

Kurt Rosentreter Tax Planning Tips Q4 2018



Season's Greetings



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Retaining Employment Insurance (EI) Benefits: Starting Part-Time Work

As of August 12, 2018, the “Working While on Claim” program became a permanent part of the EI system. Prior to the program, an individual could earn a very low weekly amount, after which the EI benefit would be eroded on a dollar for dollar basis of earnings. Under the new rules, a person who earns income while receiving EI benefits can keep \$0.50 of their EI benefits for every dollar earned, up to 90% of their previous weekly earnings. Above this 90% cap, EI benefits are reduced dollar for dollar. An individual who works a full work week is ineligible to receive EI benefits.

Kurt’s Comments on Retaining Employment Insurance Benefits:

This may provide an attractive opportunity for employees on maternity or parental leave to return to work on a part-time basis.

Kurt’s Comments on Director’s Liability: Helping Out Family:

Be cautious when acting as a director or taking responsibility for loans when not directly involved in a corporation’s activities. Failing to take certain actions may result in personal liability for certain corporate tax debts.

This program is available for the following types of EI benefits: regular, sickness, parental, maternity, fishing, compassionate care, and family caregiver benefits for adults and children. Self-employed individuals opting into the EI system are also eligible for this program.

Director’s Liability: Helping Out Family

Being a director of a corporation comes with many responsibilities. Failing to exercise due diligence in ensuring source deductions (such as EI, CPP, and income tax) are properly withheld from wages and remitted to CRA may result in a director’s personal liability for the corporation’s outstanding amount. A June 12, 2018 Tax Court of Canada case examined whether an individual who set up a corporation (along with a bank account) for his brother to operate would be held liable for unremitted source deductions, penalties and interest totaling \$37,536. The individual testified that he was not personally involved in the operations and that he had participated in this manner because his brother had “zero credit”. The operation went out of business after approximately a year and a half with wages and source deductions outstanding.

Director's Liability: Helping Out Family - Continued

The taxpayer argued that he had exercised due diligence by requiring his brother to sign an agreement at the onset to “keep deductions current” and to “keep everything in good standing”. The taxpayer indicated that while he never asked to see the records, he did enquire from time to time “if things were going ok”.

Taxpayer loses

The Court determined that a reasonably prudent person would have done more to keep abreast of the corporation's financial affairs, especially given that his brother had either little financial knowledge or financial problems in the past. Entering into the initial agreement without follow-up indicated that the taxpayer did not act with due diligence. He was, therefore, held personally liable for the unremitted amounts and associated interest and penalties.

Tax on Split Income (TOSI): Can I Take a Salary Instead of a Dividend?

Dividends received by individuals from private corporations as of January 1, 2018 may be subject to taxation at top marginal tax rates (due to the new TOSI rules) if, in general, they are determined to be unreasonable. Salaries, however, are not specifically subject to these rules. As such, some may consider replacing potentially unreasonable dividends with large salaries or bonuses. This article considers some implications and risks when deciding to pay a salary instead of a dividend (or vice versa), in context of the new TOSI rules.

First, to be deductible against corporate income, salaries or bonuses must be reasonable. In the past, CRA has considered most salaries paid to heavily involved key owner-managers of active businesses reasonable regardless of size. However, it is uncertain whether CRA would continue to provide such tolerance, and what level of ownership or involvement in the business would be required. While unreasonable salaries may result in loss of deductibility, it is also possible (although not common) that CRA may take the position that they are shareholder benefits. Such reclassification could once again make the receipts subject to TOSI in the same way that dividends are. This result would generally put the shareholder in a worse position than if they had simply received dividends subject to TOSI.



Kurt's Comments

The facts of each situation must be considered to determine whether an exception from TOSI is available, and whether remuneration in the form of dividend, salary or both is most appropriate. Consider reviewing remuneration structures with your professional advisors.

Tax on Split Income (TOSI): (Continued)

As such, it is key to determine whether the dividend or salary is reasonable. Generally, if one's labour contributions are sufficient to indicate that the salary is reasonable, it would also mean that a dividend paid instead would be reasonable (since labour is one of the factors to consider when determining dividend reasonability). However, reasonability in respect of a salary only considers labour in the period for which the salary is paid. For dividends, reasonability is considered in context of the recipient's entire historical involvement. For example, consider a shareholder that contributes \$50,000 in effort each year and receives \$50,000 salary, however, last year he received a \$200,000 dividend as well. A \$50,000 salary in the current year would be reasonable, however, a \$50,000 dividend may not be since the individual had already received total compensation far in excess of contributions. Individuals that have received large amounts in previous years may be more inclined to receive salaries.

In addition, one may also prefer to receive salaries in order to avoid the uncertainties and complication related to larger and more complex dividend reasonability calculations. On the other hand, credit for risk borne, capital provided and other contributions can increase the quantum that may be paid as a reasonable dividend, but would not increase the amount that would be a reasonable salary.

Beyond TOSI, there are a number of other considerations to weigh. Some of them include:

- Salaries require T4 filings and payroll remittances such as CPP.
- Salaries generate RRSP contribution room.
- Salaries could trigger a health payroll tax for the employer (Manitoba, Newfoundland and Labrador, Ontario, Quebec, and starting in 2019, British Columbia) or employee (Northwest Territories and Nunavut).



Tax on Split Income (TOSI): (Continued)

- When evaluating how much credit will be offered to an individual, financial institutions may give greater weight to salaries.
- Payment of a dividend may expose the individual recipient to corporate tax liabilities.
- The overall tax burden differs slightly between salaries and dividends. This difference changes annually. It is primarily a function of provincial jurisdiction, changes to tax rates and credits, and variances in income level.

In summary, various factors should be balanced when determining whether a dividend, salary, or combination of the two should be paid. Also note that dividends may receive special protection from the TOSI rules depending on a number of factors such as age, levels/types of corporate contributions, whether shares were inherited, and the type of relationship that one has with key participants in the corporation.

Contractor vs. Employee: Agreement on Contractor Status is Not Enough

In a May 8, 2018 Tax Court of Canada case, the Court reviewed whether the taxpayer was earning insurable and pensionable amounts related to her work at a health care clinic for 2015 and part of 2016 up to her termination. Classification as an employee would subject the business to various CPP, EI, and other withholdings for past and future years. Such classification could also subject the payer to other significant non-withholding liabilities such as employment benefits, wrongful dismissal, vacation pay, and sick pay.

The taxpayer's work commenced at the clinic in 2008, at which point both the taxpayer and the clinic agreed that the taxpayer was an independent contractor. She originally provided clerical services and over time took on additional duties which included acting as a chiropractic and physiotherapist assistant and a Pilates instructor. In 2016 the taxpayer realized she should have been collecting and remitting GST/HST on services performed for the clinic. The taxpayer filed a voluntary disclosure related to this GST/HST matter. At this point the taxpayer and clinic decided that the taxpayer and similar workers should become employees.

Contractor vs. Employee: (Continued)

Taxpayer determined to be an employee

The Court stated that while it appeared that the taxpayer believed she was an independent contractor (evidenced, as an example, by her efforts regarding GST/HST collection), the objective reality must be examined. The Court looked to the following factors to find that the individual was an employee:

- **Control** – With the exception of the Pilates sessions, the services were supervised either directly by the payer or by a referring health professional, as required by the legislation governing the services she provided. The taxpayer had no discretion as to how those services were to be offered and followed the exercise routine established by the health professional. The taxpayer was in a subordinate position. While the taxpayer had some autonomy (she was not required to be at the clinic if no appointment was booked), there were other restrictions on her. She was required to operate under the clinic brand and was not allowed to operate out of her home studio when seeing clinic patients. While there was a relaxed work culture at the clinic, the ultimate authority rested with the owner of the clinic. This indicated an employment relationship.
- **Ownership of Tools** – The clinic owned the equipment used by the worker in addition to bearing the costs associated with the equipment, consistent with employment status.
- **Chance of Profit and Risk of Loss** – The worker was paid an hourly rate for clerical work and a percentage of client billings for work as an assistant and Pilates instructor. Apart from the hourly rate, the Court found that the earnings were primarily a result of the success of the clinic, the flow of patients, and referrals received. Likewise, the risks borne by the taxpayer were no different than an ordinary employee whose future is tied to the success or failure of the business. While the taxpayer did pay for additional training, it was not necessarily indicative of a contractor relationship as ambitious employees may take similar steps to advance their career. The clinic was responsible for mishaps or liability issues – the taxpayer was not required to maintain any type of insurance coverage. Finally, the taxpayer was not expected to actively seek out clients as they were provided in a regular and predictable fashion through referrals by the clinic. The fact that the taxpayer could seek out clients to see at her home studio was not highly relevant. This weighed in favour of employment.

- Integration of Work into Payer’s Business – While the taxpayer had a wide latitude with respect to her Pilates sessions, the Court found that this was ancillary to the health services provided by the clinic, which was fully integrated with the clinic. The Court stated that she could not have gone out and “hung out her own shingle.” The owner of the clinic conceded that to the outside world the taxpayer would have been perceived to be an employee as, for example, the taxpayer was referred to as “staff” and attended office functions and parties. This indicated employment status.

It appeared that the taxpayer was led to believe that she could be an independent contractor if she agreed and chose to do so. However, the Court found that the express intention of the parties as to the nature of their relationship was fundamentally flawed from the beginning and should be disregarded.

The Court determined that the taxpayer was an employee, earning insurable and pensionable amounts for the years in question

Kurt’s Comments

Even though there is a clear understanding between the worker and the payor/business that services will be performed as an independent contractor, the reality and conditions of the working relationship must be examined to determine if it truly is an independent contractor relationship. Consider reviewing terms of worker engagement with a professional.

How Kurt and Team Can Help You with Taxes

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