Year-End Payroll: Watch Out for 'False Positives' When Validating Your T4s

Ensuring the accuracy of the information you list in your T4s is critically important, particularly with regard to CPP contributions (and QPP contributions if you're completing an RL-1 slip for Québec). The CRA sets out a validation formula you can use to detect and correct errors. But while it works most of the time, the CRA validation formula can also lead to "false positives." Here's a look at the trap and how to avoid it.

The CRA Validation Formula

The CRA validation formula, which is contained in the T4001 Employer's Guide—Payroll Deductions and Remittances, involves:

- Taking the gross taxable income amount you entered in box 14 of the T4 (or the amounts you entered in boxes A, Q and U of the RL-1)
- Identifying any variances between taxable income and CPP/QPP pensionable earnings for the year;
- Determining pensionable earnings by subtracting from pensionable earnings any of the above variances that aren't pensionable; and adding to pensionable earnings any variances that are pensionable;
- Calculating the basic exemption for the number of pay periods in which pensionable earnings were paid, prorating, if necessary, any months for which the employee was CPP- or QPP-exempt;
- Calculating contributory earnings by subtracting the basic exemption from the step above from pensionable earnings, i.e., the adjusted amount
- Calculating required contributions by multiplying contributory earnings by 4.95%, the CPP contribution rate for the year;
- Comparing year-to-date CPP contributions deducted in your T4 to the required contributions amount.

The "False Positives" Pitfall

The CRA validation formula is straightforward and generally reliable. But it also has a flaw that you need to be aware of: It may create "false positives," i.e., apparent CPP/QPP over-deductions that aren't actually over-deductions. There are two situations in which this can happen:

- Pensionable earnings for a pay period are less than the basic exemption for the

period; and
- There were no regular earnings during a pay period and the only pensionable earnings were due to exception pay not related to the pay period itself, such as a bonus;

The first of these situations can arise for both CPP and QPP; the second can arise only when dealing with CPP. Explanation: CPP and QPP have different rules governing treatment of the pay period basic exemption for a period.

- QPP: All types of earnings are eligible for a basic exemption for the period; regardless of the type of earnings;
- CPP: CPP pensionable earnings are only eligible for a basic exemption if they’re both earned and paid in the pay period concerned. For example, overtime, worked and banked in a prior pay period and paid in a subsequent period isn’t an earning entitled to a CPP basic exemption.

Using the CRA validation formula in either or both of these situations may create a “false positive” signalling an overpayment of CPP or QPP. The reason for this is a weakness in the CRA formula, namely that it uses a fixed basic exemption per pay period when it’s possible the pensionable earnings paid in the period were less than the basic exemption or weren’t eligible for one.

What To Do

Keep your antenna up for “false positives” when validating CPP/QPP contributions and the two situations that can trigger them. If either or both of the situations are in play, don’t treat the “false positive” as an actual employee overpayment. If you do, you will reverse accurate pay period CPP or QPP calculations.