

# Income from Office & Employment

# To Be Covered

- Key Terms & General Information
- Taxation of Fringe Benefits
- Deduction of Employment Expenses

# Employment Definitions

Wages - \$10/hour

Salary - \$30,000/year

Remuneration – broad enough to mean any benefit received, not just payments.

# Employment Definitions

Employment Insurance (EI)

Canada Pension Plan (CPP)

Old Age Security (OAS)

# Who is an Employee?

An individual in the service to some other person

- Control over work performed
- Ownership of tools
- Ability to subcontract
- Financial Risk
- Investment Capital & Management Duties
- Opportunity for Profit
- Integration

Alternative: Independent Contractor

# Example – Who is an Employee?

Claire has just gotten a job with XYZ Company.

She works from 9am – 5pm Monday to Friday at XYZ's office.

XYZ provides her with her computer, pens, and paper needed for the job.

Claire is not allowed to work for XYZ's competitors



Retrieved September 16, 2014 from:  
<http://wellbeingmagazine.co.uk/article/exercise-posture>

# Example – Who is an Employee?



Claire has just gotten a contract with ABC Company.

She is working on a project called HeliumX and believes it will take 6-8 months to complete.

Claire charges \$15,000 for her work on the project. She works from home but occasionally travels on site to check on progress.

Claire's business card says '*Claire McCormick – Construction Consultant*'

# Employee Perspective

**Deductions** – greater deductions available to Independent Contractors (self-employed)

**CPP & EI** – Greater benefits available to employees to draw on, Contractors must pay employee and employer share of CPP

**Fringe Benefits** – Employees Receive better benefits

**Tax Evasion** – Contractors under less reporting and withholding.

# Employer Perspective

**CPP & EI** – Cheaper to hire contractor, but will be liable if ‘accidentally’ an employee

**Fringe Benefits** – Cheaper to hire contractor, may need to increase pay to compensate

**Contracts** – Commitments to contractors are usually less stringent. Short term projects

**Legal Liability** – a Contractor is liable for their own work quality. Employer is liable for employee work.

# Net Employment Income

Wages, Salary, & Remuneration (Income Inclusions)

Less:

Expenses incurred to earn employment income (Deductible Expenses)

Equal:

Net Employment Income

# Income Inclusions

# Employment Income

Salary, Wages, Bonuses, and Benefits received by being an Employee of an organization.

Includes signing bonus, severance pay, and non-compete clauses.

Includes tips- which can be self assessed, otherwise CRA will deny.

Generally on a cash basis

# Timing – Ordinary Payroll

## Corporations use the accrual method

Payroll liabilities are deductible to them when incurred, or earned, by employees.

## Individuals use the cash method

Employment income is taxable to them when received.



Retrieved September 15, 2014 from:  
<http://business.financialpost.com/2013/08/07/employees-pay-capitalism/>

# Timing – Ordinary Payroll

A Co. has a Dec 31, 2014 year end. They pay their payroll on the 1<sup>st</sup> and 16<sup>th</sup> day of the month. As of year end, they will have accrued payroll from December 17-31<sup>st</sup> available to deduct on their Dec 31, 2014 tax return.

Because their employees don't receive the payroll until Jan 1, 2015, they won't pay taxes until their Dec. 31, 2015 tax return.

**Deduction-----Pay Salary-----Save Tax-----**  
**Dec 31, 2014      January 1, 2015      June 30, 2015**

**-----Receive Pay-----Pay Tax-----**  
**January 1, 2015      April 30, 2016**

# Timing - Bonuses



Taxable to the individual when received

Deductible to the employer when accrued

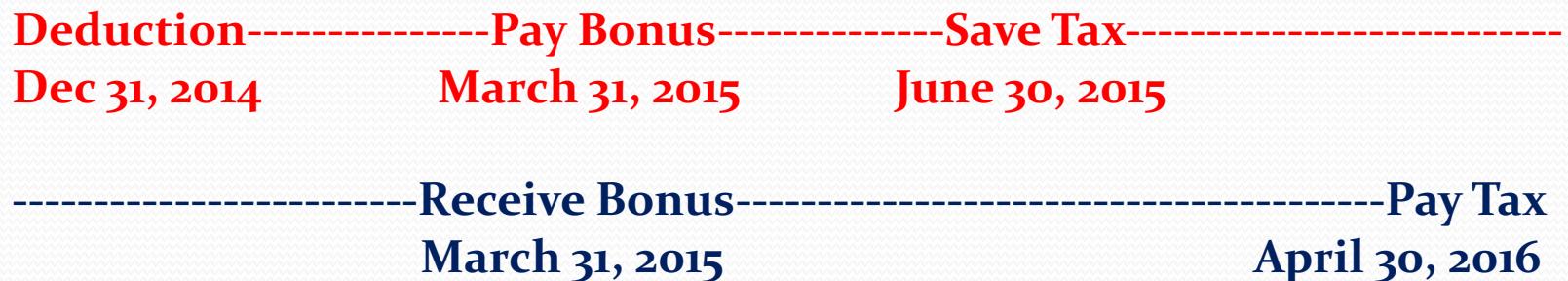
IF:

Bonuses must be paid within 180 days (on the 179<sup>th</sup> day) for these rules to apply, otherwise deductible when paid.

# Timing – Bonuses

A Co. Decides to pay a bonus to Jill on December 31, 2014. A Co. gets a deduction on their Dec. 31, 2014 tax return.

Because Jill doesn't receive the bonus until 2015, she won't pay taxes until her Dec. 31, 2015 tax return.



# Example

Sam is an employee at XYZ Limited. In 2014 he received an annual salary of \$35,000. He also calculated that he collected \$6,000 in tips and his employer gave him a bonus for coming in over the New Years holiday. He received this bonus on January 2, 2015.

Calculate Sam's taxable income for 2014.

\$35,000 – Salary (assumed received in cash) is taxable

\$6,000 - Tips are taxable as received

\$0 - Bonus is taxable in 2015, since that is when it was received

**\$41,000 Taxable Income**

# Fringe (Taxable) Benefits

Non-cash compensation provided by an employer.

In some cases may be received tax free, but in other cases must be included in the income of the employee.

These are considered: Taxable Benefits



Retrieved September 16, 2014 from:  
<http://www.personneltoday.com/blogs/workplace-advice/2007/07/do-employees-know-what-their/>

# Gifts

Expected to be taxable

CRA provides exceptions where non-cash (but not ‘near cash’)

Non-taxable if:

\$500 or less/employee annually for special events

\$500 or less/employee for long service awards (5 year increments)

Must be arm's length with employer, excess is taxable

# Gifts - Examples

Q. \$600 in gift cards on a birthday

A. \$600 Taxable

Q. \$600 Figurine given on their anniversary

A. \$100 taxable (\$600 - \$500 annual special occasion allowance)

Q. \$300 given to a spouse of sole shareholder at Christmas

A. \$300 taxable

# Gifts - Test

Q. \$300 in watch for birthday

A. \$0 Taxable

Q. \$700 25 year service award & \$200 cash bonus for Christmas. Last service award was for 20 years.

A. \$400 taxable (\$200 cash + \$200 excess long service award)

Q. \$100 picture for Wedding & \$400 earrings for Birthday

A. \$0 taxable

# Loyalty Programs

Example: Airmiles

Earned because of employment, but owned personally.

No taxation if not converted into cash or near-cash.

Otherwise taxable when converted at the fair market value received.

- Exemption removed if clearly to avoid tax.
- Taxable if company card with points used by employee
- Taxable if single employee builds points by paying for many employees

# Tuition

1. Specific Employer Related Training – No Benefit  
CPA training in a CPA firm
2. General Employment Related Training – No Benefit  
MBA/First Aid in a CPA firm
3. Personal Interest Training – Taxable Benefit  
Knitting, Music (unless musician)

Employer deducts regardless  
Benefit rules apply to meals, travel and  
accommodations required for the training.

# Taxable Benefits - Example

Harry Simpson works at XYZ Nuclear Company. He earns an annual salary of \$50,000 and his employer also paid for him to take jazz saxophone lessons which cost \$2,000. Harry's job is as a safety technician.

Calculate Harry's Taxable Income.

\$50,000 – salary assumed received is taxable

\$2,000 - tuition is taxable benefit – not for benefit of  
employer

\$52,000

# Taxable Benefits - Example

Harry Simpson works at XYZ Nuclear Company. He earns an annual salary of \$50,000 and his employer also paid for him to take pipe fitting lessons which cost \$2,000. Harry's job is as a junior plumber.

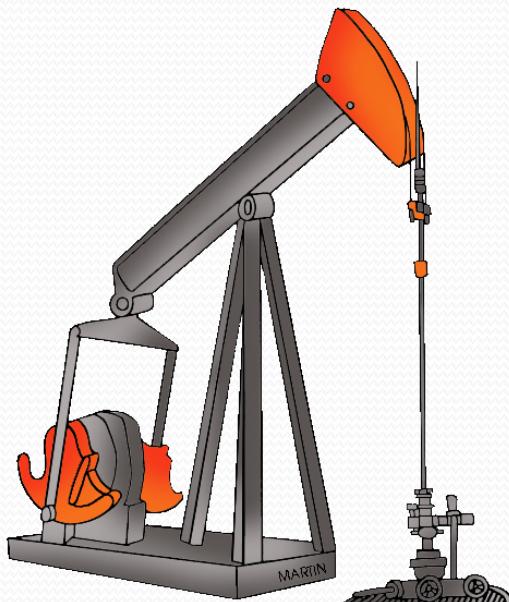
Calculate Harry's Taxable Income.

\$50,000 – salary assumed received is taxable

\$0 - tuition is non-taxable –directly relates to Harry's work

\$50,000

# Board & Lodging



phillipmartin.info

Retrieved September 16, 2014 from:  
[http://canada.phillipmartin.info/canada\\_oilrig.htm](http://canada.phillipmartin.info/canada_oilrig.htm)

## Taxable Except:

Employment at a temporary special work site

- Unreasonable to expect employee to commute

Employment at a remote work site

- Unreasonable to expect employee to establish residence because of distance to a community

# Other Benefits

## Taxable:

- Flights & Holidays
- Income tax preparation
- Spouse Costs
- Life Insurance

## Non-Taxable:

- Employee Discounts (not below cost)
- Required Uniforms or Safety Gear
- Employer Provided Recreational Facilities
- Counseling re Health, Re-Employment, Retirement.
- Professional Membership Fees
- Health & Dental

# When in Doubt

Consider the economic  
benefit and government  
intentions



# Planning – Use of Benefits

## Tax Avoidance

- Deductible to Employer – Health Plans, Tuition
- Non-Taxable to Employees

## Tax Deferral

- Deductible to Employer Immediately – RPP
- Taxable to Employees in future

# Allowances vs. Reimbursements

## Allowances

- If not based on a reasonable measure – per/km for travel, it will be taxable.
  - \$0.55 per km
  - \$17 per meal
- General allowances for other items are taxable (educational allowance where costs aren't tracked)

## Reimbursements

- Reimbursement of food, lodging, registration fees paid by the employee on behalf of the employer are non-taxable.

# Examples

- Jimbo receives a \$600 allowance per month to pay for his vehicle which he uses for work.
- $\$600 \times 12 = 7,200$  income
- Not reasonable since not based on mileage
- Jimbo receives an allowance of \$0.52 per km that he drives. In 2013 he drove 2,000 km.
  - \$0 taxable
  - Not in excess of CRA rates. Appears reasonable

# Examples

- Jimbo recently paid \$1,500 for registration in a conference and \$425 for a hotel. His employer reimbursed him \$1,925 once he submitted receipts.
- \$0 taxable
- Direct reimbursement based on receipts
- Jimbo's employer paid him \$2,000 so that he could enroll in a conference. They did not require any support for his costs.
  - \$2,000 taxable
  - No support required, not a direct reimbursement.

# Cars

- When employee provided, can charge back \$0.55/km driven for the first 5,000 km and \$0.49/km after
- When employer provided, employee receives taxable benefit for personal use:
  - Standby Charge +
  - Operating Benefits

# Standby Charge

- When owned by corp:
  - $2\% \times (\text{original cost of vehicle} \times \# \text{ of days available to employee}/30)$
  - Easiest to think of as  $2\% \times \text{cost} \times \text{months}$
- When leased by corp:
  - $2/3 \times (\text{lease costs for period available to employee} - \text{insurance}) \times (\# \text{ of days available to employee}/30)$
- Reduction if used mostly for business:
  - Multiple: personal km / (1,667 per month) by each formula (can't be used to increase the charge)
  - Only available if less than 50% is for personal use

# Operating Benefit

- If the employer pays for the operating costs (fuel, maintenance), the lesser of:
  - Employee is charged \$0.26/km for personal kms.
  - 50% of standby charge. This option available only if the car is used at least 50% for business.
- Reimbursements by employee to employer
  - Reduce the standby charge and the operating benefit

# Stock Options

- What they are:
  - An option to purchase the shares of a company, at a certain price.
  - Example: I have the option to purchase 10 shares of ABC Co. for \$10 each. If the shares are currently worth \$12 on the open market, these options are worth \$2 each (\$12 FMV - \$10 option price)
- Purpose:
  - To encourage performance that improves the company's value (increasing the value of the options)
- Definitions:
  - Exercise price : what the options give the right to purchase at.
  - In the Money: When the option price is less than FMV

# Stock Options

Exercise price (strike price) - \$10

FMV at date of grant - \$8

FMV at date of exercise - \$13

FMV at date of sale - \$17

In the money-Strike<FMV  
Not in the money – strike>FMV  
Grant

	<u>Public</u>	<u>CCPC</u>	Canadian controlled private corporation
Grant date	Nothing	Nothing	
Exercise Date - Not in the money	$\$13-10=\$3$ $(\$1.50)$	\$0	
Sale Date	$\$17-\$13=\$4$ $\times 50\% = \$2$	$\$13-10=\$3$ $(\$1.50)$ $\$17-\$13=\$4$ $\times 50\% = \$2$	

# Stock Options

<u>Public</u>	<u>(Year of Exercise)</u>	<u>Year of Sale</u>
Employment Income	\$3	
Taxable Capital Gain		\$2
Net income for tax purposes	\$3	\$2
Stock Option Deduction	(1.50)	\$0
Taxable Income	1.50	\$2

## CCPC

Employment Income	\$3
Taxable Capital Gain	\$2
Net income for tax purposes	\$5
Stock Option Deduction	(1.50)
Taxable Income	3.50

# Stock Options

Exercise price (strike price) - \$10

FMV at date of grant - \$12

FMV at date of exercise - \$13 (in 2014)

FMV at date of sale - \$17 (in 2017)

	Public	CCPC
Grant date	Nothing	Nothing
Exercise Date - IN the money	$\$13-10=\$3$ <b>(\$0)</b>	\$0
Sale Date - YES held for two yrs	$\$17-\$13=\$4$ $\times 50\% = \$2$	$\$13-10=\$3$ <b>(\$1.50)</b> $\$17-\$13=\$4$ $\times 50\% = \$2$

# Stock Options

<u>Public</u>	<u>(Year of Exercise)</u>	<u>Year of Sale</u>
Employment Income	\$3	
Gain		\$2
Net income for tax purposes	\$3	\$2
Stock Option Deduction	(0)	\$0
Taxable Income	\$3	\$2

## CCPC

Employment Income	\$3
Capital Gain	\$2
Net income for tax purposes	\$5
Stock Option Deduction	(1.50)
Taxable Income	<u>3.50</u>

# Employee Loans

- Difference between loan rate and the prescribed rate is taxable benefit
- Exceptions – Relocation, Home Purchase, Share Purchase Loans



# Employee Loans

Mr. Gilbert gives low interest loans to employees who want to take vacations. He charges 2% and thinks he has issued around \$300,000 in loans this year and has yet to collect any (if fact some employees didn't come back). The prescribed rate is 5%.

\$15,000 – interest calculated at prescribed rate (\$300,000 at 5%)  
(6,000) – interest collected (\$300,000 at 2%)

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\$9,000 – interest to be included as benefit to employees

# Deductions

# Very Specific for Employees

- Legal Expenses to collect or defend salary
- Clergyman's residence
- Dues and Memberships
- RPP Contributions
- Travel Expenses – see next slide
- Automobile Expenses – see next slide
- Apprentice mechanic & Tradespersons Tools

# Employee Travel Expenses

Must be:

- Required to pay their own expenses
- Ordinarily required to carry on duties away from employer's place of business
- Cannot be receiving a travel allowance unless it is included in income

# Employees Expenses

## Can Deduct:

- Meals & Entertainment (50%) – 12 hours out of town
- Lodging
- Vehicle (actual costs x kms drive for work/total km)
- Parking
- Home Office – special tests
- Training Costs
- Licenses
- Insurance



# Expenses

Jimbo earns a salary of \$30,000 and is required to pay for certain expenses as part of his employment. He pays association dues of \$1,000. He also supplies his own car. He drove 10,000 km total last year, of which 4,000 km were for business. He estimates he spent \$3,000 on gas, insurance, and repairs for his vehicle (and has receipts to support this).

Calculate Jimbo's Taxable Income:

\$30,000 Salary Income

(1,000) Association dues

(1,200) Vehicle costs ( $\$3,000 \times 4,000\text{km} / 10,000\text{km}$ )

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\$27,800 Total Taxable Income

# Salespersons Expenses

Must be:

- Required to pay their own expenses
- Ordinarily required to carry on duties away from employer's place of business
- Cannot be receiving a travel allowance unless it is included in income
- **Must receive some income as commissions**

# Salespersons Expenses

## Can Deduct:

- **Advertising & Promotion**
- Meals & Entertainment (50%) – 12 hours out of town
- Lodging
- Vehicle
- Parking
- Home Office – special tests
- Training Costs
- Licenses
- Insurance

Total limited to the amount of commissions received

# Home Office

Must be:

- Principle Place of Business (no other office); OR
- Regularly used solely for the purpose of meeting clients

What can be claimed:

- Employees – Maintenance, Hydro, Power
- Salesperson – Employee Expenses + Insurance and Property Tax
- Sole-Proprietor – Salesperson + CCA/Mortgage Interest

Based on percentage use of house (Sq footage)

Cannot be used to create or increase an employment loss

# Home Office

Sam is employed as a marketing salesperson. He earns a salary of \$60,000 and had commissions of \$3,000 in 2014.

He works from home since he doesn't have another office. His office is 200 sq ft, and his total house is 2,000 sq ft.

His costs are outlined on the right:

- \$500 Maintenance
- \$600 Insurance
- \$2,000 Power
- \$300 Internet (full house)
- \$6,000 Mortgage Interest
- \$8,000 Mortgage Principle
- \$2,500 Property Tax

# Home Office

- \$500 – yes for employees
  - \$600 yes since commissioned
  - \$2,000 – yes for employees
  - \$300 (yes –related to work)
  - \$0 – No Not self-employed
  - \$0 – Never, not a current expense
  - \$2,500 – Yes since commissioned
- 
- \$500 Maintenance
  - \$600 Insurance
  - \$2,000 Power
  - \$300 Internet (full house)
  - \$6,000 Mortgage Interest
  - \$8,000 Mortgage Principle
  - \$2,500 Property Tax

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\$5,900 x 200 / 2,000 sq ft

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\$590 Deduction (less than  
commission so ok)

# When in Doubt

## Home Office

Consider whether it is deductible...current or capital expense?

Consider whether it is related to the business and if so, by what %



# Topics Covered

- Key Terms & General Information
- Taxation of Fringe Benefits
- Deduction of Employment Expenses

# Extra Examples

# Example:

Steve C. works at an office and sometimes takes the office BMW to client meetings to impress clients, it also saves him money since the office pays all the costs. The office purchased the vehicle in 1990 for \$25,000 so it's pretty much a classic. Steve has been working with the company for years so he didn't feel guilty about taking sick leave from May 1 until Sept 1. Other than that time he could take the car whenever he wanted. He actually borrowed it to drive to Toronto to watch a Jays game in September. He estimates the trip was around 2,700 km, but that's the only time he's ever used it personally. He estimates he drove 10,000 km in total for the year.

# Example:

Steve C. works at an office and sometimes take the office BMW to client meetings to impress clients, it also saves him money since the office pays all the costs. The office purchased the vehicle in 1990 for \$25,000 so it's pretty much a classic. Steve has been working with the company for years so he didn't feel guilty about taking sick leave from May 1 until Sept 1. Other than that time he could take the car whenever he wanted. He actually borrowed it to drive to Toronto to watch a Jays game in September. He estimates the trip was around 2,700 km, but that's the only time he's ever used it personally. He estimates he drove 10,000km in total for the year.

## Standby Charge

- $2\% \times (\text{original cost of vehicle} \times \# \text{ of days available to employee}/30)$
- Easiest to think of as  $2\% \times \text{cost} \times \text{months}$

$2\% \times \$25,000 \times 8 \text{ months } (\text{All but May-August}) = \$4,000 \text{ Standby Charge before reduction}$

Reduction if used mostly for business:

- Multiple: personal km / (1,667 per month) by each formula (can't be used to increase the charge)
- Only available if less than 50% is for personal use

$\$4,000 \text{ standby charge before reduction} \times 2,700 \text{ personal km} / (1,667 \times 8 \text{ months of use}) = \$810 \text{ Reduced Standby Charge}$

**Standby Charge = \$810**

**Operating Benefit**

Personal use km x \$0.24 = 2,700 x \$0.26 = \$702

OR

50% of Standby Charge if used less than 50% for personal = \$810 Standby Charge x 50% = **\$405**

**Total Income**

Standby Charge + Operating Benefit

**\$810 + \$405 = \$1,215**



Retrieved September 16, 2014 from:  
<http://www.mlmgenerationplan.com/>

# Stock Option Example A

- Jan 1, 2009
  - Stock options on A Co (Public) issued to Mr. X, an arm's length employee. 100 options, Exercise price \$30, FMV \$50
- Jan 1, 2010
  - Mr. X exercises his options and purchases 100 shares of A Co at \$30. At that time the shares' FMV was \$40 on the open market.
- Jan 1, 2011
  - Mr. X sells his shares of A Co for \$50.
- What is Mr. X's income inclusion and when does it occur?

# Stock Option Example A

- Public – No deferral
- Exercise Price \$30 vs FMV \$50 = YES in the money
- 1) Exercises option when shares are worth \$40 - \$30 exercise price = \$10 income x 100 shares = \$1,000 Total Income in 2010 (no 50% reduction since was in the money)
- 2) Sells 100 shares for \$50 - \$40 FMV at time of exercise = \$10 income x 50% reduction = \$5 income x 100 shares = \$500 Total Income in 2011

# Stock Option Example B

- Jan 1, 2009
  - Stock options on A Co (Private) issued to Mr. X, an arm's length employee. Exercise price \$30, FMV \$25
- Jan 1, 2010
  - Mr. X exercises his options and purchases 100 shares of A Co at \$30. At that time the shares' FMV was \$40 on the open market.
- Jan 1, 2013
  - Mr. X sells his shares of A Co for \$50.
- What is Mr. X's income inclusion and when does it occur?

# Stock Option Example A

- Private – Can Defer Income + Extra 2 Year Rule
- Exercise Price \$30 vs FMV \$25 = NOT in the money
- 1) Exercises option when shares are worth \$40 - \$30 exercise price = \$10 income x 50% reduction since held for two years = \$5 income x 100 shares = \$500 Income in 2013
- 2) Sells 100 shares for \$50 - \$40 FMV at time of exercise = \$10 income x 50% reduction = \$5 income x 100 shares = \$500 Income in 2013