to these higher taxes ─ will reduce the possibility of a tax liability when the employee files their personal tax return.

The CRA states, "Where employer payroll systems or processes are not changed, employees could request employers to increase withholdings from September to December 2014 in an effort to reduce an amount owing on filing of their 2014 tax return." For these organizations, the CRA will enable employees to request the additional taxes using a TD1 effective from September to December 2014 and make any final payments owing on the T1 personal tax return.

This CRA/Ontario government approach will be efficient and effective for most stakeholders (government, employers, payroll software companies, payroll service bureaus, outsourcing organizations and employees) because:

- The personal tax rate changes only apply to fewer than 2% of Ontario employees but require system-wide reprogramming for employers and the government.
- Payroll systems are based on the CRA's T4127 guide that has one prescribed tax rate for each specific income threshold, so there can be no variability among employees within each organization.
- For employers/organizations with in-house or off-the-shelf systems, and/or other constraints, they have the option to not change or use the revised tax rates, and continue with the existing rates. High income earners should be encouraged to request additional income tax using a TD1.
- Employers using manual tax tables or the CRA's Payroll Deduction Online Calculator (PDOC) will have access to the new versions by mid-August.

Employers should be ready for questions from Ontario employees earning over $150,000 as their pay cheques for the months of September to December 2014 will be lower when payroll systems are programmed with the new tax rates.

For your benefit as a member of the Canadian Payroll Association, we suggest you share this Ontario tax rate briefing with senior management, and initiate a discussion about the impact on employees earning over $150,000 to explain the situation and identify the implications for them as employees and you as the person responsible for the organization's payroll compliance with government regulations.

Next Steps for Payroll Staff

Scenario 1: You have asked and received confirmation from your Payroll Service or Software Provider (PSSP) or your Information Systems staff that your payroll system will be updated with the revised Ontario income tax tables effective September 1, 2014.

Step 1: Notify senior management of the implication for Ontario employees who earn over $150,000 of the increases to their personal income tax rates by providing a copy of this CPA briefing.

Step 2: Suggest to senior management that the organization provide a copy of this CPA briefing to all Ontario employees earning over $150,000. A French copy of this briefing is available.

Step 3: Remind affected employees that the payroll system will only calculate additional taxes for their employment income and that the Ontario personal tax increases also apply to other sources of income such as investment and rental income. Offer those employees the opportunity to request additional taxes from September to December 2014 using a TD1 to reduce a potential tax liability on their taxable income when they file their T1 personal income tax return. (Suggest a discussion with a financial advisor or tax expert.)

Step 4: Process any requests for additional income tax and set a reminder to cease additional taxes for the first pay period of 2015 (or set the amount back to the amount that the employee had prior to this transitional increase).

Scenario 2: You have asked and received confirmation from your Payroll Service or Software Provider (PSSP) or your Information Systems staff that your payroll system will NOT be updated with the Ontario income tax tables effective September 1, 2014.

Step 1: Notify senior management of the impact on Ontario employees who earn over $150,000 of the increases to their personal income tax rates by providing a copy of this CPA briefing.

Step 2: Suggest to senior management that the organization provide a copy of this CPA briefing to all Ontario employees earning over $150,000. A French copy of this briefing is available.

Step 3: Advise affected employees that they will likely have a tax liability when they file their T1 personal income tax return. Offer to calculate the additional taxes that would have been deducted each pay period by using the September versions of either the CRA's Payroll Deductions Online Calculator (PDOC) or the T4032 Payroll Deductions Tables for Ontario based on your employee's payroll frequency (monthly, semi-monthly, bi-weekly, weekly). Both of these CRA publications will be updated with the new Ontario rates by mid-August.

Step 4: Offer affected employees a TD1 to request additional income taxes from September to December 2014 to reduce a potential tax liability on their taxable income when they file their T1 personal income tax return. (Suggest a discussion with a financial advisor or tax expert to discuss the additional impact of other sources of income such as investment and rental income.)

Step 5 (Optional): Ask employees who reject the offer of deducting additional taxes to complete a written acknowledgement form that you notified them of the tax increases and that they did not authorize additional taxes be deducted. (You may use the acknowledgement form provided at the back of this CPA briefing.)

Step 6: Process any requests for additional income tax and set a reminder to cease additional taxes for the first pay period of 2015 (or set the amount back to the amount that the employee had prior to this transitional increase).

Conclusion

The Canadian Payroll Association is fundamentally opposed to retroactive adjustments to payroll requirements because these cause administrative, compliance and financial burdens on employers, employees and government, and result in costs, confusion and frustration for everyone.

However, the CPA respects the decisions of the Ontario government and the CRA to enable employers and employees to most efficiently and effectively comply with the tax changes by:

- revising the tax tables for payroll remittances so that the majority of the tax increase for those affected will be implemented using the existing process, while
- being flexible and enabling employers to assess the implications on their systems and implement the changes on a best efforts basis with no penalties for employers who do not make the payroll system changes in the short time period now available.

Appendix 1

Employee Acknowledgement Form

I, ____________________________, acknowledge receipt from my employer that the
(print name)
payroll system has not been updated with the Ontario personal income tax increases and that I will be responsible for any personal income tax liability on my taxable income when I file my personal income tax return.

______________________________ ______________________________
(signature) (date)

Appendix 2

Previous Experience

The CPA's previous advocacy experience on a similar situation

This is not the first time that the CPA has advocated on behalf of employers with the CRA and a provincial government when the latter legislated income tax changes after July 1. In 2001, the Ontario government lowered income tax rates effective October 1 of that year. The CRA and Ontario Ministry of Finance asked for the CPA's input on how to implement the changes in an efficient manner. At the time, the CPA got involved and pointed out that:

- The tax rate changes were relatively small.
- Employees would benefit from the decrease when filing their personal tax returns if their employers' payroll system had not changed.
- It would cost millions of dollars for employers to implement system changes for three months.

It was therefore agreed that the adjustment to payroll system changes would be made on a best efforts basis. Most of the payroll service and software providers made the changes, while many smaller employers or those with in-house systems did not make the changes but advised their employees that they would receive the benefit when they filed their T1 (personal return).

The key differences between the previous Ontario tax adjustment in 2001 and the current situation are:

- This is a tax increase on employees earnings more than $150,000, which represents fewer than 2% of all employees, while in 2001 it was a small tax decrease for everyone i.e., across all employment income thresholds.
- This adjustment is for a full year with 8 months' retroactive and 4 months going forward compared to a reduction for 3 months for the remainder of the year in 2001.
- The Ontario government just won an election on June 12 with a budget that included this personal tax increase on income earners over $150,000 and which has been known since May.
- The province of Ontario has a big deficit and is being encouraged by most stakeholders to reduce it.

Financial planners, accountants and media stories have already advised the higher income earners affected to seek advice from professional finance and tax planners to determine if, and how, to deal with any personal tax liabilities.