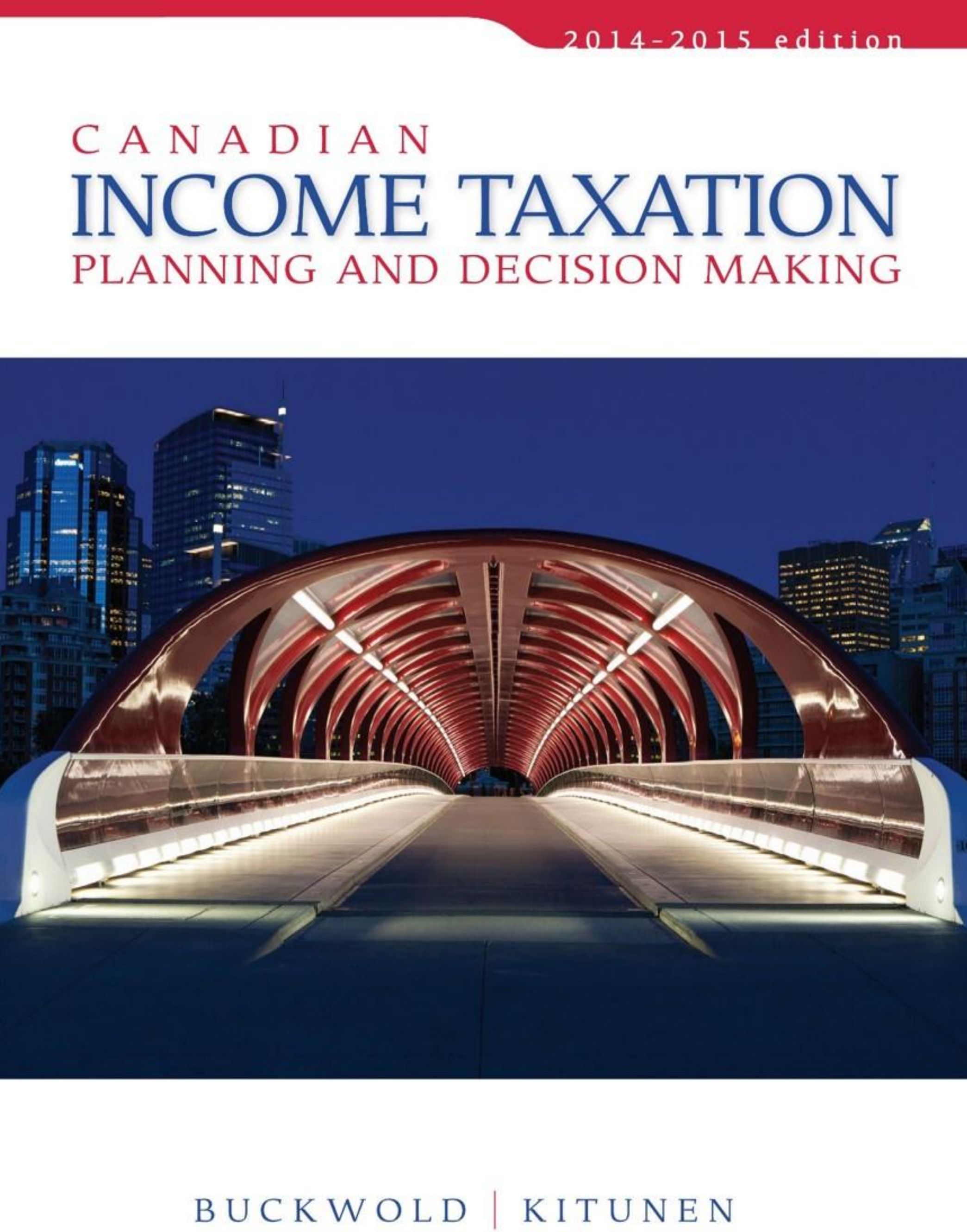

CHAPTER 4: Income from Employment

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Electronic Presentations in Microsoft® PowerPoint®

Income from Employment

I. Scope and Structure of Employment Income.
II. Cash Basis.
III. Employee Benefits.
IV. Allowances.
V. Deductions from Employment Income.
VI. Employment Income and the GST/PST/HST.
VIII. Efficient management of Employee Compensation

I. Scope and Structure of Employment Income

- **Employment income:**
  - Income for providing a service where that individual is *employed* by another party.

- E*mployed* is not defined within the *Act*.

- **Normally considered employed:**
  - when they agree to provide their services,
  - at the full direction and control of the employer,
  - in return for a specific salary or wage.

Employed - Defined

- May provide services to another party as an independent contractor.
  - Not subject to same direction or control.
  - Paid in the form of a fee.
- Distinction is important for the following reasons:
  - Deductions from employment income are restricted.
  - Employer must withhold and remit taxes to the CRA.
- Independent contractor earns business income not employment income

Employed - Defined

- **When the relationship is not clear, the courts consider four factors:**
  - Control test
  - Ownership of tools test
  - Chance of profit or loss test
  - Integration test

Control Test

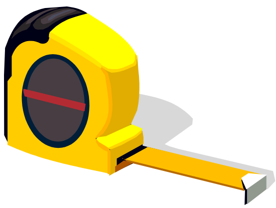
- **Who determines what is done, where, when, and how?**

Employer-employee relationship → **Employer decides**

Independent contractor → **Contractor decides**

Ownership of Tools Test

Employer-employee relationship



Independent contractor

Employer provide Tools and pays for repairs

Contractor provide Tools and pays for repairs

Chance of Profit or Loss Test

Employer-employee relationship

Employer takes the Risk and Rewards

Independent contractor

Contractor takes the Risk and Rewards

Integration Test

- A worker whose work is an integral part of the business is probably an employee.
- If the worker is an accessory to the business, he/she is probably an independent contractor.

- These tests may provide conflicting indicators.
- When that occurs, all four tests are considered and weighed against each other.
  - No one test is more important.

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Employment Income Four Fundamental Rules

- All formal compensation income, with exceptions, are taxable **when received**.
- All benefits, with exceptions, are taxable **when received**.
- All allowances, with exceptions, are taxable.

III. Employee Benefits

- **Includes:**
  - ➢Employee pension plans
  - ➢Insurance programs
  - ➢Stock options
  - ➢Automobile benefits
- Some are taxable in the year received;
- Others are taxable at some future time or are not taxable at all.

Taxable Benefits

Common forms of taxable benefits:

- Rent-free or low-rent housing,
- Gifts in cash or in kind,
- Group term life insurance policies,
- Holiday trips, prizes, and incentive awards in recognition of job performance,
- Interest-free or low-interest loans,
- Club dues when membership in the club provides little or no advantage to the employer’s business.

Non-Cash Gifts

That employers will be able to give employees:

- Long-Service/Anniversary Award: a separate award may qualify as non-taxable to the extent it doesn't exceed $500 AND is for a minimum 5 years of service (then one every 5 years after).
- Non-Cash Gifts: non-taxable providing the total cost of the awards/gifts does not exceed $500.
- Both must be to Arm's Length Employees.
- Excess over $500 will be taxable.

Taxable Benefits

- **Amount of Benefit included is the lower of:**
  - Cost to employer of supplying the benefit, or
  - FMV of the benefit.
- **Special Benefit calculations apply to:**
  - Use of employer automobiles.
  - Loans from employers.
  - Relocation expenses.
  - Stock option benefits.

Automobiles

- To the extent that an automobile is for personal use, a taxable benefit results.
- There are two components:
    1. Standby charge, and
    2. Operating cost benefit.

Standby Charge

Employer provided vehicle

– Removes the need to acquire a car.

$\downarrow$

BENEFIT

- Benefit = the time period the automobile was **available** to the employee for personal use.

Standby Charge

Employer owns the automobile, standby charge =

Original Cost Of the Automobile	x	2%	x	Number Of Months Available

The entire cost of vehicle will be included in employee's income over 4 years.

Standby Charge

- **Employer leased automobile, standby charge =**

Monthly				**Number**
Lease	**x**	**2/3**	**x**	**Of Months**
Cost				**Available**

Reduced Standby Charge

- Can be reduced to reflect a low amount of personal use.

- Reduced when the distance travelled is primarily for employment duties.

50% or more

- Personal use must be less than 20,000 kilometres for the year.

Reduced Standby Charge

- **Multiplying the basic standby charge for either an owned or a leased vehicle by the following fraction:**

$$\frac{\text{Non-Employment Kilometres}}{\text{1,667 Kilometres x Month of Availability}}$$

Example – Reduced Standby Charge

An employee drives 30,000 km in a year, 18,000 km (60%) is for business and 12,000 km (40%) is for personal use. The original cost for the vehicle is $25,000 (including taxes). The standby charge is calculated as follows:

$25,000 x 2% x 12month x [12,000/(12x1667)]

= $3,600

Operating Cost Benefit

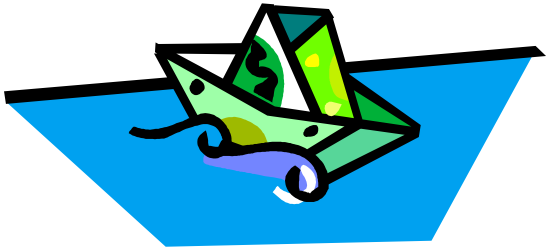
- **Operating Costs = Prescribed Rate x Personal KMS**

- For 2014, the prescribed rate is $0.27.

- Driving between home and the employer's place of business is considered personal use.

Employee Loans

- Loan-cost or interest free loans provided by employers are a taxable benefit
- Taxable Benefit = CRA Prescribed Rate – actual interest paid.
- Prescribed rate is set by the CRA every quarter.

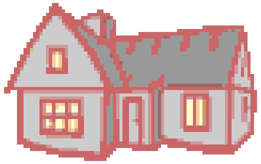


Employee Loans

- **Interest benefit relates to work relocation:**
  - If the employee has moved 40 or more kilometres closer to the new work location
  - The employee is eligible for a home relocation deduction up to maximum of $25,000
    - Deduction = lesser of:
      - The interest benefit included in income and
      - $25,000

Relocation Expenses

- Generally reimbursement of moving expense are not taxable.
- Reimbursement of two specific types of relocation expenses are taxable:
  1. Reimbursement of costs to finance a residence is taxable.
  2. Reimbursement of loss on sale of home:
     - First $15,000 - not taxable, but
     - one-half of any amount above $15,000 is taxable.



Benefits – Stock Options

- Employee can buy shares in company at a set price.
- ***In-The-Money Options*****:** Stock options of **public companies** with an **option price below FMV** at the date the option is granted.
- ***Not-In-The-Money Options*****:** Stock options of **public companies** with an **option price equal to or greater than the FMV** at the date the option is granted.
- Option benefit = **Option Price Paid** **<** **Fair Market Value**
- For CCPC the Benefit is taxable in year employee sells shares, For public company's shares, benefit is taxable in year that employee buys the shares

Non-Taxable and Tax-Deferred Benefits

Specific benefits are excluded on a deferred or permanent basis:

Employer contributions to a

- RPP
- Private health services plan (“PHSP”)
- Employer contribution for an employee to a pooled RPP
- Deferred profit-sharing plan (“DPSP”)
- Group sickness or accident insurance
- Supplementary unemployment benefit plan, and
- Counseling services.
- Employer scholarships to family members – taxed as scholarship income to family member

Tax-exempt Benefits

Arbitrary non-taxable benefits include:

- Discounts on merchandise.
- Subsidized meals.
- Uniforms and special clothing.
- In house recreational facilities
- Club dues, which it is clearly to the employer's advantage to be a member of the club.
- Internet at home – providing primary benefit is to the employer
- Cell phones and computers – primarily for business purpose
- Tuition/Training costs reimbursed – primary benefit to employer

IV. Allowances

- All allowances are taxable, subject to specific exceptions.
- **Allowance refers to:**
  - a fixed, specified amount that is paid on a regular basis,
  - over and above a normal salary,
  - to cover certain expenses incurred.
- Unique aspect: do not have to account for or provide details of how it was spent.

Exceptions (When is an Allowance Not-taxable)

1. **Travel allowance (non-car) tax-free only if:**

   -The allowance is a reasonable amount; and the employee travels outside the municipality or metropolitan area in which the employer is located.

2. **Automobile allowances are considered tax-free if:**

   -The allowance is **based only on kilometres driven.**

3. Overtime meals→Reasonable overtime meals – not taxable if:

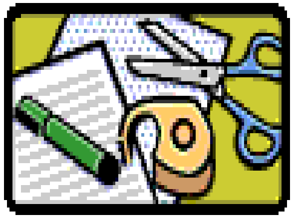
- Employee works two or more hours of overtime after scheduled hours and must be infrequent and occasional (less than three times a week).

IV. Deductions from Employment Income

No deductions are permitted **unless** specifically **listed**.

Most Common:

1. Salespeople's Expenses
2. Traveling Expenses
3. Professional and Union Dues
4. Cost of Supplies
5. Contributions to RPP
6. Works Space in Home
7. Legal expenses paid to establish right to salary or wages



Travel Expenses

- Travel expenses incurred in the course of work-related duties
- **Travel expenses include:**
  - Transportation, includes all methods including vehicle costs,
  - Meals – limited to 50%,
  - Lodging, and
  - All other expenses created by the travel activity.

Travel Expenses

- Vehicle cost, subject to limitations, include:
  - Gas and oil,
  - General repairs,
  - Insurance,
  - Financing costs (interest), and
  - Capital cost or lease costs.
- Limitations to Vehicle Costs
  - Vehicle cost limited to $30,000.
  - Lease cost limited to $800 per month.
  - Interest Cost limited to $300 per month.

Salespeople's Expenses

- Employees who are involved with the selling of property or the negotiation of contracts are permitted a broad range of deductions.
  - Can deduct all amounts expended – to each employment income,
  - Limited to commission earned.
- Items not limited to commission:
  - CCA on an automobile,
  - Automobile financing costs.

→**YOU NEED A T2200 SIGNED BY THE EMPLOYER**

Salespeople's Expenses

- The following items are specifically not deductible:

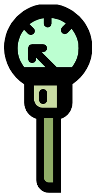
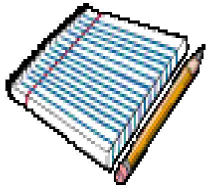
1. Payments for the use of a yacht, camp, lodge, or golf course.

2. Membership fees or dues in a club,
   - main purpose to provide dining, recreational, or sporting facilities to its members.
3. Expenditures of a capital nature that have a long-term benefit.

Salespeople's Expenses

Deductible items include:

- Advertising and promotion
- Telephone
- Parking
- Automobile
- Supplies
- Fees paid to assistants
- Work space in home
- Travel expenses


Work Space in Home

Permitted only when the work space is either:

- ➢ The principal place duties are performed, or
- ➢ If first condition not met, then:
  - Used exclusively for earning employment income, **and** Used on a regular/continuous basis for meeting customers or clients.

Employees – non salespeople:

- ➢ Appropriate portion of maintenance and utility costs.

Salespersons:

- ➢ The preceding items, plus an appropriate percentage of property taxes and house insurance premiums.

VIII. Efficient Management of Employee Compensation

A. **Basic Objectives and General Tax Principles**

B. **Indirect Compensation**

   1. Taxable Indirect Compensation
   2. Non-taxable Indirect Compensation

C. **Deferred Compensation**

   1. Registered Plans
   2. Non-Registered Plans
   3. Stock-Based Plans

A. Basic Objectives and General Tax Principles

- Objective is to provide maximum satisfaction to the employees at the least possible cost.
- **Usually we want:**
  - Compensation expenses which are fully deductible by employer when incurred and not taxable to employees

Non-Taxable Indirect Compensation

- Certain benefits to be received tax-free.
- CRA considers other types of benefits also to be non-taxable. Common benefits:
    - Private Health Services plans
    - Supplementary unemployment benefits
    - Certain membership fees
    - Counselling fees
    - Discount on merchandise, etc..

Taxable Benefits

Overall Cash Savings If:

1. Employee needs the benefit and would acquire it from after-tax disposable income
2. Employee can acquire the benefit at a lower cost than the employee.

C. Deferred Compensation

Two advantages from the employee's perspective:

1. Taxing income later may result in lower tax rates
   - especially if payments are delayed until retirement.
2. If delayed payments are invested, investment returns will be achieved on pre-tax income.

C. Deferred Compensation

Three categories of deferred plans:

1. Registered Plans
2. Deferred Profit Sharing Plans
3. Stock-Based Plans

Registered Plans – An Example

Compensation – Salary $3,500
Tax Rate – 45%
After-tax Compound Int. – 5.5%
Invest every year for 30 years

Salary	$ 3,500
Tax	(1,575)
After-tax Cash	$ 1,925

Total Wealth after 30 years
After tax = $ 147,000

Compensation – RRP $3,500
Tax Rate – 45%
Before tax Compound Int. – 10%
Invest every year for 30 years

RPP Contribution	$ 3,500
Tax	(0)
After-tax Cash - Invest	$ 3,500

Total Wealth after 30 years
After tax = $ 348,000

TAX PLANNING CHECKLIST

→Employees should try to maximize their use of employer-provided benefits programs, even when the benefit is taxable, because often the employer can acquire the particular service at a lower cost.

→In lieu of salaries, employers should consider offering a shopping list of benefits from which employees can choose. This way employees receive only those benefits they really need.

→Salary deferrals may be beneficial when the employer pays interest on the deferred amount. However employees should consider when the deferral to a future year will alter the tax rate that would otherwise be applicable

TAX PLANNING CHECKLIST- Continued

→When provided with an employer's car for extensive personal use over several years, the employee should consider buying the depreciated car, since the standby charge is always based on the original cost.

→An employee who wants to take advantage of the reduced standby charge for low personal use SHOULD KEEP A LOG

→An employer who is prepared to fund an employee's personal auto costs should investigate whether the auto should be owned or leased and by which party.

→When an employee is using his own car for business use, a decision should be made as to whether an allowance or a reimbursement should be given. If an allowance is given, then should it be taxable or not.

TAX PLANNING CHECKLIST- Continued

→When home reallocation employee loans are given and interest rates decreases, consider renegotiating the loan to lock in the lower CRA prescribed rate for the next 5 years

→Employees who have been granted stock options should consider when the options should be exercised. If share price is rising, should consider exercising sooner. Should also consider the time value of dishing out money now.

→A salesperson can choose the more advantageous of deductions under 8(1)(f) or 8(1)(h) or 8(1)(h.1).

→Salesperson should lease capital equipment required for work (cell phones, computers, printers etc.) since CCA is not allowed.