

Tran Chung

Income or Loss From and Office or Employment

INTRODUCTION

Subdivision a of Division B defines employment income under the Act.

Section 5 – salary, wages and gratuities received

Section 6 – other income inclusions arising from employment

Section 7 – stock option benefits

Section 8 – deduction allowed against employment income

BASIC RULES

Employed vs. Self-employed/Independent Contractor

The issue of whether an individual is an employee or independent contractor is a question of law.

Key tax differences:

Employee	Self-Employed
Limited in the deduction of expenses	Can deduct reasonable expenses incurred to earn the income
Must contribute to EI	Does not contribute to EI – Opt in
Must contribute to CPP	Must contribute both the employee's and employer's portion

Some other considerations:

- Job security
- Benefits
- WorkSafe BC
- Insurance
- Expenses

Making the Distinction

The following **interrelated** tests have evolved in the courts:

a. **Economic reality or entrepreneur test** (*Montreal v. Montreal Locomotive Works*);

- 1) Control –

- 2) Ownership of tools –

- 3) Degree of Financial risk –

b. **Integration or organization test;**

How integrated is the individual vis-à-vis the business?

c. **Specific result tests.**

Is the individual paid by the job or by the hour?

Class Problem on Employee vs. Contractor

The Door Depot Inc. is carrying on the business of installing and repairing doors. In carrying on its business, it engaged the services of a considerable number of door installers and repairers on the understanding that they would be running their own businesses and would be responsible for their own taxes and for workers' compensation, unemployment insurance, and CPP contributions. The worker was free to accept or refuse any particular job The Door Depot asked him to do, and the worker was not required to work or attend at the taxpayer's place of business. The worker had to guarantee his work for a period of time and bear the cost for warranty work. The workers provided their own trucks and tools except special drills and racks owned by the The Door Depot. The workers were paid by the job and not by the hour.

Required: Are the door installers an employee or independent contractor of The Door Depot?

Salaries, Wages and Other Remuneration including Gratuities

“Salaries” and “wages” are terms commonly used, however, “remuneration” has a broader meaning. Remuneration includes bonuses, honoraria, commissions, tips paid to employees.

The use of the word “received” in **section 5** means that the employee must report employment income on a cash basis, not on an accrual basis.

SPECIFIC INCLUSIONS

Section 6 – benefits

Section 7 – stock based compensation

Generally, the applicability of *paragraph 6(1)(a)* requires that two conditions be met:

- (1) the taxpayer must receive a benefit; and
- (2) that benefit must be received or enjoyed in the taxpayer’s capacity as an employee.

Please read *IT-470R* for CRA’s administrative practice on fringe benefits.

Some interesting items:

Employer Provided Parking

Normally a taxable benefit pursuant to *paragraph 6(1)(a)*.

No taxable benefit taxable where parking is provided for business purposes *and* the recipient employee regularly uses his or her automobile in the performance of employment duties.

Employer-paid Educational Costs

The CRA guidelines with respect to employer-provided training create three broad categories of training:

- specific employer-related training,
- general employment-related training, and
- personal interest training.

Gifts and Incentive Awards

- Aggregate cost of non-cash gifts and awards up to \$500 per year (excess is taxable), and
- Aggregate cost of non-cash awards for long service/anniversary not exceed \$500 per year (excess is taxable)

What about “near-cash” gifts (e.g. gift certificate)?

Example:

Employee receives the following non-cash gifts and awards:

- bottle of wine (wedding gift) \$350
- Gift certificate to Future Shop (Sales award) \$200
- Hockey tickets (birthday gift) \$450
- Tissot watch (5 year service award) \$375
- Company logo t-shirts and coffee mugs \$50

Discuss the tax consequences:

Employer Supplied Automobiles

Below are key concepts:

- Standby Charge (*paragraph 6(1)(e) and 6(2) and regulation 7305.1*)

- Operating Cost Benefit (*paragraph 6(1)(k)*)

- Payments by Employee for Vehicle Use
 - *Subparagraphs 6(1)(e) and 6(1)(k)* provide for reduction in standby charge and operating cost benefit for payments made by employee to the employer for use of vehicle

Employer Provided Automobile Examples

EXAMPLE ONE: Mr. Joseph Martin is the president of the Company and is provided with a Mercedes that has been leased by the Company for \$2,100 per month. During the current year, the car was driven a total of 42,000 kilometers, of which 19,000 could be considered employment related travel. Operating costs averaged \$0.80 per kilometer. Because of an extended illness which required hospitalization, the car was only available to Mr. Martin for the first seven months of the year.

EXAMPLE TWO: Mrs. Grace Martin, the vice president in charge of marketing, is provided with a Lexus that the Company has purchased for \$78,000. During the current year, this car was driven a total of 15,000 kilometers, of which all but 2,000 kilometers were employment related. Operating costs for the year amounted to \$3,500 and the car was available to Mrs. Martin throughout the year.

EXAMPLE THREE: Mr. William Martin William Martin, the vice president in charge of finance, is provided with a Ford that the Company leases for \$600 per month. The total mileage during the current year amounted to 38,000 kilometers, of which 32,000 kilometers related to personal matters. Operating costs for the year were \$7,400 and the car was available to Mr. Martin throughout the year. William Martin paid the Company \$300 per month for the use of the car.

Employee-Owned Automobile Operating Expense Benefit

Benefit = (Personal-use km)/(Total km) x Total Costs paid by employer

Allowance and Reimbursement

General allowances are considered taxable benefits (with specific exceptions for certain traveling expenses and motor vehicle allowances)

An allowance is a non-accountable advance provided to an individual without regard for the actual use of the funds or amount of expenses represented by it.

A reimbursement is an amount settled upon presentment of some form of proof of expense such as a purchase voucher or invoice.

Reasonable Allowance for Employee-owned Automobiles

“Reasonable” auto allowance is not taxable. There is no guidance on what is reasonable.

“Reasonable” is not defined. But CRA has stated that a reasonable allowance must meet two conditions:

1. The allowance must be based on kilometers driven.
2. The allowance must be below the prescribed limit below.

For 2016, the prescribed amount is \$_____ for the first 5,000 kilometers and \$_____ for each additional kilometers. (See regulation 7306)

Are reasonable monthly gas allowances taxable?

Reasonable Allowance for Traveling Expenses

Reasonable allowance (e.g. per diem) is not taxable. No hard guideline, but one must use her judgment.

Employee Insurance Benefits

Life Insurance – cost of providing the life insurance benefits to employees is a taxable benefit under *subsection 6(4)*.

Disability Insurance –

Paragraph 6(1)(a) - premiums paid by employer on behalf of an employee to a group sickness or accident insurance not taxable.

Paragraph 6(1)(f) – the disability payment received when the employee is disabled is taxable if the employer pays all or any portion of the premium.

However, if the employee pays 100% of the premium, then the disability payment is NOT taxable.

Example:

Employee pays \$399 premium, Employer pays \$1
Employee injured while skiing and received \$4,000 from the insurance company. Assume that this is the first year of the disability plan. Discuss the tax consequences.

Health Care Insurance – Premiums for provincial or federal funded health care program (e.g. MSP) are taxable benefits to the employees if paid by the employer. Payments for private health care, such as dental and extended medical, are not taxable benefits.

Loans to Employees

Subsection 6(9) brings into employment income a deemed interest benefit on an interest-free or low-interest loan made by an employer and received by an employee in his or her capacity as an employee.

Subsection 80.4(1) defines the benefit as follows:
Employee benefit (if any) = Prescribed interest less interest paid by employee (paid by Jan 30 of the following year)

Prescribed rate of interest can be found in regulation 4301.

Note that the CRA computes interest on a daily basis.

Example:

Employee receives a \$100,000 loan from her employer on February 9, 2016. She paid interest at 0.5% per annum on the loan. Compute the employee's taxable benefit on the loan.

Exceptions to Employee Loans

If the interest on the loan is equal to or greater than the prescribed rate *at the time the loan is made*, then the rules on the imputed interest do not apply.

Home Relocation Loans and Home Purchase Loans

The employee can choose between the lower of:

- The prescribed rate at the time the loan was made (e.g. historical prescribed rate); and
- The current prescribed rate.

The historical prescribed rate is refreshed on every 5th anniversary of the loan.

EXAMPLE:

Home purchase loan was provided to employee on January 3, 2015. The prescribed rate for 2016 is 1% for every quarter.

- (a) Determine the taxable income effect for 2016 if the employee pays no interest on the loan.

- (b) Determine the taxable income effect for 2016 if the employee paid 2% interest on the loan.

Home Relocation Loans (ITA 110(1)(j))

An employee is allowed a deduction against TAXABLE INCOME on home relocation loans on the first \$25,000 multiply by the prescribed rate used to calculate the employment benefit.

Forgiveness of Employee Loans

Subsection 6(15) determines, for purposes of paragraph 6(1)(a), the value of an employment benefit arising on the forgiveness of an employee loan.

Stock Options Benefits

What is a stock option?

General Tax Rules

CCPC (Canadian controlled private corp)	Other (Public)
<i>At the time of grant</i>	<i>At the time of grant</i>
<i>At time options vest</i>	<i>At time options vest</i>

Year of Exercise

Stock Option Benefit =

Year of Exercise

In the year of sale of the shares

In the year of sale of the shares

110(1)(d) Deduction – all companies stock options

Employee can receive a 50% x SOB deduction against TAXABLE INCOME if at the time of grant, the exercise price is equal to or greater than the FMV at the time of grant. E.g. the options were issued at-the-money or out-of-the-money.

110(1)(d.1) Deduction – CCPC only

If 110(1)(d) does not apply AND the employee held onto the shares for at least 2 years after the date of exercise, then employee can receive a 50% x SOB deduction against TAXABLE INCOME

Stock Option Class Problem

Mr. Mizuno, who is employed by Public Co. Ltd was grant an option in year one to acquire 5,000 common shares at \$10 (e.g. exercise price) after the completion of his fifth year of employment. The fair market value of common shares at the time of granting the right was \$12. He does not have any other shares of Public Co.

During Mr. Mizuno's seventh year of employment he decided to exercise part of this right and purchased 1,000 shares with a fair market value of \$15 as at that date.

Three years later, Mr. Mizuno sold the shares at \$25/shares.

Required:

- A. Discuss the tax implications of each of the above transactions.
- B. How would your answer differ if the exercise price was \$13?
- C. How would your answer differ if Mr. Mizuno was employed by a Canadian controlled private corporation (CCPC)?

DEDUCTIONS FROM EMPLOYMENT INCOME

Subsection 8(1) lists the deduction available

Section 67 imposes a general limitation on the deductibility of expenses in computing income. The first thing is that the expenditure must be “reasonable in the circumstances”.

Subsection 67.1(1) limits the deductibility of food and entertainment costs to 50% of the amount paid.

Section 8(4) requires that the meals can only be deductible if the employee was away from the municipality or metropolitan area where the employer is located for at least 12 hours.

We will only cover selected topics in subsection 8(1).

SALESPERSON	NON-SALEPERSON
<p>Paragraph 8(1)(f)</p> <p>Deduct reasonable expenses incurred to earn income except luxury items like golfing, yachting, camping club dues.</p> <p>Deduction is limited to commission income</p>	<p>Not available</p>
<p>Paragraph 8(1)(h)</p> <ul style="list-style-type: none"> - Reasonable travel expense <p>Paragraph 8(1)(h.1)</p> <ul style="list-style-type: none"> - Reasonable automobile expense (no CCA) <p>For salesperson, she must choose deduction under 8(1)(f) <u>OR</u> 8(1)(h) and (h,1).</p>	<p>Paragraph 8(1)(h)</p> <ul style="list-style-type: none"> - Reasonable travel expense <p>Paragraph 8(1)(h.1)</p> <p>Reasonable automobile expense</p>
<p>Paragraph 8(1)(i)</p> <ul style="list-style-type: none"> - Miscellaneous items (see below) <p>Paragraph 8(1)(j)</p> <ul style="list-style-type: none"> - CCA (capital cost allowance) and interest cost on automobile and aircraft. 	<p>Paragraph 8(1)(i)</p> <ul style="list-style-type: none"> - Miscellaneous items (see below) <p>Paragraph 8(1)(j)</p> <p>CCA (capital cost allowance) and interest cost on automobile and aircraft.</p>

Sales/Negotiating Person's Expenses

Here is a list of some items that are deductible.

- advertising and promotion
- meals and entertainment (subject to the previously noted 50 percent limit)
- lodging
- motor vehicle costs (other than CCA and interest)
- parking (which is not considered a motor vehicle expense)
- work space in the home costs (maintenance, property taxes, and insurance — no mortgage interest or amortization)
- supplies (including long distance telephone calls and cellular phone airtime, but not the basic monthly charge for a telephone or amounts paid to connect or licence a cellular phone)
- licences (e.g., for real estate sales)
- bonding and liability insurance premiums
- salary to assistant or substitute
- office rent
- training costs
- transportation costs
- computers and office equipment (leased only)

The amount of deduction is **limited** to the commissions or other sales related earnings for the year.

Paragraph 8(1)(i) Expenses

Paragraph 8(1)(i) allows certain expenses to be deductible:

- Annual professional membership dues (e.g. CA, CGA, PEng, etc);
- Office rent paid or salary paid to an assistance (note on CPP and EI);
- Cost of supplies paid; and
- Annual union membership dues.

Work Space in Home

Subsection 8(13) provides that expenses incurred in a home office will only be allowed if

1. the individual principally performs his or her duties at this work space, or
2. the space was used exclusively for the period of time when the expenses were incurred for earning income from employment and is used on a regular and continuous basis for meeting customers or other persons in the ordinary course of performing the duties of employment.

Pursuant to paragraph 8(13)(b) , expenses may not exceed the income earned by the office or employment, although paragraph 8(13)(c) allows an indefinite carryforward period if certain conditions are met.

HOME OFFICE EXPENSES AND OTHER

* take pro-rata portion of the square footage of home office over square footage of house

	SALES PERSON	NON-SALES	BUSINESS
Maintenance	8(1)(f) or 8(1)(i) Deductible	8(1)(i) - deductible	9(1) - deductible
Utilities *general telephone line not deductible but business LD calls are deductible	8(1)(f) or 8(1)(i) Deductible	8(1)(i) - Deductible	9(1) - deductible
Rent	8(1)(f) or 8(1)(i) Deductible	8(1)(i) - Deductible	9(1) - deductible
House insurance	8(1)(f) - deductible	Not deductible	9(1) - deductible
Property tax	8(1)(f) - deductible	Not deductible	9(1) - deductible
Interest on mortgage	Not deductible	Not deductible	9(1) and 20(1)(c) deductible
CCA on house	Not deductible	Not deductible	9(1) and 20(1)(a) deductible
Office supplies	8(1)(f) or 8(1)(i) Deductible	8(1)(i) Deductible	9(1) - deductible

Office furniture / equipment (purchased)	Not deductible	Not deductible	9(1) and 20(1)(a) deductible
Office furniture / equipment (leased)	8(1)(f) - deductible	Not deductible	9(1) and deductible
Meals to entertain clients	8(1)(f) - deductible - limited to 50%	Not deductible	9(1) and deductible - limited to 50%

CHAPTER PROBLEM (ADAPTED FROM BYRD AND CHEN)

Mr. Carlos Segovia is a very successful salesperson and is employed by a large Canadian public company. For 2016, his base salary is \$252,000. In addition, he earns commissions of \$18,500. Other information relevant to Mr. Segovia's 2016 employment income is as follows:

1. Mr. Segovia is required by his employer to pay all of his own employment related expenses. He is also required to provide his own office space. Mr. Segovia has a Form T2200 signed by his employer that certifies this.
2. His travel costs for the year, largely airline tickets, food, and lodging, total \$29,000. This includes \$9,500 spent on business meals.
3. His annual dues to the Salesperson's Association (a trade union) were \$450.
4. He is a member of his employer's registered pension plan. During the year, his employer contributed \$5,500 to this plan on his behalf. In addition, \$5,500 was withheld from his salary and contributed to the plan.
5. During the year, Mr. Segovia was billed a total of \$13,500 by his golf club. Of this amount, \$3,300 was the annual membership fee, with the remainder being charges for meals and drinks with clients.
6. During the year, Mr. Segovia used 35 percent of his personal residence as an office. The designated space is where he principally performs his employment duties. Interest payments on his mortgage totalled \$11,500 for the year and property taxes were \$4,800. Utilities paid for the house totalled \$2,600 and house insurance paid for the year was \$1,250. Other maintenance costs associated with the property amounted to \$1,450. Mr. Segovia does not intend to deduct CCA on the home office portion of the house.
7. For business travel, Mr. Segovia drives a car that he purchased in 2013 for \$49,000. He financed the purchase of the car through his local bank and, for 2016, the interest on the loan was \$2,250. During the year, he drives the car a total 60,000 kilometres, 45,000 of these being for employment related travel. His accountant has advised him that, if the car were used 100 percent for employment related activities, the CCA (tax depreciation) for the year would be \$7,650. The costs of operating the car during the year totaled \$7,500.
8. As rewards for winning various sales contests during the year he received three non-cash awards. The first, a spa weekend at a local hotel, had a fair market value of \$300. The second was a \$400 gift-certificate at a men's clothing store. The third award, a bottle of 1995 Haut Brion, had a fair market value of \$450.
9. In 2013, his employer granted him options to buy 1,000 shares of the company's stock at \$20 per share. At the time of the grant, the shares were trading at \$19 per share. On June 1, 2013, all of these options are exercised. At this time, the shares were trading at \$31 per share. In 2014, he sold all the shares received from the exercise of the stock options for \$35 per share.
10. Assume that Mr. Segovia makes any elections that are available to reduce his income inclusions or increase his deductions.

Required: Calculate Mr. Segovia's minimum net employment income for the 2016 taxation year. Ignore GST, PST, and HST considerations.

ASSIGNMENT PROBLEM TWO – 9 WORK SHEET

The required calculation of minimum Net Employment Income would be as follows:

Salary	
Commissions	
Expenses	
RPP Contributions	
Awards	
Stock Option Benefit	
Net Employment Income	

As the deduction under ITA 8(1)(f) is limited by commission income, alternative calculations are required to determine the maximum deduction. These calculations are as follows:

	ITA 8(1)(f) (Limited to \$)	ITA 8(1) (h) and (h.1)	ITA 8(1) (i) and (j)
Professional Dues			
Automobile Costs:			
Operating Costs			
Financing Costs			
CCA			
Home Office Costs:			
Utilities			
Maintenance			
Insurance			
Property Taxes			
Interest			
CCA			
Travel Costs			
Non-Deductible Meals			
Golf Club Fees			
Non-Deductible Membership Fees			
Non-Deductible Entertainment			
Total			