

CHAPTER 3



Income Or Loss From An Office Or Employment

Employment Income Defined

General Rules

3-1. Income or loss from an office or employment (employment income, hereafter) is covered in Part I, Division B, Subdivision a of the *Income Tax Act*. This relatively short Subdivision is made up of Sections 5 through 8, the general contents of which can be described as follows:

Section 5 contains a definition of employment income.

Section 6 provides detailed information on what amounts must be included in the determination of employment income.

Section 7 is a more specialized Section that provides the tax rules associated with stock options granted to employees.

Section 8 provides detailed information on what amounts can be deducted in the determination of employment income.

3-2. The basic description of employment income is as follows:

ITA 5(1) Subject to this Part, a taxpayer's income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year.

3-3. While ITA 5(2) contemplates the possibility of a loss from an office or employment, the limited amount of deductions that can be made against employment income inclusions would make such an event very unusual.

3-4. "Employment" is generally defined in ITA 248(1) as the position of an individual in the service of some other person. Similarly, "office" is defined as the position of an individual entitling him to a fixed or ascertainable stipend or remuneration. As will be discussed later, determining whether an individual is, or is not, an employee can be a contentious issue.

3-5. As to what is included in employment income, the terms "salary" and "wages" generally refer to monetary amounts provided in return for employment services. However, the term "remuneration" is somewhat broader and includes any type of reward or benefit

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associated with employment services. With the specific inclusion of gratuities, it is clear that employment income includes not only payments from an employer but, in addition, includes any other payments or benefits that result from a taxpayer's position as an employee, without regard to the source of the payment or benefit.

3-6. While it would not be common, it is possible that an individual could receive a payment from an employer that is not related to the quantity or quality of services performed as an employee. For example, if the employee made a personal loan to the employer, any interest paid by the employer to the employee on the loan would not be considered employment income.

Cash Basis And The Use Of Bonus Arrangements

Amounts Received

3-7. As presented in Paragraph 3-2, the definition of an employee's income states that it is made up of amounts "received by the taxpayer in the year". The use of the term "received" serves to establish that employment income must be reported on a cash basis, not on an accrual basis.

Tax Planning Opportunity

3-8. This fact, when combined with the fact that business income for tax purposes is calculated on an accrual basis (see Chapter 6), provides a tax planning opportunity. A business can declare a bonus to one of its employees and, because it is on an accrual basis, deduct it for tax purposes by simply recognizing a firm obligation to pay the amount. In contrast, the employee who has earned the bonus will not have to include it in employment income until it is actually received.

Example A business with a December 31 year end declares a bonus to an employee in December, 2015, but stipulates that it will not be paid until January, 2016.

Analysis While the business would get the deduction in 2015, the employee would not include the amount in income until the 2016 taxation year. If the bonus had been paid in December, 2015, the employee would have had to include it in income in 2015. In effect, this arrangement defers the taxation applicable to the employee by one taxation year even though the payment has been deferred by only a few days.

Limits On Deferral

3-9. There are, however, limits to this deferral. ITA 78(4) indicates that, where such a bonus is paid more than 180 days after the employer's year end (note that this is not always December 31), but less than three years, the employer will not be able to deduct the amount until it is paid.

Example An employer with a June 30 year end declares a bonus for an employee on June 30, 2015 that is payable on January 1, 2016.

Analysis As January 1, 2016 is more than 180 days after the employer's year end, the employer will not be able to deduct the bonus in the fiscal year ending June 30, 2015. It will have to be deducted in the fiscal year ending June 30, 2016.

3-10. A different situation can arise when a "bonus" will not be paid until more than three years after the end of the calendar year in which the employee's services were rendered. In this case, the "bonus" may become a "salary deferral arrangement", resulting in the employee being taxed on the relevant amounts in the calendar year in which the services were rendered. The employer deducts the bonus in the fiscal year it is declared. This type of arrangement is discussed in more detail in Chapter 10, Retirement Savings And Other Special Income Arrangements.

3-11. The tax consequences associated with the three types of bonus arrangements are summarized in the following Figure 3-1:

Figure 3 - 1 Bonus Arrangements

Type Of Bonus Arrangement	Tax Consequences
Standard Bonus (Paid within 180 days of business year end.)	Employer deducts when declared. Employee includes when received.
Other Bonus (Paid more than 180 days after the employer's year end, but prior to 3 years after the end of the year in which the bonus was earned.)	Employer deducts when paid. Employee includes when received.
Salary Deferral Arrangement (Paid more than 3 years after the end of the year in which services were rendered.)	Employer deducts when declared. Employee includes when services rendered. (See Chapter 10)

Exercise Three - 1

Subject: Bonus

Neelson Inc. has a September 30 year end. On August 1, 2015, it declares a bonus of \$100,000 payable to Mr. Sam Neelson, an executive of the Company. The bonus is payable on May 1, 2016. Describe the tax consequences of this bonus to both Neelson Inc. and Mr. Neelson.

Solution available in paper and eText Study Guide.

We suggest you work Self Study Problem Three-1 at this point.

Net Concept

3-12. Employment income is a net income concept. That is, it is made up of both inclusions (e.g., salaries and wages) and deductions (e.g., registered pension plan contributions and union dues). In conjunction with this, we would point out that the deductions that are described in ITA 8 can only be deducted against employment income inclusions. Given the limited deductions available in the determination of employment income, it would be very rare for these deductions to exceed the inclusions.

3-13. If an employment loss were to occur, the excess ITA 8 deductions could not be applied against any other source of income. However, if other sources of income are available, the same result can be accomplished by deducting the net employment loss under ITA 3(d) as per the calculation of Net Income For Tax Purposes that is described in Chapter 1.

Example An individual has employment income of \$3,000 and employment expenses of \$4,500 (as indicated this is unlikely to occur in the real world).

Analysis This would result in an employment loss of \$1,500 (\$4,500 - \$3,000). Provided the individual has at least a \$1,500 balance after ITA 3(c) (see Chapter 1), this amount can be deducted in the determination of Net Income For Tax Purposes.

Employee Versus Self-Employed**Introduction**

3-14. An individual doing work for an organization will be undertaking this activity in one of two possible roles. He may be working as an employee. If this is the case, he is earning employment income and is subject to the rules discussed in this Chapter.

3-15. In contrast, he may be working as a self-employed individual, often referred to as an independent contractor. From the point of view of the organization using the individual's services, such arrangements are often referred to as contracting out. The payments made to

Employee Versus Self-Employed

such self-employed individuals are classified as business income and are subject to the rules that are covered in Chapter 6, Business Income.

3-16. This distinction is of considerable importance, both to the individual worker and to the organization using his services. Given this importance, the following material describes the tax features of these alternatives, both from the point of view of the worker and from the point of view of the organization using his services.

3-17. In terms of tax planning, structuring a working relationship to achieve the desired classification of the individual doing the work may result in tax avoidance for both parties. For the worker, being classified as a self-employed individual will generally result in larger deductions against income, thereby reducing Tax Payable. From the point of view of the organization using the individual's services, the independent contractor classification can reduce the costs of using those services.

Employee Perspective***Deductions Available***

3-18. As will be discussed later in this Chapter, an individual's ability to deduct expenses from employment income is quite limited when compared to self-employed individuals. If an individual is self-employed, any income that he earns is classified as business income, making it eligible for the wider range of deductions that is available under the business income provisions of the *Income Tax Act*. For example, a self-employed professional can deduct the costs of driving to work. If this individual were classified as an employee, this deduction would not be available.

CPP Contributions

3-19. If an individual is an employee, his employer will be required to withhold a portion of his pay for Canada Pension Plan (CPP) contributions and Employment Insurance (EI) premiums. With respect to CPP contributions, for 2015 both the employee and the employer are required to contribute 4.95 percent of up to \$53,600 of gross wages reduced by a basic exemption of \$3,500. This results in maximum contributions by both the employee and employer of \$2,480, or a total of \$4,960.

3-20. In contrast, if an individual is self-employed, there will be no withholding of CPP from the amounts received as business income. However, this does not mean that this individual can escape these costs. A self-employed individual must make contributions on the same basis as an employee. Further, self-employed individuals are required to pay both an employee share and an employer share, resulting in a potential maximum payment of \$4,960.

3-21. As noted in Chapter 2, CPP amounts for the self-employed are collected by the CRA. They are calculated on the T1 tax return where they become part of the amount owing. Further, the CRA includes them in the instalment base when instalments are required which means that they may be a factor in determining the size of quarterly instalments. This could be viewed as a modest advantage of being self-employed as there is some deferral of the required CPP payments, as compared to their payment through payroll deductions.

3-22. However, any benefit resulting from deferral of the CPP payments is clearly offset by the fact that the self-employed individual has to pay both the employee and the employer share. There is clearly an overall disadvantage to the self-employed individual.

EI Premiums

3-23. With respect to EI premiums, the amount that will be withheld from employee earnings amounts to 1.88 percent of the first \$49,500 in gross wages, with a maximum annual value of \$931. The employer is assessed 1.4 times this amount, a maximum of \$1,303. This represents an effective rate for the employer of 2.63 percent.

3-24. Employees are generally required to participate in the EI program, One exception is for employees owning more than 40 percent of the shares of the employer. In that case, since no EI can be collected, no EI premiums are paid. The EI rules are complex which can make the

determination of insurable employment difficult, especially in the case of an owner-manager employing family members. A non-arm's length employee (such as an adult child or a spouse) would only be eligible for participation in the EI program if it is reasonable to conclude that the owner would have hired a non-related person under a similar contract of employment.

3-25. Self-employed individuals can opt into the EI program on a voluntary basis for special (restricted) EI benefits, such as maternity benefits. They must opt in at least 12 months prior to making a claim, but once they opt in, they are committed for the taxation year. Further, if a claim is made under this program, the individual is committed for life, or until they stop being self-employed. The good news is that self-employed individuals do not have to pay the employer's share of EI premiums. This means the maximum cost for 2015 would be \$931.

3-26. As is the case with CPP payments for self-employed individuals, EI premiums for self-employed individuals are collected by the CRA. This means that payments are paid through instalments or on the balance due date for the return, thereby providing a small amount of deferral. More importantly, with participation voluntary, a self-employed individual can choose whether or not to participate in this program. In addition, since the self-employed individual does not pay the employer's share of the EI (unlike the situation with the CPP), the EI rules appear to be advantageous to the self-employed individual.

Fringe Benefits

3-27. A significant disadvantage of being classified as an independent contractor rather than an employee is the fact that independent contractors do not receive fringe benefits. An employee may receive a wide variety of benefits such as dental and drug plans, membership in a registered pension plan, vacation pay, or life insurance coverage. Such benefits have a significant value, in some cases adding as much as 20 percent to an employee's remuneration. Further, even if the self-employed individual were willing to pay for such benefits, some benefits may not be available to a single individual at a reasonable cost (e.g., extended medical coverage). In any case, a self-employed individual will have to receive significantly higher basic remuneration to be in the same economic position as an individual working as an employee who has generous benefits.

Opportunity For Tax Evasion

3-28. While we certainly do not condone this, as a practical matter, being self-employed can offer significantly larger opportunities for tax evasion. When employment income is received from a business, there are stringent reporting requirements that make it difficult for an employee to avoid detection if he fails to report employment income.

3-29. In contrast, self-employment income is sometimes received partially or wholly in cash, depending on the clients. Usually when cash is received, the work is being done for an individual who cannot deduct the cost of the work and does not require a receipt to be issued. A common example of this would be the owner of a residence who hires a self-employed contractor to do renovations.

3-30. If the self-employed individual is willing to evade taxes by not reporting these revenues, then the lack of withholding on self-employment earnings becomes a permanent reduction in taxes. Although it is a clearly illegal form of behavior, for some individuals, not reporting earnings received in cash is one of the main motivations behind being self-employed.

Conclusion

3-31. As the preceding indicates, the desirability of self-employed status is not clear cut. For an individual with limited deductible expenses, self-employment may not be advantageous from an economic point of view. Alternatively, if an individual's work is such that large amounts of business expenses are generated, it is probably desirable to be taxed as a self-employed contractor.

3-32. Non-tax advantages could include the ability to set work schedules and the freedom to choose the amount and type of work accepted. The added cost of accounting for the

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business and the implications of the GST/HST would also have to be considered. As noted in Chapter 21, in most cases, a self-employed individual would have to register for the GST/HST if he is not a small supplier.

Employer Perspective

3-33. There are several advantages to a business from using the services of self-employed individuals as opposed to employees. One of the major advantages associated with the hiring of these independent contractors (a.k.a. contracting out) is that the employer avoids payments for Canada Pension Plan (CPP), Employment Insurance (EI), Workers' Compensation, and Provincial Health Care (where applicable).

3-34. The amounts involved here are consequential. CPP and EI payments alone can add more than 7 percent to the wage costs. Provincial payroll taxes can push the total of these costs above 10 percent of wage costs. Further cost savings result from the fact that the employer will avoid the administrative costs associated with having to withhold and remit income taxes and the employee's share of CPP and EI payments.

3-35. Also in favour of using independent contractors is the fact that the business will avoid the costs of any fringe benefits that it normally extends to its employees. A less measurable benefit is that employers are freed from ongoing commitments to individuals because there is generally no long-term contract with self-employed workers.

3-36. An additional and less direct advantage of using independent contractors is that the business is not legally responsible for their work. If an employee does work that results in some type of legal liability for damages, it is the employer that will be responsible for any costs that arise. In contrast, if such work is carried out by an independent contractor, the organization may escape any legal responsibility.

3-37. Given all of these advantages, it is not surprising to find more businesses contracting out in order to control labour costs and limit liability.

Making The Distinction

Intent

3-38. The general approach to distinguishing between an employee and an independent contractor is the question of whether an employer/employee relationship exists. As there is no clear definition of employer/employee relationships, disputes between taxpayers and the CRA are very common. To avoid such disputes, and to assist taxpayers in determining whether or not an individual is an employee, the CRA provides a Guide titled "Employee Or Self-Employed?" (RC4110).

3-39. As described in this Guide, the first step in making this distinction is to determine the intent of both parties. Both the worker and the payer must be clear as to whether there is a contract of service (employee/employer) or alternatively, a contract for services (business relationship). This intent may or may not be in the form of a written agreement.

Other Factors - Employee Vs. Self-Employed

3-40. In many cases, the intent is clear. However, the worker and payer must ensure that their intent is reflected in the actual terms and conditions of their relationship. In making this determination, the Guide indicates that the following factors will be considered by the CRA:

Control In an employer/employee relationship, the employer usually controls, directly or indirectly, the way the work is done and the work methods used. The employer assigns specific tasks that define the real framework within which the work is to be done.

Ownership Of Tools And Equipment In an employer/employee relationship, the employer usually supplies the equipment and tools required by the employee. In addition, the employer covers the following costs related to their use: repairs, insurance, transport, rental, and operations (e.g., fuel).

In some trades, however, it is customary for employees to supply their own tools. This is generally the case for garage mechanics, painters, and carpenters. Similarly, employed computer scientists, architects, and surveyors sometimes supply their own software and instruments.

Ability To Subcontract Or Hire Assistants If the individual must personally perform the services, he is likely to be considered an employee. Alternatively, if the individual can hire assistants, with the payer having no control over the identity of the assistants, the individual is likely to be considered self-employed.

Financial Risk In general, employees will not have any financial risks associated with their work. In contrast, self-employed individuals can have risk and can incur losses. Responsibility for fixed monthly costs is a good indicator that an individual is self-employed.

Responsibility For Investment And Management If the individual has no capital investment in the business and no presence in management, he is likely to be considered an employee. Alternatively, if the individual has made an investment and is active in managing the business, he should be considered self-employed.

Opportunity For Profit In an employer/employee relationship, the employer alone normally assumes the risk of loss. The employer also usually covers operating costs, which may include office expenses, employee wages and benefits, insurance premiums, and delivery and shipping costs. The employee does not assume any financial risk, and is entitled to his full salary or wages regardless of the financial health of the business.

Correspondingly, an employee will have little or no opportunity for profit. While there may be productivity bonuses for exceptional work, such amounts are not generally viewed as profit.

3-41. The CRA Guide includes a long list of indicators for each of the preceding factors that could affect whether an individual was considered an employee or self-employed. This Guide can be quite helpful if more detailed information in this area is required.

3-42. We would point out that it is extremely important for a business to be sure that any individual who is being treated as a self-employed contractor qualifies for that status. Actions that can be taken to ensure self-employed status for the individual include:

- Having the individual register for the GST.
- Having the individual work for other businesses.
- Having the individual advertise his services.
- To the extent possible, having the individual cover his own overhead, including phone service, letterhead, equipment, and supplies.
- Having the individual prepare periodic invoices, preferably on an irregular basis.
- Having a lawyer prepare an independent contractor agreement.
- If feasible, having the individual incorporate.

Request A CPP/EI Ruling

3-43. A failure to correctly determine whether a worker should be considered an employee or, alternatively, self-employed, could prove to be very costly to a business using the services of that individual. It is possible that, if the CRA judges the individual to be an employee, the business could be held liable for CPP and EI amounts that should have been withheld from the individual's earnings, as well as the employer's share of these amounts.

3-44. As evidenced by the large number of court cases involving this issue, it is clear that wrong classifications are not uncommon. A fairly reliable way of avoiding this problem is to request a CPP/EI ruling from the CRA. Such a ruling can be requested either by the business or the worker by sending a letter, or completing Form CPT1, *Request for a Ruling as to the Status of a Worker Under the Canada Pension Plan and/or the Employment Insurance Act*.

We suggest you work Self Study Problem Three-2 at this point.

Inclusions - Salaries And Wages

3-45. We have noted that ITA 5 specifies that employment income includes salaries, wages, and other remuneration. When only salaries or wages are involved, there is little need to elaborate on employment income inclusions. Such amounts clearly must be included in the determination of employment income. However, for a variety of reasons, employers make use of many benefits other than salaries or wages. These alternative forms of compensation are commonly referred to as fringe benefits and they create additional complexity in the determination of employment income for income tax purposes.

Inclusions - Fringe Benefits

Amounts To Be Included In Income - ITA 6(1)

3-46. ITA 6 contains several Subsections dealing with inclusions in employment income. The first of these, ITA 6(1), contains a number of Paragraphs that either list specific items to be included in employment income (e.g., standby charge for automobiles), or describe a type of item that must be incorporated into this determination (e.g., personal or living expenses).

3-47. The first of these Paragraphs, ITA 6(1)(a), contains a general provision which states that all benefits received or enjoyed by an individual by virtue of an office or employment must be included in income. However, this same Paragraph also notes a number of important items that can be excluded. The items that can be excluded include:

- an employer's contributions to:
 - registered pension plans;
 - group sickness or accident insurance plans, provided that any benefits received under the plan will be taxed under ITA 6(1)(f);
 - private health services plans;
 - supplementary unemployment benefit plans;
 - deferred profit sharing plans;
 - employee life and health trusts.
- counseling services related to the mental or physical health of the employee or a related party, or related to re-employment or retirement of the employee.
- benefits under a retirement compensation arrangement, employee benefit plans (e.g. death benefit plans), and employee trusts. However actual payments or allocations from such plans or arrangements are taxable elsewhere.
- benefits resulting from reduced tuition provided to the children of teachers at private schools, provided the teacher is dealing at arm's length with the school and the reduction is not a substitute for salary or other remuneration from the school.

Note If you were to read ITA 6(1)(a), you would find that the listed exclusions include both group term life insurance, as well as benefits related to automobiles. This sounds like these items are not taxable benefits. However, this is not the case. In a somewhat awkward approach to this issue, these benefits are excluded under ITA 6(1)(a), but included under other provisions. Automobile benefits are included under ITA 6(1)(e) and (k) as listed in the following paragraph, and group term life insurance premiums are included under ITA 6(4).

3-48. Other Paragraphs under ITA 6(1) provide additional guidance in the form of specific items that must be included in employment income. These are:

- ITA 6(1)(b) amounts received as an allowance for personal or living expenses or as an allowance for any other purpose;
- ITA 6(1)(c) director's or other fees;
- ITA 6(1)(d) allocations under profit sharing plans;
- ITA 6(1)(e) standby charge for automobiles;
- ITA 6(1)(f) wage loss replacement plans, provided they are received on a periodic basis and are intended to replace employment income;
- ITA 6(1)(g) employee benefit plan benefits;
- ITA 6(1)(h) allocations under employee trusts;
- ITA 6(1)(i) salary deferral arrangement payments (to the extent they have not previously been included in income);
- ITA 6(1)(j) reimbursements and awards; and
- ITA 6(1)(k) automobile operating expense benefit.

CRA Administrative Practice On Fringe Benefits (IT-470R)

Inclusions Under IT-470R

3-49. At a less formal level, an important Interpretation Bulletin provides guidance with respect to fringe benefits. This Bulletin, IT-470R (Consolidated), indicates that the following benefits should be considered as part of employment income:

- board and lodging that is provided free or at an unreasonably low rate
- rent free and low rent housing
- travel benefits
- personal use of an automobile furnished by an employer
- gifts (see Paragraph 3-50)
- holiday trips, other prizes and incentive awards
- points used for personal travel that were earned in frequent flyer programs while traveling on employer paid business trips (see Paragraph 3-54 for exceptions)
- travel expenses of the employee's spouse if there is no business reason for the travel
- premiums that are allocated to specific employees under provincial hospitalization and medical care insurance plans, and certain Government of Canada plans
- employer paid educational costs (see paragraph 3-57)
- employer reimbursement for the cost of tools required to perform work
- wage loss replacement plans
- amounts related to interest free or low interest loans
- financial counseling and income tax return preparation

Gifts

3-50. Employers commonly provide both gifts and awards to their employees. These items are clearly benefits to the recipient employees and, in the absence of some type of special provision, would be taxable. This view is reflected in the list of taxable items that is found in IT-470R.

3-51. Despite the clarity of the legislation applicable to this situation, the CRA has, for many years, attempted to provide some room for providing a limited amount of such benefits on a tax free basis. The current policy was issued in Income Tax Technical News No. 40 (June, 2009). The discussion which follows is based entirely on the content of this publication.

3-52. As found in Technical News No. 40, the current policy is as follows:

- Non-cash gifts and non-cash awards to an arm's length employee, regardless of number, will not be taxable to the extent that the total aggregate value of all non-cash gifts and awards to that employee is less than \$500 annually. The total value in excess of \$500 annually will be taxable.
- In addition to the preceding, a separate non-cash long service/anniversary award may also qualify for non-taxable status to the extent its total value is \$500 or less. The value in excess of \$500 will be taxable. In order to qualify, the anniversary award cannot be

for less than five years of service or for five years since the last long service award had been provided to the employee. For the purposes of applying the \$500 thresholds, the annual gifts and awards threshold and the long service/anniversary awards threshold are separate. In other words, a shortfall in value under one policy cannot be used to offset an excess value of the other.

- The employer gift and award policy will not apply to non-arm's length employees (e.g., relative of proprietor, shareholders of closely held corporations) or related persons of the non-arm's length employee.
- For clarification purposes, items of an immaterial or nominal value, such as coffee, tea, T-shirts with employer logos, mugs, plaques, trophies, etc., will not be considered a taxable benefit to employees. There is no defined monetary threshold that determines an immaterial amount. Factors that may be taken into account include the value, frequency, and administrative practicability of accounting for nominal benefits.

3-53. Three additional examples are given of rewards and reimbursements that do not qualify for treatment as gifts and that will be taxable to the recipient under these rules:

- Performance related rewards (e.g., rewards for being the month's top salesperson).
- Cash and near cash rewards (e.g., gift certificates that can be redeemed for a wide selection of items).
- Employer reimbursement for items purchased by an employee. The amount of the reimbursement will be taxable to the recipient. (The item may be deductible.)

Exercise Three - 2

Subject: Gifts To Employees

During the current year, Jeffrey's employer provides him with a number of gifts and awards. Describe the tax consequences for Jeffrey that result from each of the following gifts and awards.

Gift	Fair Market Value
T-shirt with employer logo	\$ 15
Birthday gift (gift certificate at The Bay)	75
Reward for exceeding sales targets	400
10 year anniversary award (Seiko watch)	275
Wedding gift (crystal vase)	300
Weight loss award (tickets to sporting event)	250
Holiday season gift (gourmet food basket)	150

Solution available in paper and eText Study Guide.

Loyalty Programs (Frequent Flyer Points)

3-54. It is not uncommon for employees to earn points in loyalty programs as a result of expenditures made when involved in employment related activities. Perhaps the most important of these situations involves individuals who earn points in airline or other loyalty programs as the result of business travel.

Example Ms. Gerri Donat flies 250,000 miles on Air Canada during the current year. All of this travel was related to her employment. The \$150,000 cost of the airline tickets was charged to her credit card. However, her employer reimbursed all of these costs. As a result of her travel and the fact that her credit card also provided Aeroplan miles, Ms. Donat has 650,000 Aeroplan miles.

3-55. You will recall that IT-470R required that employees include the value of point travel

in their Net Income For Tax Purposes. However, this policy created significant difficulties for employees and employers (e.g., what is the fair market value of the tickets). Given this, the CRA changed its administrative practice in this area several years ago. As noted in Income Tax Technical News No. 40 (June, 2009), the CRA does not require that the cost of personal benefits related to points earned through employment activity be included in income provided:

- the points are not converted to cash;
- the plan is not an alternative form of remuneration; and
- the plan is not for tax avoidance purposes.

3-56. Two other considerations are noted:

- If the employer controls the points (e.g., they are earned using a company credit card, with the points accruing to the employee), use of the points will create a taxable benefit.
- If the employee is allowed to use a personal credit card to pay the expenses of other employees or other general business costs in order to maximize point accumulation, and is reimbursed for these costs, use of the points will create a taxable benefit.

Tuition Fees

3-57. The basic idea here is that employer-paid educational costs are not a taxable benefit if the learning experience is primarily for the benefit of the employer. If the costs are primarily for the benefit of the employee, it will be considered a taxable benefit. To assist in making this distinction, IT-470R describes three different situations:

- **Specific Employer-Related Training** Courses that are taken for maintenance or upgrading of employer-related skills will generally be considered to primarily benefit the employer and therefore be non-taxable. An example of this would be an employer who provides bookkeeping services paying the tuition fees for an employee to take an accounting course.
- **General Employment-Related Training** Other business-related courses, even if not directly related to the employer's business, will generally be considered non-taxable. Examples of non-taxable general training would include stress management, employment equity, first-aid, and language skills.
- **Personal Interest Training** Employer-paid courses for personal interest or technical skills that are not related to the employer's business are considered of primary benefit to the employee and thus taxable. For example, fees paid for a self-interest music course would result in a taxable benefit.

3-58. Note that the employer will be able to deduct these costs, without regard to whether they create a taxable benefit for the employee. The Bulletin also indicates that the relevant costs could include meals, travel, and accommodation as required by the educational program, again without regard to whether the employee is receiving a taxable benefit. If the tuition fees create a taxable benefit, the employee will be able to claim any related tuition fee tax credit (see Chapter 4).

Non-Taxable Benefits Under IT-470R

3-59. Also found in IT-470R is a list of non-taxable benefits that are not included in employment income. These include:

- discounts on merchandise, other than big ticket items such as homes or appliances, and the waiving of commissions on sales of merchandise or insurance for the personal use of the employee
- subsidized meals provided in employer facilities
- uniforms and special clothing
- subsidized school services in remote areas
- transportation to the job in employer vehicles in specific circumstances
- use of employer in-house recreational facilities or fitness facilities, or membership fees to another organization providing such facilities, as long as the facilities or

- membership is available to all employees,
- membership fees in social or athletic clubs, provided it is an advantage to the employer for the employee to belong to such organizations,
- reimbursement of certain moving expenses (See Chapter 9 for a detailed discussion of moving costs.)
- premiums under private health services plans [as noted in Paragraph 3-47, this is specifically excluded from employment income under ITA 6(1)(a)]
- employer's required contributions under certain provincial hospitalization and medical care insurance plans where remittances are based on some percentage of total payroll
- transportation passes for employees of bus or rail companies, and certain passes for employees of airline companies
- the costs of providing counseling services related to the mental or physical health of the employee, his re-employment, or his retirement [this item is also explicitly excluded from employment income under ITA 6(1)(a)]
- the cost of an employee's professional membership fees where the professional association is related to an employee's duties and membership is a requirement of employment

Other ITA 6 Inclusions

3-60. ITA 6(1) is the most broadly based Subsection in ITA 6. There are, however, a number of other Subsections that deal with specific items. These Subsections and where their coverage begins are as follows:

- ITA 6(2) and (2.1) **“Reasonable Standby Charges”** - Paragraph 3-87.
- ITA 6(3) and (3.1) **“Payments By Employer To Employee”**, which requires the inclusion of amounts paid either immediately before employment begins, or subsequent to the period of employment - Paragraph 3-183.
- ITA 6(4) **“Group Term Life Insurance”** - Paragraph 3-143.
- ITA 6(6) **“Employment At Special Work Site Or Remote Location”** - Paragraph 3-76.
- ITA 6(7) **“Cost Of Property Or Service”**, which requires the addition of applicable GST/HST/PST to the amount of some taxable benefits - Paragraph 3-74.
- ITA 6(9) **“Amount In Respect Of Interest On Employee Debt”** - Paragraph 3-152.
- ITA 6(11) **“Salary Deferral Arrangements”** - Paragraph 3-10 and in Chapter 10, Retirement Savings And Other Special Income Arrangements.
- ITA 6(15) and (15.1) **“Forgiveness Of Employee Debt And Forgiven Amount”**, which require that employee debt forgiven by an employer must be included in employment income - Paragraph 3-184.
- ITA 6(19) through (22) **“Housing Loss And Eligible Housing Loss”** limit the amount that can be reimbursed on a tax free basis to an employee who has suffered a housing loss as the result of a required move. These Subsections are covered in this Chapter beginning in Paragraph 3-185, as well as in Chapter 9 as part of our discussion of moving expenses.

Exercise Three - 3

Subject: Employee Benefits

John Nilson is an employee of a high end furniture store. During the current year, John receives a number of benefits from his employer. Describe the tax consequences for John that result from receiving each of the following benefits.

- A 35 percent discount on merchandise with a total value of \$10,000.
- Reimbursement of \$2,000 in tuition fees for a course in creative writing.
- Business clothing with a value of \$8,500 to be worn during working hours. (John's employer felt he needed a better image in dealing with clients.)
- A set of china on the occasion of John's wedding anniversary costing \$450, including taxes.
- A private health care plan for John and his family. The employer pays an annual premium of \$780 for this plan.

Solution available in paper and eText Study Guide.

Tax Planning Considerations

Salary The Benchmark

3-61. As previously discussed, some of the benefits provided to employees are fully taxable while other benefits can be extended without creating a taxable benefit. This has important implications in planning employee compensation.

3-62. As the bulk of compensation for most employees is in the form of wages or salaries, such payments provide the benchmark against which other types of compensation must be evaluated. From an income tax point of view, these benchmark payments are fully deductible to the employer in the year in which they are accrued and fully taxable to the employee in the year in which they are received. There is no valid tax reason for using a type of fringe benefit that has these same characteristics.

3-63. For example, if an employer rewards a valued employee with a holiday trip for achieving a sales goal, the cost of the trip will be fully deductible to the employer. Further, the trip's cost will be fully taxable to the employee on the same basis as if the amount had been paid in the form of additional salary. This means that, while there may be a motivational reason for using a holiday trip as a form of compensation, there is no significant income tax advantage in doing so.

Tax Avoidance

3-64. The most attractive form of non-salary compensation involves benefits that are deductible to the employer, but are received tax free by the employee. Since IT-470R indicates that private health care benefits are not taxable, an employer can provide employees with, for example, a dental plan without creating any additional tax liability for the employee.

3-65. From a tax point of view, this type of compensation should be used whenever practical, provided it is desirable from the point of view of the employee. For example, although providing a dental plan to an employee is a tax free benefit, if the employee's spouse has already been provided with an identical family dental plan by her employer, this benefit is of no value to the employee.

Tax Deferral

3-66. Also attractive are those benefits that allow the employer to deduct the cost currently, with taxation of the employee deferred until a later period. We have already considered an example of this involving the use of bonus arrangements. A further important example of this would be contributions to a registered pension plan. The employer can deduct the contributions in the period in which they are made, while the employee will not be taxed until the benefits are received in the form of pension income. This will usually involve a significant deferral of taxation for the employee.

Club Dues And Recreational Facilities

3-67. In the preceding cases, the tax planning considerations are very clear. There are no tax advantages associated with benefits that are fully and currently taxable to the employee. In contrast, advantages clearly arise when there is no taxation of the benefit, or when the taxation of the employee is deferred until a later point in time.

Inclusions - GST/HST/PST On Taxable Benefits

3-68. There is, however, a complicating factor in the case of certain employer provided recreational facilities or employer payment of club dues. While IT-470R indicates that such benefits are not taxable to the employee, the employer is not allowed to deduct the cost of providing such benefits (see Chapter 6 for a more detailed description of these rules). This means that the advantage of no taxes on the employee benefit is offset by the employer's loss of deductibility.

3-69. Whether this type of benefit is tax advantageous has to be evaluated on the basis of whether the tax savings to the employee are sufficient to offset the extra tax cost to the employer of providing a non-deductible benefit. The decision will generally be based on the relative tax rates applicable to the employee and the employer. If the employee's tax rate is higher than the employer's, this form of compensation may be advantageous from a tax point of view. There are also other non-tax factors that may be important, such as employee loyalty.

Two Problem Benefits - Automobiles and Loans

3-70. Before leaving this general discussion of tax planning considerations related to employee benefits, we would note that two important types of benefits present significant difficulties with respect to determining their desirability. These two benefits are employer provided automobiles and loans to employees.

3-71. The basic problem in both cases is that the benefit to the employee is not based on the cost to the employer. In the case of the employee benefit associated with having the use of an employer supplied car, it is partially based on an arbitrary formula, under which the cumulative assessed benefit can exceed the cost of the car. In the case of employee loans, the taxable benefit is assessed using the prescribed rate of interest, not the cost of the funds to the employer.

3-72. Because of this lack of reciprocity in the measurement of the cost and benefit, a case-by-case analysis is required. In each situation, it must be determined whether the cost to the employer is greater than, or less than, the benefit to the employee. If the cost is greater, the employer may wish to consider some alternative, and more tax effective, form of compensation. This makes these benefits considerably more difficult to administer.

3-73. The taxable benefits associated with both employer provided automobiles and employer provided loans are discussed in detail at a later point in this chapter.

Exercise Three - 4

Subject: Planning Employee Benefits

As part of her compensation package, Jill Tyler is offered the choice of: a dental plan for her family, an annual vacation trip for her family, or an annual birthday gift of season's tickets to the ballet for her and her spouse. The alternative benefits are each worth about \$4,000 per year. Indicate which benefit would be best for Jill from a tax point of view and explain your conclusion.

Solution available in paper and eText Study Guide.

Inclusions - GST/HST/PST On Taxable Benefits

3-74. Many benefits included in employment income are goods and services on which an employee would have to pay GST, HST, or PST if he personally acquired the item or service. For example, if an employer provides a free domestic airline ticket to reward an employee for outstanding service, this is an item on which the employee would have to pay such taxes if he purchased the ticket on his own. This means that the taxable benefit should also include a sales tax component as the employee has received a benefit with a real value that includes both the price of the ticket and the related sales taxes.

3-75. Given this situation, ITA 6(7) requires the calculation of employee benefits on a basis that includes any GST/HST/PST that was paid by the employer on goods or services that are included in the benefit. In situations where the employer is exempt from these taxes, a notional amount is added to the benefit on the basis of the amounts that would have been paid had the employer not been exempt.

Exercise Three - 5

Subject: GST On Taxable Benefits

Ms. Vicki Correli, as the result of an outstanding sales achievement within her organization, is awarded a two week vacation in the Bahamas. Her Alberta employer pays a travel agent \$4,500, plus GST of \$225 for the trip. What is the amount of Ms. Correli's taxable benefit?

Solution available in paper and eText Study Guide.

Inclusions - Board And Lodging

3-76. Two aspects of this fringe benefit require further explanation. The first relates to valuation. Under IT-470R, any board and/or lodging benefit received is valued at fair market value, less any amounts recovered from the employee. Also of note is that subsidized meals do not have to be included as long as the employee is required to pay a reasonable charge. This puts subsidized meals provided in conjunction with free or subsidized lodging on a similar tax footing as subsidized meals in general. There is a difference, however, in that any benefit associated with lodging is based on fair market value, while, if there is a benefit associated with meals, it would be valued at the cost to the employer.

3-77. As an exception to this general approach to employer provided meals and housing, ITA 6(6) indicates that under certain circumstances, these benefits will not be considered employment income. Two such situations are described in ITA 6(6):

Employment At A Temporary Special Work Site If the work site is at such a distance from the employee's principal residence that it would not be reasonable to expect daily commuting, the benefit is not taxable.

Employment At A Remote Work Site If the work site is at such a distance from an established community that it would not be reasonable to expect the employee to establish and maintain a domestic establishment, the benefit is not taxable.

3-78. In general, taxable benefits should be computed on a GST/HST/PST included basis. However, as explained in Chapter 21, long-term (one month or more) residential rents and provision of lodging at remote work sites are not subject to GST/HST/PST. As a result, no GST/HST/PST amount would be associated with this type of employee benefit.

Inclusions - Automobile Benefits

Employees And Automobiles

Influence On Employment Income

3-79. Automobiles have an influence on the determination of an individual's employment income in three different situations. These situations can be described as follows:

Employer Provided Automobiles It is fairly common for a business to provide an automobile to an employee in order to assist the individual in carrying out his employment duties. In most cases, the employee will be able to make some personal use of the vehicle that is provided. If this is the case, the employee will have a taxable benefit which must be added to his employment income.

Inclusions - Automobile Benefits

Allowances As an alternative to providing an employee with an automobile, some employers pay an allowance to the employee for employment related use of his personally owned automobile. This allowance may be included in employment income and, when this is the case, the employee will be able to deduct some portion of the automobile's costs against such inclusions.

Deductible Travel Costs Under certain circumstances, employees can deduct various travel costs. If the employee uses his personally owned automobile for travel related to his employment, a portion of the costs associated with this vehicle can be deducted in the determination of employment income.

3-80. In this Chapter, we will give detailed attention to the benefit resulting from employer provided automobiles, as well as to the appropriate treatment of allowances for automobile costs. With respect to automobile related travel costs, the rules for these deductions are the same for both employees and businesses. Because of this, we will defer some of our coverage of this subject to Chapter 6 which deals with business income.

Tax Benefit - Employer Provided Automobile

3-81. There are two types of costs that can be associated with ownership of an automobile. First, there is a fixed cost that accrues from simply owning the vehicle over time. As you are all aware, if you own a car, its value will decline, even if you do not drive the vehicle a single kilometer. For an average vehicle, this "depreciation" takes place on something close to a 25 percent declining balance basis.

3-82. In addition to this fixed cost or annual depreciation, there will be costs associated with operating the vehicle. These costs will tend to have a direct relationship to the number of kilometers driven. However, the per kilometer amount will vary significantly, depending on the type of vehicle that is being operated.

3-83. Tax legislation reflects this economic analysis. The two benefits that can be assessed to an employee who is provided with an employer owned or leased automobile can be described as follows:

Standby Charge This benefit is assessed under ITA 6(1)(e). This benefit reflects the fixed cost of owning an automobile. However, we will find that the amount assessed can vary with the amount of personal, non-employment usage of the vehicle.

Operating Cost Benefit This benefit is assessed under ITA 6(1)(k) and, as the name implies, it reflects the costs of operating the vehicle. You should note, however, that it is not based on the employer's actual costs. It is assessed at a fixed rate for each kilometer that the employee drives for personal or non-employment usage.

3-84. As discussed in Paragraph 3-74, a GST/HST/PST component must be included when taxable benefits provided to employees involve goods or services that would normally be subject to the GST, PST, or HST. Personal use of an automobile falls into this category. Both the standby charge benefit and the operating cost benefit that are discussed in the following material are calculated in a manner that includes a GST/HST/PST component.

Allowances And Deductible Travel Costs

3-85. Both allowances and deductible travel costs involve the determination of amounts that can be deducted by an employee who owns or leases his own automobile. As you may be aware, tax legislation places limits on the amounts that can be deducted for automobile costs (e.g., for 2015, lease payments in excess of \$800 per month before taxes are not deductible and tax depreciation (capital cost allowance or CCA) cannot be deducted on automobile costs in excess of \$30,000 before taxes). As these limits are the same for an employee who owns or leases a vehicle that is used in employment activities, and for a business that owns or leases a vehicle that is used in business activities, they are given detailed coverage in Chapter 6 on business income.

3-86. However, it is important to note here that the limits that are placed on the deductibility of automobile costs have no influence on the amount of the taxable benefit that will be assessed to an employee who is provided with a vehicle by his employer. The taxable benefit to the employee will be the same, without regard to whether the employer can deduct the full costs of owning or leasing the vehicle. This means that if an employer provides an employee with an automobile that costs \$150,000, the employee's benefits will be based on the full \$150,000, despite the fact that the employer will be able to deduct capital cost allowance on only \$30,000.

Taxable Benefits - Standby Charge

Employer Owned Vehicles

3-87. While ITA 6(1)(e) requires the inclusion of a standby charge in income, ITA 6(2) provides the formulas for calculating this amount. If the employer owns the automobile, the basic standby charge is determined by the following formula:

$$[(2\%)(\text{Cost Of Car})(\text{Periods Of Availability})]$$

3-88. The components of this formula require some additional explanation:

Cost Of Car The cost of the car is the amount paid, without regard to the list price of the car. It includes all related GST/PST/HST amounts.

Periods Of Availability Periods of availability is roughly equal to months of availability. However, it is determined by dividing the number of days the automobile is "made available" by 30 and rounding to the nearest whole number. Oddly, a ".5" amount is rounded down rather than up.

Made Available One would think that if an employee simply returned the automobile and its keys to an employer's premises it would not be considered "available for use". For example, if an employee was traveling out of the country for 2 months, you might assume that, if he left the vehicle and keys with his employer during this period, it would not be considered available for his use. However, this is not the case. In a 2011 Income Tax Ruling (#040922), the CRA has indicated that the employee must be "required" to return the vehicle to the employer's premises to avoid the accrual of a taxable benefit. This means that it is not sufficient to voluntarily return the vehicle. It must be the policy of the employer to require this return.

3-89. If we assume that a vehicle was available throughout the year and cost \$33,900, including \$3,900 in HST, the standby charge would be \$8,136 $[(2\%)(\$33,900)(12)]$. If the vehicle continues to be available to the employee throughout the year for subsequent years, the benefit would be the same each year, without regard to the age of the car.

3-90. You should note that the application of this formula can result in a situation where the cumulative standby charge will exceed the cost of the automobile.

Example An employee has use of an automobile that cost \$56,500, including HST. This availability continues for five years (60 months).

Analysis The taxable benefit resulting from the standby charge calculation would be \$67,800 $[(2\%)(\$56,500)(60)]$. This taxable benefit is 20 percent larger than the cost of the car to the employer.

Employer Leased Vehicles

3-91. In those cases where the employer leases the automobile, the basic standby charge is determined by the following formula:

$$[(2/3)(\text{Lease Payments For The Year Excluding Insurance})(\text{Availability Factor})]$$

3-92. As was the case with the formula for employer owned vehicles, the components of this formula require additional explanation:

Lease Payments The amount to be included here is the total lease payments for the year, including any relevant GST/PST/HST. This total would be reduced by any amounts that have been included for insuring the vehicle. The insurance costs are excluded as the CRA considers them to be part of the operating cost benefit.

Availability Factor This is a fraction in which the numerator is the number of days during the year the vehicle is available to the employee and the denominator is the number of days during the year for which lease payments were made. If the employee had the use of the vehicle throughout the lease period, the value of this fraction would be 1. When the car is owned by the employer, the *Act* clearly requires the availability period to be based on the days of availability, rounded to the nearest number of 30 day periods. In contrast, when the car is leased, a strict reading of the *Act* requires the availability period to be based on the days available as a fraction of the days in the lease period. However, the *Employers' Guide: Taxable Benefits And Allowances* (T4130), uses the 30 day rounding rule for both purchase and lease situations. We will be using this latter approach in our examples and problems.

3-93. An example will illustrate these procedures:

Example A vehicle is leased for 3 months at a rate of \$750 per month, including HST. The \$750 includes a monthly insurance payment of \$75 per month. An employee has use of the vehicle for 85 of the 92 days in the lease term.

Analysis Since both $(85 \div 30)$ and $(92 \div 30)$ would round to 3, the standby charge would be \$1,350 $[(2/3)(3)(\$750 - \$75)(3 \div 3)]$. If the calculation in the *Act* was strictly followed, the benefit would be \$1,247 $[(2/3)(3)(\$750 - \$75)(85 \div 92)]$.

3-94. Unlike the situation with an employer owned vehicle, it is unlikely that the taxable benefit associated with a leased vehicle will exceed the value of the automobile. While we have seen no comprehensive analysis to support this view, it seems clear to us that, in most normal leasing situations, the taxable benefit on a leased vehicle will be significantly less than would be the case if the employer purchased the same vehicle.

Example In the real world, a \$55,000 (HST inclusive) vehicle could be leased for 48 months with a lease payment of \$800 per month (HST inclusive).

Analysis - Vehicle Purchased If the car is purchased, the standby charge will be \$13,200 per year $[(2\%)(\$55,000)(12)]$.

Analysis - Vehicle Leased If the vehicle is leased, the standby charge will be \$6,400 per year $[(2/3)(12)(\$800)(12 \div 12)]$.

3-95. This example illustrates what we believe to be a fairly general result. For a given automobile, the taxable benefit for the employee will be lower in situations where the employer leases the vehicle, rather than purchasing the vehicle. It is our opinion that the only exceptions to this would occur when the lease has a very short term.

Reduced Standby Charge

3-96. When an employer provides an automobile to an employee, it is usually used by that employee for a combination of personal activities and employment related activities. Among different employees, there are significant variations in the mix of these activities. Employees of some organizations may use the car almost exclusively in carrying out employment related activities. In other situations, particularly when the employer and the employee are not at arm's length (e.g., the employee is related to the owner of the business), the car may be used almost exclusively for personal travel.

3-97. This would suggest that there should be some modification of the basic standby charge in situations where there is only limited personal use of the automobile. This, in fact, is the case. The ITA 6(2) standby charge formula provides for a reduction based on the amount of personal usage of the vehicle.

3-98. The reduction involves multiplying the regular standby charge for either an employer owned or an employer leased vehicle by the following fraction:

$$\frac{\text{Non - Employment Kilometres (Cannot Exceed Denominator)}}{1,667 \text{ Kilometres Per Month Of Availability }^*}$$

*The number of months of availability is calculated by dividing the number of days that the automobile is available by 30, and rounding to the nearest whole number.

3-99. In applying this formula, the numerator is based on the number of kilometers driven for personal or non-employment activities. To prevent the fraction from having a value in excess of one, the numerator is limited to the value in the denominator. The denominator is based on the idea that, if the employee uses the automobile for as much as 1,667 kilometers of personal activities in a month (20,004 kilometers per year), the vehicle has fully replaced the need for a personally owned vehicle.

3-100. This fraction can be used to reduce the basic standby charge provided two conditions are met:

- The employee is required by the employer to use the automobile in his employment duties.
- The use of the automobile is "primarily" employment related. In general, "primarily" is interpreted by the CRA to mean more than 50 percent. Note that this standby charge reduction formula is not completely fair to everyone, in that it fails to distinguish between an employee who uses the employer's automobile 49 percent for employment related activity from an employee who uses the automobile exclusively for personal travel. Despite the significant difference in personal usage, they would each be assessed the same standby charge on a given vehicle.

3-101. While the fraction is still applicable when personal use is more than 1,667 kilometers per month (20,004 kilometers for the year), it will be equal to 1 ($20,004 \div 20,004$) and will not provide for any reduction in the basic standby charge.

Operating Cost Benefit

Basic Calculation

3-102. In those cases where the employer pays the operating costs for an automobile that is available to an employee, that employee is clearly receiving a benefit related to the portion of these costs that are associated with his personal use of the automobile. An obvious approach to assessing an operating cost benefit would be to simply pro rate operating costs paid by the employer between personal and employment related usage. The problem with this, however, is that the employer would be required to keep detailed cost and mileage records for each employee. This approach is further complicated by the fact that some operating costs incur GST or HST (e.g., gasoline), while other operating costs are exempt from GST or HST (e.g., insurance and licenses).

3-103. Given these problems, ITA 6(1)(k) has provided an administratively simple solution. The operating cost benefit is determined by multiplying a prescribed amount by the number of personal kilometers driven. For 2015, this prescribed amount is \$0.27. This amount includes a notional GST or HST component and, as a consequence, no further GST or HST benefit has to be added to this amount.

3-104. Note that this amount is applicable without regard to the level of the actual operating costs, resulting in favourable treatment for employees driving cars with high operating costs and unfavourable treatment for employees using vehicles with low operating costs.

Alternative Calculation

3-105. There is an alternative calculation of the operating cost benefit. Employees who use an employer provided automobile "primarily" (i.e., more than 50 percent) for employment

Figure 3 - 2 Summary Of Automobile Benefit Calculations

The **full** standby charge calculation on an employer owned or leased vehicle is:

Owned $[(2\%)(\text{Cost Of Car}^*)(\text{Days Available} \div 30 \text{ Rounded})]$

Leased $\left[\left(\frac{2}{3} \right) \left(\text{Lease Payments For The Year}^* \right) \left(\frac{\text{Days Available} \div 30 \text{ Rounded}}{\text{Days Leased} \div 30 \text{ Rounded}} \right) \right]$

* Including GST/HST/PST, but excluding any insurance in lease payment

A **reduced** standby charge is available if employment related usage is greater than 50%. The calculation is as follows:

$$\left[\left(\text{Full Standby Charge} \right) \left(\frac{\text{Personal Use Kilometres (Cannot Exceed Denominator)}}{1,667 \text{ Kilometres Per Month Of Availability}} \right) \right]$$

The **regular** operating cost benefit for 2015 is \$0.27 per personal use kilometer.

An **alternative** operating cost benefit calculation is available if employment related usage is greater than 50%. It is $[(1/2)(\text{Standby Charge, reduced if applicable})]$.

related activities can elect to have the operating cost benefit calculated as one-half of the standby charge by notifying their employer. This alternative calculation does not have to be used and, in many situations, it will not be a desirable alternative as it will produce a higher figure for the operating cost benefit.

Parking

3-106. It should be noted that ITA 6(1.1) specifically excludes any benefit related to employer provided parking from the automobile operating cost benefit. This does not mean that employer provided parking is not a taxable benefit. While it is not considered to be a component of the automobile benefit calculation, it would still have to be included in the employee's income under ITA 6(1)(a). The logic of this is that parking may be provided to employees who are not provided with an automobile and, as a consequence, it should be accounted for separately in the employee automobile benefit calculation.

3-107. While employer provided parking is generally considered a taxable benefit, there are some exceptions to this:

- The provision of "scramble" parking is not considered a taxable benefit. This refers to situations where parking is available on a first-come, first-served basis and there are not enough spaces for all employees.
- Parking is not considered a taxable benefit if it is provided free of charge to non-employees as well as employees.
- Parking is not considered a taxable benefit if the employee is required to use his car for employment purposes.

Summary Of Automobile Benefit Calculations

3-108. Figure 3-2 summarizes the calculations that relate to the taxable benefit arising from employer provided automobiles.

Payments By Employee For Automobile Use

3-109. Under ITA 6(1)(e), the standby charge benefit can be reduced by payments made by the employee to the employer for the use of the automobile. In corresponding fashion under ITA 6(1)(k), the operating cost benefit can be reduced by such payments.

3-110. Note, however, that if the employee pays part of the operating costs (e.g., the employee personally pays for gasoline), it does not reduce the basic \$0.27 per kilometer benefit. This is not a desirable result and, if the employee is going to be required to pay a portion of the operating expenses, the employer should pay for all of the costs and have the employee reimburse the employer for the appropriate portion. Under this approach, the payments will reduce the operating cost benefit.

Example - Employer Owned Automobile

3-111. The following data will be used to illustrate the calculation of the taxable benefit where an employee is provided with a vehicle owned by an employer in 2015.

Cost Of The Automobile (\$30,000 + \$3,900 HST)	\$33,900
Days Available For Use	310
Months Owned By The Employer	12
Total kilometers Driven	30,000
Personal kilometers Driven	16,000

3-112. The 310 days of availability would be rounded to 10 months (310 ÷ 30 rounded). The basic standby charge benefit to be included in employment income would be calculated as follows:

$$\text{Standby Charge} = [(2\%)(\$33,900)(10)] = \underline{\underline{\$6,780}}$$

3-113. As less than 50 percent $[(30,000 - 16,000) \div 30,000 = 46.7\%]$ of the driving was related to the employer's business, no reduction in the basic standby charge is available. Also note that the cost figure used in the preceding calculation includes the HST.

3-114. The operating cost benefit to be included in employment income is as follows:

$$\text{Operating Cost Benefit} = [(\$0.27)(16,000)] = \underline{\underline{\$4,320}}$$

3-115. As the employment related use of the car was less than 50 percent, there is no alternative calculation of the operating cost benefit.

3-116. As the employee does not make any payments to the employer for the personal use or operation of the automobile, the total taxable benefit included in employment income is as follows:

$$\text{Total Taxable Benefit} = (\$6,780 + \$4,320) = \underline{\underline{\$11,100}}$$

Exercise Three - 6

Subject: Taxable Benefits - Employer Owned Automobile

Mrs. Tanya Lee is provided with an automobile by her employer. The employer acquired the automobile in 2014 for \$25,000, plus \$1,250 GST and \$2,000 PST. During 2015, Ms. Lee drives the automobile a total of 28,000 kilometers, 16,000 of which were related to employment duties. The automobile is available to Mrs. Lee throughout the year. Calculate Mrs. Lee's minimum 2015 taxable benefit for the use of the automobile.

Solution available in paper and eText Study Guide.

Example - Employer Leased Vehicle

3-117. To provide a direct comparison between the employer owned and employer leased cases, this example will be based on the same general facts that were used in the ownership example. If the employer was to lease a \$30,000 car with a 36 month lease term, the lease payment, calculated using normal lease terms, would be approximately \$822 per month,

including HST (this cannot be calculated with the information given). With the exception of the fact that the car is leased rather than purchased by the employer, all of the other facts are the same as in the Paragraph 3-111 example. The standby charge benefit would be calculated as follows:

$$\text{Standby Charge} = [(2/3)(\$822)(10^*)] = \underline{\$5,480}$$

* The availability factor of 10 is calculated as $(310 \div 30 \text{ rounded})$.

A Note On Calculations The ITA 6(2) formula requires the total lease payments made for the year be multiplied by a ratio that has months available divided by the months leased. As lease payments are generally given on a monthly basis, the literal use of this formula would result in the following calculation:

$$\text{Standby Charge (ITA Calculation)} = [(2/3)(12)(\$822)(10/12^*)] = \underline{\$5,480}$$

* The availability factor is calculated as $[(310 \div 30 \text{ rounded}) / (365 \div 30 \text{ rounded})]$.

Many of our users were previously confused by the fact we first multiplied by the 12 months in the lease period and then divided by the same 12 months. As they pointed out, this double calculation is not relevant to the final result. Given this, in our calculations and problem material, we use the simpler calculation shown in the first equation in which the factor of 2/3 is multiplied by the total lease payments for the period of availability. *Income Tax Act* purists are likely to be offended. However, our focus is on helping users understand the difficult material that is found throughout this text.

3-118. As was the case when the car was owned by the employer, there is no reduction for actual business kilometers driven because the car was driven less than 50 percent for employment related purposes. Also note that the benefit is based on the lease payment including HST.

3-119. The operating cost benefit is the same as the employer owned case and is as follows:

$$\text{Operating Cost Benefit} = [(\$0.27)(16,000)] = \underline{\$4,320}$$

3-120. As in the case where the employer owned the car, with the employment related use of the car at less than 50 percent, there is no alternative calculation of the operating cost benefit.

3-121. As the employee does not make any payments to the employer for the personal use or operation of the automobile, the total taxable benefit is as follows:

$$\text{Total Taxable Benefit} = (\$5,480 + \$4,320) = \underline{\$9,800}$$

3-122. Note that the total benefit is significantly less (\$9,800 as compared with \$11,100) when the employer leases the car as opposed to purchasing it. As indicated in our earlier discussion in Paragraph 3-95, this would be the anticipated result.

Exercise Three - 7

Subject: Taxable Benefits - Employer Leased Automobile

Mr. Michael Forthwith is provided with a car that is leased by his employer. The monthly lease payments for 2015 are \$525, plus \$68 HST. During 2015, he drives the automobile a total of 40,000 kilometers, of which 37,000 kilometers are employment related. The automobile is used by him for 325 days during the year. His employer paid a total of \$11,250 in operating costs. When he is not using the automobile, company policy requires that it be returned to their premises. Calculate Mr. Forthwith's minimum 2015 taxable benefit for the use of the automobile.

Solution available in paper and eText Study Guide.

Employer Provided Cars And Tax Planning

3-123. Providing employees with cars is not a clearly desirable course of action. As is discussed in more detail in Chapter 6, there are limits on the ability of the employer to deduct the costs of owning or leasing the vehicle (e.g., leasing costs in excess of \$800 per month before taxes are not deductible). Further, the taxable benefit calculations are such that they may produce a taxable benefit that exceeds the value to the employee of having the car.

3-124. This means that a decision by an employer to provide an employee with a car requires a careful analysis of all of the relevant factors. While a complete analysis of all of these issues goes beyond the scope of this material on employment income, some general tax planning points can be made.

Require The Car Be Returned In many situations, there will be periods of time when an employee does not use an employer provided vehicle. Examples would include vacation periods, extensive periods of travel for work, or confinement because of illness. During such periods, the vehicle will be considered available for use unless the employer **REQUIRES** it to be returned to their premises. Given this, the employer should have a policy of requiring vehicles to be returned during periods of non-use by the employee.

Record Keeping In the absence of detailed records, an employee can be charged with the full standby charge and 100 percent personal usage. To avoid this, it is essential that records be kept of both employment related and personal kilometers driven.

Leasing Vs. Buying As was previously noted, in most cases, a lower taxable benefit will result when the employer leases the car rather than purchases it. One adverse aspect of leasing arrangements should be noted. Lease payments are made up of a combination of both interest and principal payments on the car. As the taxable benefit is based on the total lease payment, the interest portion becomes, in effect, a part of the taxable benefit.

Minimizing The Standby Charge This can be accomplished in a variety of ways including longer lease terms, lower trade-in values for old vehicles in purchase situations, larger deposits on leases, and the use of higher residual values in leasing arrangements. However, this minimization process is not without limits. As is explained in Chapter 6, refundable deposits in excess of \$1,000 on leases can reduce the deductible portion of lease costs.

Cars Costing More Than \$30,000 With the taxable benefit to the employee based on the full cost of the car and any portion of the cost in excess of \$30,000 not being deductible to the employer (this limit on the deductibility of automobile expenses is discussed in Chapter 6), it is difficult to imagine situations in which it would make economic sense for a profit oriented employer to provide any employee with a luxury car. As the taxable benefit to the employee is based on the actual cost of the car, while the deductible amount is limited to \$30,000, a situation is created in which the employee is paying taxes on an amount which can be significantly larger than the amount that is deductible to the employer. For example, the standby charge on a \$150,000 Mercedes-Benz is \$36,000 per year $[(2\%)(\$150,000)(12)]$, an amount that may be fully taxable to the employee. In contrast, the employer's deduction for capital cost allowance (tax depreciation) in the first year of ownership is limited to only \$4,500 $[(\$30,000)(30\%)(1/2)]$. The only winner in this type of situation is the CRA.

Consider The Alternative The alternative to the employer provided automobile is to have the employer compensate the employee for using his own automobile. In many cases this may be preferable to providing an automobile. For example, in those situations where employment related use is less than 50 percent, the provision of an automobile to an employee will result in a benefit assessment for the full standby charge. If employment related use was 45 percent, for example, it is almost certain that the amount assessed will exceed the actual benefit associated with 55 percent

personal use of the vehicle. If, alternatively, the employee is reasonably compensated for using his own personal vehicle, there is no taxable benefit.

We suggest you work Self Study Problems Three-3 to Three-5 at this point.

Inclusions - Allowances

Allowance Vs. Reimbursement

3-125. A reimbursement is an amount paid to an employee to compensate that individual for amounts that he has disbursed in carrying out his employment duties. An example of this would be an employee who purchases an airline ticket for travel on behalf of his employer. The employee will present the receipt to the employer who reimburses the employee for the amount shown on the receipt. In such cases the employee will have no net cost and will have neither an income inclusion nor a deduction. The employer will, of course, be able to deduct the amount reimbursed.

3-126. The situation is more complex with allowances. These are amounts that are paid, usually to provide a general level of compensation, for costs that an employee incurs as part of his employment activities. However, as there is no direct, dollar-for-dollar relationship with the actual costs incurred, the tax treatment of these items is more complicated. These complexities are dealt with in the material that follows.

General Rules

3-127. The term allowance is used to refer to amounts received by employees from an employer other than salaries, wages, benefits, and reimbursements. In practice, allowances generally involve payments to employees as compensation for travel costs, use of their own automobile, or other costs that have been incurred by employees as part of their efforts on behalf of the employer. A mileage allowance for a traveling salesperson or a technician who does service calls would be typical examples of such an allowance.

3-128. ITA 6(1)(b) provides a general rule which requires that allowances for personal or living expenses must be included in an employee's income. However, many of the items for which employees receive allowances are costs that an employee can deduct against employment income under ITA 8. (See the discussion of deductions later in this Chapter for a full explanation of these amounts.) Examples of such deductible items are as follows:

- ITA 8(1)(f) salesperson's expenses
- ITA 8(1)(h) traveling expenses other than motor vehicle expenses
- ITA 8(1)(h.1) motor vehicle traveling expenses
- ITA 8(1)(i) professional dues, office rent, salaries, and supply costs
- ITA 8(1)(j) motor vehicle capital costs (interest and capital cost allowance)

3-129. If allowances for these items are included in the employee's income, a circular process is involved in which they are added under ITA 6(1)(b) and then subtracted under ITA 8. In view of this, ITA 6(1)(b) indicates that there are exceptions to the rule that allowances must be included in income. While there is a fairly long list of such items, the most important of these exceptions involve allowances paid for the types of costs that would be deductible under ITA 8. Specifically, the following allowances are among those that do not have to be included in an employee's income:

- ITA 6(1)(b)(v) - Reasonable allowances for traveling expenses paid during a period in which the employee was a salesperson (includes allowances for the use of a motor vehicle).
- ITA 6(1)(b)(vii) - Reasonable allowances for traveling expenses for employees other than salespersons, not including allowances for the use of a motor vehicle.
- ITA 6(1)(b)(vii.1) - Reasonable allowances for the use of a motor vehicle for employees other than salespersons.

Taxable Vs. Non-Taxable Allowances

3-130. The preceding general rules mean that there are two possible treatments of allowances paid to employees for travel and motor vehicle costs.

Non-Taxable Allowances If a reasonable allowance is paid to an employee, it will not be included in the employee's income records (T4 Information Return). However, when such allowances are not included in income, the employee will not be able to deduct his actual costs. For example, if an individual received \$150 per day of travel to cover hotel costs, this would probably be considered reasonable and not included in his income. If the employee chose to stay at a luxury hotel for \$400 per day, he would not be able to deduct the additional cost associated with this choice. Alternatively, if he chose to stay at a hostel for \$50 per day, he would pocket the excess allowance on a tax free basis.

Taxable Allowances If an allowance is not considered to be reasonable, it will be included in the employee's T4 Information Return for the period. To the extent the employee can qualify for the deduction of employment related travel or commission salespersons expenses, related expenses incurred by the employee can be deducted in the determination of his net employment income. If the employee's actual costs exceed the allowance, having the allowance included in his income will be advantageous. Conversely, if his actual costs are less than the allowance, the result will be a net inclusion in employment income.

3-131. It is not clear what constitutes a reasonable amount in the case of the general costs of travel. It appears that, as long as an allowance appears to be in line with actual costs for food, lodging, and miscellaneous costs, the allowance that is provided is likely to be viewed as reasonable.

3-132. However, if a junior employee was given \$30,000 a month for food and lodging and he was known to be staying at budget motels and eating fast food, it is likely that the allowance would have to be included in income and reduced, to the extent possible, by actual costs incurred (while this example sounds unrealistic, it might be attempted in an owner-managed business where the employee was not dealing at arm's length with the employer).

3-133. Although it may be more difficult to administer and more costly for the employer, reimbursement of actual costs is less likely to cause this type of tax problem for employees than providing an arbitrarily determined general allowance to cover all possible costs.

Reasonable Allowances For Motor Vehicles

3-134. In Paragraph 3-129, we noted that ITA 6(1)(b)(v) and 6(1)(b)(vii.1) indicate that "reasonable allowances" for an employee's use of a motor vehicle do not have to be included in the employee's income. While the Act is not specific as to what constitutes a reasonable allowance for the use of a motor vehicle, it does point out that an allowance will be deemed not to be reasonable:

- if it is not based solely on the number of kilometers for which the vehicle is used in employment duties [ITA 6(1)(b)(x)]; or
- if the employee, in addition to the allowance, is reimbursed for all or part of the expenses of using the vehicle [(ITA 6(1)(b)(xi)].

3-135. With respect to the first of these conditions, it is clear that an allowance of \$200 per month would have to be included in the employee's income. Any allowance that is not specifically based on kilometers is deemed to be unreasonable. This, however, does not answer the question as to what constitutes a reasonable allowance.

3-136. On the upper end, the CRA has indicated that if a per kilometer allowance exceeds the prescribed amount that is deductible for a business, it will be considered unreasonable, resulting in its inclusion in the employee's income. For 2015, the relevant amounts are \$0.55 per kilometer for the first 5,000 kilometers driven by a given employee, and \$0.49 for each additional kilometer.

3-137. If the per kilometer allowance is less than this prescribed amount, it appears that the administrative practice of the CRA is to view the allowance as reasonable. This means that, unless an employee is willing to pursue the matter, he does not have the option of including a non-taxable allowance in income and deducting his actual costs. While there has been one case (Brunet vs. H.M.Q.) where an employee was allowed to include a \$0.15 per kilometer allowance and deduct actual costs, there have been other cases where this was not allowed.

Exercise Three - 8

Subject: Deductible Automobile Costs

Ms. Lauren Giacomo is required by her employer to use her own automobile in her work. To compensate her, she is paid an annual allowance of \$3,600. During the current year, she drove her automobile a total of 24,000 kilometers, of which 6,500 kilometers were employment related. Her total automobile costs for the year, including lease costs, are \$7,150. What amounts should Ms. Giacomo include and deduct in determining net employment income for the current year?

Exercise Three - 9

Subject: Automobile Allowances

During the current year, Jacob Lorenz leases an automobile for \$450 per month, a total for the year of \$5,400. He drives a total of 60,000 kilometers, of which 35,000 are employment related. His total operating costs for the year are \$15,000. His employer pays him \$0.10 for each employment related kilometer driven, a total of \$3,500. What amounts should Mr. Lorenz include and deduct in determining net employment income for the current year?

Solutions available in paper and eText Study Guide.

Employer's Perspective Of Allowances

3-138. From the point of view of the employer, paying taxable allowances is the easiest solution. All amounts paid will be included in the income of the employees and, as a consequence, there is no necessity for the employer to maintain detailed records of actual costs. It is up to the employee to keep these records and to claim the relevant deductible costs against the allowances included in their T4 Information Return.

3-139. Somewhat more onerous is an approach which uses direct reimbursements of the employee's actual costs. Some efficiencies are available here in that the CRA will generally accept a modest per diem for food without requiring detailed documentation from either the employer or the employee. However, for more substantial costs, the reimbursement approach involves more detailed record keeping than is the case with the use of taxable allowances.

3-140. In the case of employee owned automobile costs, the use of non-taxable allowances is particularly complex. As we have noted, the 2015 amounts that can be deducted by an employer for automobile costs are generally limited to \$0.55 per kilometer for the first 5,000 kilometers driven by a given employee, and \$0.49 for each additional kilometer. If a non-taxable allowance is based on these rates, the employer will have to keep detailed employee-by-employee mileage records to support the deduction of automobile costs.

Employee's Perspective Of Allowances

3-141. From the employee's point of view, the receipt of a non-taxable allowance represents a very simple solution to the problem. While records may have to be kept for the information needs of the employer, the employee has the advantage of simply ignoring the

allowance and the related costs when it comes time to file a tax return.

3-142. In real economic terms, however, the non-taxable allowance approach may or may not be advantageous. If the employee's actual deductible costs exceed the allowance, the non-inclusion of the allowance in income eliminates the deductibility of the additional costs. Alternatively, if the actual costs are less than the allowance, the employee has, in effect, received a tax free benefit.

Exercise Three - 10

Subject: Travel Allowances

Sandra Ohm travels extensively for her employer. Her employer provides an allowance of \$200 per day to cover hotel costs. In addition, she is paid \$0.41 per kilometer when she is required to use her automobile for travel. For her work, during the current year, she traveled a total of 82 days and drove 9,400 kilometers. Her employer paid her \$16,400 for lodging [(82)(\$200)], as well as \$3,854 dollars for mileage [(9,400)(\$0.41)]. Her actual lodging costs were \$18,300, while her total automobile costs were \$7,200, including monthly lease payments. Her total mileage on the car during the year was 23,500 kilometers. What amounts should Ms. Ohm include and deduct in determining net employment income for the current year?

Solution available in paper and eText Study Guide.

Inclusions - Employee Insurance Benefits

Life Insurance

3-143. The cost of providing life insurance benefits to employees is a taxable benefit under ITA 6(4). This means that any premiums paid on a life insurance policy by the employer must be included in employment income. In the event of the employee's death, the benefit payment received by his estate would not be taxable. No GST (or HST) amount would be included in this benefit as insurance services are exempt from GST (see Chapter 21).

Disability Insurance

(a.k.a. Group Sickness Or Accident Insurance Plan)

3-144. The basic rules for group disability insurance plans are as follows:

Contributions By Employee Contributions made by an employee are not deductible by the employee against employment income. However, they can be offset against disability benefits received.

Contributions By Employer Employer contributions do not create a taxable benefit to the employee as long as the plan benefits received by an employee are taxable. Under ITA 6(1)(f), benefits are taxable to an employee provided they are (1) paid on a periodic basis, and (2) paid to compensate the individual for loss of employment income. If plan benefits do not meet both of these criteria (such as benefits for accidental death), they are not taxable and the employer contributions will be considered a taxable benefit to the employee.

Benefits Received (Employer Makes No Contributions) In the unusual situation where the employee makes all of the contributions to the plan, benefits will be received tax free.

Benefits Received (Employer Makes Any Part Of The Contributions) If benefits under the plan are taxable under ITA 6(1)(f), the employee can offset the income inclusion by the amount of contributions that he has made to the plan prior to

receiving the benefits and during the year he received the benefits. If plan benefits are not taxable, the employer's contribution will be treated as a taxable benefit.

3-145. These rules give rise to three possible situations:

Employee Pay All Plans If the employee makes 100 percent of the contributions to the plan, the contributions will not be deductible and any benefits received will not be taxed.

Employer Contributes - Benefits Not Taxed If the employer makes all or part of the contributions to the plan and benefits received are not taxed (because they are not periodic or do not replace employment income), the employer contributions to the plan will be treated as a taxable benefit to the employee. Any employee contributions to the plan are not deductible.

Employer Contributes - Benefits Taxed If the employer makes all or part of the contributions to the plan and benefits received by the employee are taxed, the employer's contributions do not create a taxable benefit. Any employee contributions to the plan are not deductible by the employee. However, the cumulative amount of contributions made prior to receiving benefits and those made during the year the benefits are received can be used to offset the benefits received.

3-146. The most common of these situations is the last one in which the employer makes contributions that do not create a taxable benefit for the employee, with any benefits received being taxed in the hands of the employee. Most of our examples and problems will be based on this type of situation.

3-147. You should note that these rules only apply to group disability plans. If the plan is not a group plan, any contributions made by an employer will be treated as a taxable benefit to the employee.

Example Jane Forthy's employer sponsors a group disability insurance plan which provides periodic benefits to compensate for lost employment income. During the period January 1 through April 1 of the current year, Jane's contributions to the plan totaled \$1,200. On April 1 of the current year she was involved in a car accident which prevented her from working during the remainder of the year. During this period from April 1 through December 31, she received disability benefits of \$16,000. In the previous year, the first year she participated in the plan, Jane contributed a total of \$3,600 in premiums to this plan.

Analysis Jane's income inclusion for the current year would be \$11,200 [\$16,000 - \$1,200 - \$3,600].

3-148. As noted in the previous section on life insurance, insurance services are exempt from GST/HST, and no GST/HST amount is associated with taxable benefits related to disability insurance.

Exercise Three - 11

Subject: Disability Insurance Benefits

Mr. Lance Bardwell is a member of a group disability plan sponsored by his employer. The plan provides periodic benefits to compensate for lost employment income. During 2015, his employer's share of the annual premium was \$1,800. During 2014, Mr. Bardwell was required to contribute \$300 to this plan. During the last 6 weeks of 2015, Mr. Barwell became incapacitated and, as a consequence, received \$5,250 in benefits from the disability plan. Because of this period of disability, his 2015 contribution to the disability plan was only \$225. What amount will Mr. Bardwell include in his 2015 employment income?

Solution available in paper and eText Study Guide.

Health Care Insurance

3-149. Where an employer pays the individual premiums on provincial or Government of Canada health care plans (e.g., Alberta and British Columbia), the amounts are considered taxable benefits of the employees. Where provincial health care is funded by an employer payroll tax or other general levy (e.g., Manitoba and Quebec) and there are no individual premiums, these payments are not allocated to employees as a taxable benefit.

3-150. Payments made for private health services plans, for instance a dental plan, are specifically excluded from treatment as a taxable benefit under guidelines provided in ITA 6(1)(a)(i). The benefits received under such plans are not taxable and, in addition, any contributions made by the employee to such private health care plans can be treated as a medical expense eligible for a credit against taxes payable. (See Chapter 4.)

3-151. As was the case with other types of insurance benefits, there is no GST amount associated with taxable health care benefits.

Loans To Employees

General Rules

3-152. If an employer extends a loan to an employee that is either interest free or has a rate that is below the going market rate, the employee is clearly receiving a benefit that should be taxed. This view is reflected in ITA 6(9), which requires the assessment of a taxable benefit on all interest free or low interest loans to employees. This provision applies whether the loan is made as a consequence of prior, current, or future employment.

3-153. As specified in ITA 80.4(1), which describes how this benefit is calculated, the taxable benefit would equal imputed interest calculated at a rate specified in the *Income Tax Regulations*. This rate, as determined by ITR 4301, is referred to as the prescribed rate (note that this rate was discussed in more detail in Chapter 2). It is established for each calendar quarter on the basis of Government Of Canada Treasury Bill yields. In general, the taxable benefit is calculated using the prescribed rate that is applicable to each calendar quarter. The amount of the benefit is reduced by any interest paid on the loan by the employee during the year or within 30 days of the end of the year.

Example On January 1 of the current year, Ms. Brooks Arden borrows \$50,000 from her employer at an annual rate of 1 percent. Assume that during this year, the prescribed rate is 3 percent during the first two quarters, and 4 percent during the last two quarters. Ms. Arden pays the required 1 percent interest on December 31.

Analysis The taxable benefit to be included in Ms. Arden's net employment income would be calculated as follows:

Imputed Interest:	
Quarters I and II [(3%)(50,000)(2/4)]	\$ 750
Quarters III and IV [(4%)(50,000)(2/4)]	1,000
<hr/>	
Total Imputed Interest	\$1,750
Interest Paid [(1%)(50,000)]	(500)
<hr/>	
Taxable Benefit	\$1,250

In general, interest calculations that are made for tax purposes are based on the number of days the principal is outstanding. However, IT-421R2, in its illustration of employee loan interest calculation, uses calendar quarters and treats each calendar quarter as one-quarter of the year. In situations where full calendar quarters are involved we will use this approach in our text and problem material.

3-154. Several additional points should be made with respect to these loans:

- If the rate negotiated with the employer is at least equal to (or greater than) the rate that the employee could have negotiated himself with a commercial lender, then under ITA 80.4(3), no benefit will be assessed to the employee regardless of subsequent changes to the prescribed rate. However, this is rarely applicable as the prescribed rate is consistently lower than rates available on loans to individuals from commercial lenders.
- ITA 80.4(2) contains a different set of rules that is applicable to loans made to certain shareholders of a company. The different rules that are applicable to shareholders are described in Chapter 15, “Corporate Taxation And Management Decisions”.
- Proceeds from a loan to an employee could be used to invest in assets that produce business or property income. In general, interest paid on loans to finance investments is deductible against the income produced. ITA 80.5 clearly states that an imputed interest benefit assessed under ITA 80.4(1) or 80.4(2) is deemed to be interest paid for the purposes of determining net business or property income. Referring to the example in Paragraph 3-153, if Ms. Arden had invested the \$50,000 loan proceeds in income producing assets, her deductible interest would total \$1,750, the \$500 that she paid, plus the assessed \$1,250 taxable benefit.
- When the purpose of the loan is to assist an employee with a home purchase or home relocation (see Paragraph 3-155), ITA 80.4(4) indicates that the annual amount of interest used in the benefit calculations cannot exceed the annual amount determined using the prescribed rate in effect when the loan was extended. Note that this rule is applied on an annual basis, not on a quarter by quarter basis.

This provides a ceiling for the benefit and, at the same time, allows the taxpayer to benefit if the prescribed rate becomes lower. This ceiling on the benefit is only available for the first five years such loans are outstanding. ITA 80.4(6) indicates that, after this period of time, the loan will be deemed to be a new loan, making the calculation of the benefit subject to the prescribed rate in effect at this point in time. This new rate will again serve as a ceiling for the amount of the benefit for the next five years.

Example On January 1 of the current year, an employee receives a \$200,000, interest free home purchase loan from his employer. Assume that the prescribed rate is 4 percent for the first quarter, 3 percent during the second and third quarters and 7 percent in the fourth quarter.

Analysis If interest is calculated on a quarterly basis, the benefit would be \$8,500 $[(\$200,000)(4\%)(1/4) + (\$200,000)(3\%)(2/4) + (\$200,000)(7\%)(1/4)]$. Alternatively, using the prescribed rate in effect at the time the loan was made, the amount is \$8,000 $[(\$200,000)(4\%)]$. As this is lower, the taxable benefit would be \$8,000.

Home Relocation Loans

3-155. If an employer provides a home purchase loan when an employee moves to a new work location, it is referred to as a home relocation loan if certain conditions are met. If this is an interest free or low interest loan, the ITA 80.4(1) rules apply as outlined in the preceding section. However, in the case of a home relocation loan, there is an offsetting deduction.

3-156. This deduction is equal to the benefit associated with an interest free home relocation loan of up to \$25,000. Note, however, the deduction is applied in the calculation of Taxable Income. This being the case, the usual ITA 80.4(1) imputed interest benefit will be included in net employment income, a figure that will not be changed by the home relocation loan deduction. The deduction will be applied after net employment income has been added to other sources in the determination of Net Income For Tax Purposes. The details of this deduction from Taxable Income are covered in Chapter 4.

3-157. There is no GST benefit on imputed interest on a low or no interest loan. This reflects the fact that no GST is charged on financial services (see Chapter 21).

Exercise Three - 12

Subject: Housing Loan

On January 1, 2015, Mrs. Caldwell receives a \$100,000 loan from her employer to assist her in purchasing a home. The loan requires annual interest at a rate of 1 percent, which she pays on December 31, 2015. Assume that the relevant prescribed rate is 2 percent during the first quarter of 2015, 3 percent during the second quarter, and 1 percent during the remainder of the year. Calculate Mrs. Caldwell's taxable benefit on this loan for the year (1) assuming that the loan qualifies as a home relocation loan and (2) assuming that it does not qualify as a home relocation loan.

Solution available in paper and eText Study Guide.

Tax Planning For Interest Free Loans

General Approach

3-158. Tax rules result in a taxable benefit to the employee if the interest rate on the loan is lower than the prescribed rate. Given this, the question arises as to whether the use of employee loans is a tax effective form of providing employee benefits. As with other types of benefits, the question is whether it is better that the employer supplies the benefit or, alternatively, provides sufficient additional salary to allow the employee to acquire the benefit directly. In the case of loans, this additional salary would have to be sufficient to allow the employee to carry a similar loan at commercial rates.

3-159. To determine whether a loan is an effective form of employee compensation, several factors have to be considered:

- the employer's rate of return on alternative uses for the funds
- the employer's and the employee's tax rate
- the prescribed rate
- the rate available to the employee on a similar arm's length loan

3-160. In analyzing the use of loans to employees, we begin with the assumption that we would like to provide a requested benefit to one or more employees and we are looking for the most cost effective way of providing the benefit. As noted, the alternative to providing an employee with a loan is to provide that employee with sufficient after tax income to carry an equivalent loan at commercial rates of interest.

3-161. It then becomes a question of comparing the cash flows associated with the employer providing the loan (this would have to include sufficient additional income to pay the taxes on any loan benefit that will be assessed), with the cash flows required for the employer to provide the employee with sufficient income to carry an equivalent loan acquired from a commercial lender.

Example Of Interest Free Loan Benefit

3-162. The following example illustrates the calculations required to determine whether the use of a low or no interest loan is a tax effective form of employee compensation.

Example A key executive asks for a \$100,000 interest free housing loan. The loan does not qualify as a home relocation loan. At this time, the employer has an investment opportunity that is expected to provide a rate of return of 12 percent before taxes. Assume the prescribed rate for the period is 2 percent, while the rate for home mortgages is 5 percent. The employee is subject to a marginal tax rate, the tax rate applicable to additional income, of 45 percent, while the employer pays corporate taxes at a marginal rate of 28 percent.

Alternative 1 - Provide Additional Salary In the absence of the interest free loan, the employee would borrow \$100,000 at 5 percent, requiring an annual interest

payment of \$5,000. In determining the amount of salary required to carry this loan, consideration has to be given to the fact that additional salary will be taxed at 45 percent. In terms of the algebra that is involved, we need to solve the following equation for X:

$$\$5,000 = [(X)(1 - 0.45)]$$

You will recall that this type of equation is solved by dividing both sides by (1 - 0.45), resulting in a required salary of \$9,091:

$$X = [\$5,000 \div (1 - 0.45)] = \$9,091$$

Using this figure, the employer's after tax cash flow required to provide sufficient additional salary for the employee to carry a conventional \$100,000 mortgage would be calculated as follows:

Required Salary [$\$5,000 \div (1 - 0.45)$]	\$9,091
Tax Savings From Deducting Salary [$(\$9,091)(28\%)$]	(2,545)
<u>Employer's After Tax Cash Flow - Additional Salary</u>	<u>\$6,546</u>

Alternative 2 - Provide The Loan If the loan is provided, the employee will have a taxable benefit of \$2,000 [(2% - Nil)($\$100,000$)], resulting in additional taxes payable of \$900 [(45%)($\$2,000$)]. To make this situation comparable to the straight salary alternative, the employer will have to provide the executive with both the loan amount and sufficient additional salary to pay the \$900 in taxes on the benefit that will be assessed. The required amount would be \$1,636 [$\$900 \div (1 - 0.45)$].

The employer's cash flow associated with the after tax cost of providing the additional salary as well as the after tax lost earnings on the \$100,000 loan amount would be calculated as follows:

Required Salary [$\$900 \div (1 - 0.45)$]	\$1,636
Tax Savings From Deducting Salary [$(\$1,636)(28\%)$]	(458)
After Tax Cost Of Salary To Cover Taxes On Benefit	\$1,178
Employer's Lost Earnings [(12%)(1 - 0.28)($\$100,000$)]	8,640
<u>Employer's After Tax Cash Flow - Loan</u>	<u>\$9,818</u>

Conclusion Given these results, payment of additional salary appears to be the better alternative. However, the preceding simple example is not a complete analysis of the situation. Other factors, such as the employee's ability to borrow at going rates and the employer's ability to grant this salary increase in the context of overall salary policies, would also have to be considered.

Exercise Three - 13

Subject: Loans To Employees - Tax Planning

A key executive asks for a \$125,000 interest free housing loan that does not qualify as a home relocation loan. At this time, the employer has investment opportunities involving a rate of return of 7 percent before taxes. Assume that for the period, the relevant prescribed rate is 2 percent, while the market rate for home mortgages is 5 percent. The employee's tax rate on additional income, i.e., his marginal tax rate, is 42 percent, while the employer's marginal tax rate is 26 percent. Should the employer grant the loan or, alternatively, provide sufficient salary to carry an equivalent loan from a commercial lender? Explain your conclusion.

Solution available in paper and eText Study Guide.

We suggest you work Self Study Problem Three-6 at this point.

Inclusions - Stock Option Benefits

The Economics Of Stock Option Arrangements

3-163. Stock options allow, but do not require, the holder to purchase a specified number of shares for a specified period of time at a specified acquisition price. Because of tax considerations, at the time of granting, the option price is usually at or above the market price of the shares. For example, options might be issued to acquire shares at a price of \$10 at a time when the shares are trading at that same \$10 value.

3-164. At first glance, such an option would appear to have no value as it simply allows the holder to acquire a share for \$10, at a time when that share is only worth that amount. In reality, however, this option could have significant value, in that it allows the holder to participate in any upward price movement in the shares without any obligation to exercise the option if the price stays at, or falls below, \$10. Stated alternatively, the option provides full participation in gains on the option shares, with no downside risk. Further, for an employee receiving such options, they provide this participation with no real investment cost until such time as the options are exercised.

Example Because of his excellent work, Andrew Chang is given options to buy 1,000 shares of his employer's stock at a price of \$10 per share. At this time, the shares are trading at \$10 per share. One year later, he exercises the options and immediately sells the acquired shares for \$12 per share.

Analysis Andrew has enjoyed a gain of \$2,000 $[(1,000)(\$12 - \$10)]$ with no initial investment. This clearly illustrates why the options have a value, even when they are not issued "in-the-money". The expression "in-the-money" refers to situations where the option price (\$10 in this example) is below current market value. In this example, the options are in-the-money when the market value is greater than \$10.

3-165. Stock options are granted to employees in the belief that, by giving an employee an interest in the stock of the company, he has an incentive to make a greater effort on behalf of the enterprise. In some companies, use of this form of compensation is restricted to senior executives. In contrast, other corporations make options available to larger groups of employees.

3-166. At one point in time, a very significant advantage to the use of stock options was that the cost of issuing such options was not recorded in the financial statements of the issuing corporation. Because of an inability of accountants to agree on the appropriate value for options that were not "in-the-money", corporations were able to issue huge quantities of stock options without recording any compensation expense at all.

3-167. However, this is not the current situation. Canadian and international GAAP requires the recognition of a compensation expense when stock options are issued.

3-168. In contrast to the accounting treatment under GAAP, the issuance of stock options has no tax consequences at the time of issue, either for the issuer or the recipient. The issuer cannot deduct any amount to reflect the economic value of the issued options. Further, the recipient does not have any income inclusion when the options are issued.

Overview Of The Tax Rules

3-169. This is a difficult subject to present in that it involves several different areas of tax legislation. In addition to issues related to employment income, stock options influence the determination of Taxable Income and the calculation of taxable capital gains. While it would be possible to present this material on a piecemeal basis, we have found this to be confusing to our readers. An alternative would be to defer any discussion of this issue until Chapter 8 when

all of the relevant material has been covered.

3-170. However, this fails to reflect the fact that stock option issues relate most directly to employment income. As a consequence, most of our material on stock options will be presented in this Chapter. As this involves some material that will not be covered until later Chapters, an overview of the stock option material that will be presented in this Chapter is useful. The basic points here are as follows:

Value At Issue As noted previously, the tax rules give no recognition to the fact that stock options have a positive value at the time of issue. The issuing employer can make no deduction and the recipient employee has no income inclusion.

Employment Income Inclusion - Measurement The employment income inclusion will be measured on the date that the options are exercised. The amount will be equal to the excess of the per share fair market value on the exercise date over the option price, with the difference multiplied by the number of shares acquired. This amount will be nil or positive as the employee would not normally exercise the options unless the value of the shares is equal to, or exceeds, the option price.

Employment Income Inclusion - Recognition While the employment income inclusion will always be measured at the time the options are exercised, it may not be recognized until the shares are sold. Whether the inclusion will be recognized at the time of exercise or at the time of sale will depend on the type of corporation that is issuing the stock options. Note that when the appropriate event triggers recognition of this income inclusion, it will be classified as employment income, even if the taxpayer is no longer an employee of the organization that issued the options.

Taxable Income Deduction As many of you are aware, gains on dispositions of securities are considered to be capital gains, subject to taxation on only one-half of their total amount. In the absence of some mitigating provision, the full amount of the employment income inclusion that arises on the exercise of options or the sale of option shares would be subject to tax. As this would not be an equitable situation, tax legislation permits a deduction in the calculation of Taxable Income equal to one-half of the employment income inclusion. While general coverage of Taxable Income is found in Chapters 4 and 11, this deduction will be covered here as part of our discussion of stock options. Note, however, this deduction does not influence the calculation of Net Employment Income. This means that, if you are solving a problem that requires the calculation of Net Employment Income, you will **NOT** include this deduction in your calculation.

Capital Gains With the difference between fair market value at the exercise date and the option price being treated as an employment income inclusion, fairness requires that the adjusted cost base of the acquired shares be based on their fair market value at the exercise date, not the actual cost to the employee. This means that, when the shares are eventually sold, there will be a capital gain or loss based on the difference between the sale price and the fair market value of the shares at the time of exercise. As is discussed more fully in Chapter 8, only one-half of capital gains are subject to tax (the "taxable capital gain"). One-half of capital losses are deductible (the "allowable capital loss"), but only to the extent that there are taxable capital gains in the year.

3-171. A simple example will serve to illustrate the relevant calculations:

Example An executive receives options to acquire 1,000 of his employer's common shares at an option price of \$25 per share. At this time, the common shares are trading at \$25 per share. He exercises the options when the shares are trading at \$40 per share. In the following year, he sells the shares for \$50 per share.

Analysis Assuming that the employment income inclusion must be recognized when the options are exercised, the tax consequences for the year of exercise would be as follows:

Inclusions - Stock Option Benefits

Employment Income [(1,000)(\$40 - \$25)]	\$15,000
Taxable Income Deduction (One-Half)	(7,500)
Taxable Income In Year Of Exercise	\$ 7,500

When the shares are sold, the additional tax consequences to the employee would be as follows:

Proceeds Of Disposition [(1,000)(\$50)]	\$50,000
Adjusted Cost Base [(1,000)(\$40)]	(40,000)
Capital Gain	\$10,000
Inclusion Rate	1/2
Taxable Capital Gain In Year Of Sale	\$ 5,000

3-172. Several points should be made with respect to this example:

- The employment income inclusion will always be measured at the time the options are exercised. However, its recognition for tax purposes may be deferred until the acquired shares are sold. This will be discussed in more detail in the material that follows.
- The \$7,500 deduction is from Net Income For Tax Purposes in the calculation of Taxable Income, not from employment income. The net employment income that will be included in the executive's current or future Net Income For Tax Purposes, as well as his Earned Income inclusion for RRSP purposes (see Chapter 10), is \$15,000.
- The availability of the \$7,500 deduction requires that certain conditions be met. These conditions will be discussed in detail in the material that follows.
- As we have noted, when the \$15 per share employment income benefit is included in employment income, this amount will be added to the adjusted cost base of the shares, increasing their value to \$40 per share (\$25 + \$15). This inclusion is provided for under ITA 53(1)(j).

CCPCs Vs. Public Companies

3-173. As is discussed more fully in Chapter 12, a Canadian controlled private corporation (CCPC) is generally a corporation that is controlled by Canadian residents and does not have its shares traded on a prescribed stock exchange. This is an important distinction in many areas of tax work. However, our concern here is with the difference between the tax treatment of stock options issued by public companies and the tax treatment of stock options issued by CCPCs.

3-174. In very simplified terms, for options issued by public companies, the general rule is that the employment income inclusion will be taxed when the options are exercised. In contrast, for options issued by Canadian controlled private corporations, the employment income inclusion is still measured when the options are exercised, but the benefit is not taxed until the acquired shares are sold.

3-175. This clearly places individuals receiving stock options to acquire shares of public companies at a disadvantage. They are required to pay taxes on an unrealized amount of income, sometimes resulting in a need to dispose of some portion of the acquired shares.

Rules For Public Companies

3-176. Under ITA 7(1)(a), when options to acquire the shares of a publicly traded company are exercised, there is an employment income inclusion equal to the excess of the fair market value of shares acquired over the price paid to acquire them. A deduction from Taxable Income, equal to one-half of the employment income that is included under ITA 7(1)(a), can be taken under ITA 110(1)(d).

Inclusions - Stock Option Benefits

3-177. Note, however, this ITA 110(1)(d) deduction in the calculation of Taxable Income is only available if, at the time the options are issued, the option price was equal to, or greater than, the fair market value of the shares at the option grant date. If the option price is less than the fair market value of the shares at the time of issue, the deduction will not be available and the individual will be subject to tax on the full amount of the employment income inclusion.

Example On December 31, 2013, John Due receives options to buy 10,000 shares of his employer's common stock at a price of \$25 per share. The employer is a publicly traded company and the options are exercisable as of their issue date. At this time, the shares are trading at \$25 per share.

On July 31, 2015, Mr. Due exercises all of these options. At this time, the shares are trading at \$43 per share. On September 30, 2016, Mr. Due sells the shares that he acquired with his options. The proceeds from the sale are \$45 per share.

Analysis The tax consequences of the preceding events and transactions are as follows:

- **Issue Date** (December 31, 2013) Despite the fact that the options clearly have a positive value at this point in time, there are no tax consequences resulting from the issuance of the options.
- **Exercise Date** = Measurement and Recognition Date (July 31, 2015) As the option price was equal to the fair market value of the shares at the option grant date, Mr. Due can use the ITA 110(1)(d) deduction in calculating his Taxable Income. The tax consequences resulting from the exercise of the options would be as follows:

Fair Market Value Of Shares Acquired [(10,000)(\$43)]	\$430,000
Cost Of Shares [(10,000)(\$25)]	(250,000)
<hr/>	
ITA 7(1)(a) Employment Income Inclusion	
= Increase In Net Income For Tax Purposes	\$180,000
ITA 110(1)(d) Deduction [(1/2)(\$180,000)]	(90,000)
Increase In Taxable Income	\$ 90,000

- **Disposition Date** (September 30, 2016) The tax consequences resulting from the sale of the shares would be as follows:

Proceeds Of Disposition [(10,000)(\$45)]	\$450,000
Adjusted Cost Base [(10,000)(\$43)]	(430,000)
<hr/>	
Capital Gain	\$ 20,000
Inclusion Rate	1/2
Taxable Capital Gain	\$ 10,000

Note that, in the 2016 calculation, the adjusted cost base of the shares has been bumped up to the value of the shares at the time of exercise, reflecting the fact that the difference between the \$43 per share value on that date and the \$25 option price has already been included in the taxpayer's Net Income For Tax Purposes.

Also note that, if the taxpayer had sold the shares in 2016 for less than the \$43 value that was established at the time of exercise in 2015, the result would be a capital loss. If this was the case, the taxpayer would not be able to deduct the loss in 2016, unless he had capital gains from some other source. This creates a situation that could be viewed as unfair in that the taxpayer has had to include gains up to the \$43 value, but might not be able to deduct the loss resulting from a subsequent decline in value. Note that he cannot carry back the capital loss against the 2015 gain because that amount was classified as employment income, not as a capital gain.

Exercise Three - 14

Subject: Stock Options - Public Company

During 2013, Mr. Gordon Guise was granted options to buy 2,500 of his employer's shares at a price of \$23.00 per share. At this time, the shares are trading at \$20.00 per share. His employer is a large publicly traded company. During July, 2015, he exercises all of the options when the shares are trading at \$31.50 per share. In September, 2015, the shares are sold for \$28.00 per share. What is the effect of the exercise of the options and the sale of the shares on Mr. Guise's 2015 Net Income For Tax Purposes and Taxable Income? Where relevant, identify these effects separately.

Solution available in paper and eText Study Guide.

Rules For Canadian Controlled Private Corporations

3-178. The basic public company rules that we have just described require the recognition of a taxable benefit when the options are exercised, prior to the realization in cash of any benefit from the options granted. This may not be an insurmountable problem for employees of publicly traded companies, in that they can sell some of the shares or use them as loan collateral if they need to raise the cash to pay the taxes on the benefit.

3-179. However, for employees of a Canadian controlled private corporation (CCPC), a requirement to pay taxes at the time an option is exercised could create severe cash flow problems since the shares are not publicly traded. As a consequence, a different treatment is permitted for stock options issued by CCPCs. The employment income inclusion is still measured at the time the options are exercised, but it is not taxed until the shares are sold.

3-180. For CCPCs, the employment income inclusion is determined under ITA 7(1)(a) and 7(1.1). The ITA 110(1)(d) deduction from Taxable Income is also available to CCPCs provided the option price was equal to, or more than, the fair market value of the shares at the option grant date. However, if this condition is not met, an additional provision under ITA 110(1)(d.1) allows the taxpayer to deduct one-half of the employment income inclusion, provided the shares are held for at least two years after their acquisition.

3-181. Using the same information that is contained in the example in Paragraph 3-177, altered only so that the employer is a CCPC, the tax consequences would be as follows:

Analysis For CCPC Example

- **Issue Date** (December 31, 2013) Despite the fact that the options clearly have a positive value at this point in time, there are no tax consequences resulting from the issuance of the options.
- **Exercise Date** = Measurement Date (July 31, 2015) While the amount of the employment income inclusion would be measured on this date, it would not be included in income at this point. Based on the increase in share value from \$25 to \$43 per share, the benefit would be measured as \$180,000 $[(\$43 - \$25)(10,000 \text{ Shares})]$. This benefit, along with the related \$90,000 Taxable Income deduction, would be deferred until such time as the shares are sold.
- **Disposition Date** = Recognition Date (September 30, 2016) The tax consequences resulting from the sale of the shares would be as follows:

Deferred Employment Income		
[($\$43 - \25)(10,000)]		\$180,000
Proceeds Of Disposition [(10,000)($\$45$)]	\$450,000	
Adjusted Cost Base [(10,000)($\$43$)]	(430,000)	
Capital Gain	\$ 20,000	
Inclusion Rate	1/2	10,000
Increase In Net Income For Tax Purposes		\$190,000
ITA 110(1)(d) Deduction [(1/2)($\$180,000$)]		(90,000)
Increase In Taxable Income		\$100,000

3-182. Note that this is the total increase in Taxable Income that would have resulted from simply purchasing the shares at \$25 and later selling them for \$45 [(10,000)(1/2)($\$45 - \25) = \$100,000]. The structuring of this increase is different and, in some circumstances, the difference could be significant. For example, the fact that the \$180,000 increase in value has been classified as employment income rather than capital gains means that it is not eligible for the lifetime capital gains deduction (see Chapter 11), but it will increase Earned Income for RRSP purposes (see Chapter 10). Although the timing is different, the \$100,000 total increase in Taxable Income is the same as in the public company example in Paragraph 3-177.

Exercise Three - 15

Subject: Stock Options - CCPC

In 2011, Ms. Milli Van was granted options to buy 1,800 of her employer's shares at a price of \$42.50 per share. At this time, the shares have a fair market value of \$45.00 per share. Her employer is a Canadian controlled private corporation. In June, 2014, when the shares have a fair market value of \$75.00 per share, she exercises all of her options. In September, 2015, Ms. Van sells her shares for \$88,200 (\$49.00 per share). What is the effect of the exercise of the options and the sale of the shares on Ms. Van's 2014 and 2015 Net Income For Tax Purposes and Taxable Income? Where relevant, identify these effects separately.

Solution available in paper and eText Study Guide.

We suggest you work Self Study Problems Three-7, 8 and 9 at this point.

Other Inclusions

Payments By Employer To Employee

3-183. As noted in Paragraph 3-60, ITA 6(3) deals with employment related payments made prior to, or subsequent to, the employment period. This includes payments for accepting employment, as well as payments for work to be completed subsequent to the termination of employment. ITA 6(3) requires that all such amounts be included in employment income.

Forgiveness Of Employee Loans

3-184. There may be circumstances in which an employer decides to forgive a loan that has been extended to an employee. As noted in Paragraph 3-60, ITA 6(15) requires that the forgiven amount be included in the income of the employee in the year in which the forgiveness occurs. The forgiven amount is simply the amount due, less any payments that have been made by the employee.

Housing Loss Reimbursement

3-185. When an employee is required to move, employers often provide various types of financial assistance. As is discussed in Chapter 9, an employer can pay for the usual costs of moving (e.g., shipping company costs) without tax consequences to the employee. In recent years, particularly when an employee is moved from an area with a weak housing market, it has become more common for employers to reimburse individuals for losses incurred in the disposition of their principal residence.

3-186. The current rules limit the amount of housing loss that can be reimbursed without tax consequences. This is accomplished in ITA 6(19) by indicating that amounts paid to employees for housing losses, except for amounts related to "eligible housing losses", must be included in income.

3-187. ITA 6(22) defines an "eligible housing loss" as a loss that is related to a move that qualifies for the deduction of moving expenses. While this issue is discussed in more detail in Chapter 9, we would note here that an employee is generally allowed to deduct moving expenses when he moves at least 40 kilometers closer to a new work location.

3-188. ITA 6(20) limits the amount of housing loss reimbursement that can be received by indicating that one-half of any amount received in excess of \$15,000 as an eligible housing loss must be included in the employee's income as a taxable benefit. Stated alternatively, the tax free amount of housing loss reimbursement is limited to the first \$15,000, plus one-half of any amount paid in excess of \$15,000.

Discounts On Employer's Merchandise

3-189. When an employee is allowed to purchase merchandise which is ordinarily sold by an employer, any discount given to the employee is not generally considered to be a taxable benefit. If discounts are extended by a group of employers, or if an employer only extends the discounts to a particular group of employees, a taxable benefit may arise. In addition, this administrative position is not intended to apply to big-ticket items (e.g., a contractor giving an employee a discount on a new home).

3-190. A further interesting note is that the CRA has indicated that, in the case of airline employees, a benefit is assessed if the employee travels on a space confirmed basis and pays less than 50 percent of the economy fare. The benefit is the difference between 50 percent of the economy fare and the amount paid.

3-191. When a benefit must be included in income as the result of merchandise discounts, it will include any GST/HST that is applicable to these amounts.

Club Dues And Recreational Facilities

3-192. In situations where an employer owns recreational facilities such as a swimming pool, a tennis court, or an exercise room, Paragraph 33 of IT-470R makes it clear that the use of such facilities by employees does not give rise to a taxable benefit. This is the case even if the employees are allowed to use the facilities free of charge or for a nominal fee. (See Paragraph 3-59 for more coverage of IT-470R.)

3-193. However, when an employer pays fees for an employee to be a member of a social or athletic club, Paragraph 34 of IT-470R indicates that no taxable benefit arises, provided "the membership was principally for the employer's advantage rather than the employee's". This suggests that, if an employer pays for an employee's membership in a golf club and the employee's use of the club has no benefits for the employer, the employee could be assessed a taxable benefit. If this occurs, it would create a very unfortunate situation in which the employee is assessed a taxable benefit and, because club dues are involved, the employer would not be able to deduct the cost of providing the benefit.

Specific Deductions

Overview

3-194. The provisions covering deductions that can be made against employment income are found in ITA 8. In addition, ITA 8(2) contains a general limitation statement that makes it clear that unless an item is listed in ITA 8, it cannot be deducted in the calculation of employment income.

3-195. We have noted previously that the ITA 8 list of deductions is very limited, particularly in comparison with the list of deductions available to self-employed individuals earning business income. Despite the shortness of its list, the application of ITA 8 is fairly complex. This results from the fact that there are restrictions on the type of employee that can deduct certain items, on the items that can be deducted, and on the simultaneous use of some of the statutory provisions. Given this complexity, a listing and brief description of the more significant deductions available is a useful introduction to this material.

ITA 8(1)(b) Legal Expenses allows an employee to deduct any legal costs paid to collect or establish the right to salary or wages owed by an employer or former employer. Also deductible are legal costs incurred to recover benefits, such as health insurance, that are not paid by an employer or former employer, but that are required to be included in employment income when received.

ITA 8(1)(f) Sales Expenses covers the deductions available to individuals who earn commission income. It covers travel expenses, motor vehicle expenses, and other types of expenses associated with earning commissions (e.g., licenses required by real estate salespersons).

ITA 8(1)(h) Travel Expenses covers deductions available to all employees for travel expenses, other than motor vehicle expenses. An employee earning commissions can deduct travel costs under ITA 8(1)(f) or ITA 8(1)(h), but cannot use both provisions simultaneously.

ITA 8(1)(h.1) Motor Vehicle Travel Expenses covers deductions available to all employees for motor vehicle expenses. An employee earning commissions can deduct motor vehicle costs under ITA 8(1)(f) or ITA 8(1)(h.1), but cannot use both provisions simultaneously.

ITA 8(1)(i) Dues And Other Expenses Of Performing Duties covers a variety of deductions available to all employees. Included here would be professional dues, office rent paid or costs of maintaining a work space in the home, salaries to an assistant, and the cost of supplies used in employment related activities.

ITA 8(1)(j) Motor Vehicle And Aircraft Costs In general, employees cannot deduct capital costs. This includes tax depreciation (capital cost allowance or CCA) and interest on funds borrowed to acquire capital assets. This Paragraph creates an exception for motor vehicles and aircraft used in employment activities. Both CCA and financing costs on these assets can be deducted under this provision.

ITA 8(1)(p) Musical Instruments This is a second exception to the general rule that employees cannot deduct capital costs. This Paragraph allows the deduction of CCA on musical instruments required by employment activities. Unlike the provision for motor vehicle and aircraft costs, this provision does not allow the deduction of interest related to the financing of such instruments.

ITA 8(1)(m) Employee's Registered Pension Plan (RPP) Contributions As was noted previously, ITA 6(1)(a) excludes employer's contributions to an RPP from treatment as a taxable benefit. Adding to the attractiveness of these arrangements is the fact that ITA 8(1)(m) provides for the employee's contributions to be treated as a deduction. This deduction is given detailed attention in Chapter 10 which provides comprehensive coverage of the various retirement savings arrangements.

ITA 8(1)(r) Apprentice Mechanic's Tool Costs provides for the deduction of tools that are required by an apprentice mechanic. This is a very complex provision that allows for a deduction of costs in excess of an annual threshold amount. The threshold is the lesser of \$500 plus the Canada employment credit amount (see Chapter 4), and 5 percent of an adjusted income figure.

ITA 8(1)(s) Tradesperson's Tool Expenses provides for the deduction of up to \$500 for tools that are required by a tradesperson. Only costs in excess of \$1,146 can be deducted. As noted in Chapter 4, this amount is also the base for the Canada Employment Tax Credit.

ITA 8(4) Meals Both ITA 8(1)(f) and ITA 8(1)(h) refer to travel costs. As such costs could include meals, ITA 8(4) specifies when meals can be considered a part of travel costs. This Subsection notes that, for meals to be deductible as travel costs under ITA 8(1)(f) or ITA 8(1)(h), the meal must be consumed when the taxpayer is required, by his employment duties, to be away from the municipality or metropolitan area where his employer's establishment is located for at least 12 hours. Some sources disagree with this travel limitation on the deductibility of meals against employment income. However, it is likely that these sources are confusing meals paid for by an employee out of his own funds, and meals that are reimbursed by an employer. In the latter case, the 12 hour limitation does not apply as the employer is deducting the meals against business income.

We would also note here that ITA 67.1(1) limits the deductibility of food and entertainment costs to 50 percent of the amount paid. This limitation applies without regard to whether the individual is working as an employee, or as a self-employed individual earning business income.

ITA 8(13) Work Space In Home provides rules for an employee deducting the costs of a work space in his home (a.k.a. home office costs).

3-196. Most of these provisions will be given more detailed attention in the material in this Chapter. The Employee and Partner GST Rebate available on deductible expenses is covered in Chapter 21. Other, less commonly used Paragraphs such as ITA 8(1)(e) which allows the deduction of certain expenses of railway employees, will not be given coverage.

Salesperson's Expenses Under ITA 8(1)(f)

3-197. Individual employees who are involved with the selling of property or the negotiating of contracts are permitted to deduct all expenses that can be considered necessary to the performance of their duties. As stated in ITA 8(1)(f), to be eligible to deduct salesperson's expenses, all of the following conditions must be met:

1. The salesperson must be required to pay his own expenses. The employer must sign Form T2200 certifying that this is the case. While the form does not have to be filed, it must be available if requested by the CRA.
2. The salesperson must be ordinarily required to carry on his duties away from the employer's place of business.
3. The salesperson must not be in receipt of a travel allowance that was not included in income.
4. The salesperson must receive at least part of his remuneration in the form of commissions or by reference to the volume of sales.

3-198. Items that can be deducted under ITA 8(1)(f) include:

- advertising and promotion
- meals with clients while traveling and client 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 (see the discussion in Paragraph 3-215).

Specific Deductions

- training costs
- transportation costs
- licences (e.g., for real estate sales)
- bonding and liability insurance premiums
- computers and office equipment (leased only - see following Paragraph)

3-199. Except in the case of an automobile or aircraft, an employee who is a salesperson cannot deduct CCA or interest on funds borrowed to acquire capital assets. This means that if a salesperson purchases a computer to maintain customer records, he will not be able to deduct CCA on it. Alternatively, if the computer is leased, the lease payments are deductible.

3-200. In order to deduct 50 percent of the cost of meals, the salesperson must be away from the municipality or metropolitan area where the employer's establishment is located for at least 12 hours. As is the case in the determination of business income, no deduction is permitted for membership fees for clubs or recreational facilities. A salesperson is permitted to deduct motor vehicle costs, supplies, salaries to an assistant, office rent and the cost of maintaining an office in his home. However, these costs can also be deducted by other types of employees and, as a consequence, will be dealt with later in this Chapter.

3-201. The amount of qualifying expenses that can be deducted under ITA 8(1)(f) is limited to the commissions or other sales related revenues received during the year. This limitation does not, however, apply to CCA or interest on a motor vehicle or aircraft. These costs are deductible under ITA 8(1)(j) (see Paragraph 3-212). The deduction under ITA 8(1)(j) is not limited to commission income and, because it can be used in conjunction with ITA 8(1)(f), the salesperson's total deductions can exceed commission income.

Travel Expenses And Motor Vehicle Costs Under ITA 8(1)(h) and 8(1)(h.1)

3-202. The conditions for deducting expenses under ITA 8(1)(h) and (h.1) are similar to those for deductions under ITA 8(1)(f), except that there is no requirement that some part of the employee's remuneration be in the form of commissions. The conditions are as follows:

1. The person must be required to pay his own travel and motor vehicle costs. As was the case with commission salespersons, the employee must have Form T2200, signed by the employer, certifying that this is the case.
2. The person must be ordinarily required to carry on his duties away from the employer's place of business.
3. The person must not be in receipt of an allowance for travel costs that was not included in income.

3-203. There is one further condition that will be discussed more fully beginning at Paragraph 3-207. Both ITA 8(1)(h) and (h.1) state that, if a deduction is made as a salesperson under ITA 8(1)(f), no deduction can be made under either ITA 8(1)(h) or 8(1)(h.1).

3-204. ITA 8(1)(h) provides for the deduction of travel costs such as accommodation, airline or rail tickets, taxi fares, and meals. As was the case with salespersons' expenses, only 50 percent of the cost of meals is deductible. Here again, the deductibility of meals is conditional on being away from the municipality or metropolitan area in which the employer's establishment is located for at least 12 hours.

3-205. ITA 8(1)(h.1) provides for the deduction of motor vehicle costs, other than CCA and financing costs, when an employee uses his own vehicle to carry out employment duties. Note that these are the same costs that could be deducted by a salesperson under ITA 8(1)(f).

3-206. These deductions can be claimed by any employee who meets the specified criteria. Further, they are not limited by employment income. The deductions can be used to create a net employment loss which, if not usable against other types of income in the current year, is subject to the carry forward provisions that are discussed in Chapter 11.

The Salesperson's Dilemma

3-207. All of the travel and motor vehicle costs that a salesperson could deduct under ITA 8(1)(h) and (h.1) could also be deducted using ITA 8(1)(f). However, the use of ITA 8(1)(f) involves both good news and bad news:

- **Good News** The good news is that, if the salesperson uses ITA 8(1)(f), he can deduct expenses related to sales activity that are not deductible under any other provision (e.g., advertising and promotion).
- **Bad News** The bad news is that, if a salesperson uses ITA 8(1)(f), the amount that he can deduct is limited to the amount of commission income.

3-208. At first glance, the logical course of action here would be to use ITA 8(1)(h) and (h.1) for the travel and motor vehicle costs (this deduction would not be limited by commission income), and to then use ITA 8(1)(f) to deduct the maximum amount of other items that are available under this latter Paragraph (subject to the commission income limitation). However, this cannot be done — the *Income Tax Act* prohibits the use of ITA 8(1)(h) or (h.1), if a deduction is made under ITA 8(1)(f).

3-209. The result is, in situations where potential deductions under ITA 8(1)(f) exceed commission income, the salesperson must undertake an additional calculation to determine whether the total travel costs under ITA 8(1)(h) and (h.1) would be greater than the commission limited amount of deductions under ITA 8(1)(f). Should this be the case, the salesperson would deduct the larger amount that is available under ITA 8(1)(h) and (h.1). It is difficult to understand the tax policy goal that is achieved through this complexity.

3-210. Note that this choice does not influence the amount of other deductions available to the salesperson. The amounts deducted under other ITA 8(1) Paragraphs will be unchanged by whether the salesperson uses ITA 8(1)(f) or the combination of ITA 8(1)(h) and (h.1).

Exercise Three - 16

Subject: Commission Salesperson Expenses

Mr. Morton McMaster is a commission salesperson. During 2015, his gross salary was \$82,000 and he received \$12,200 in commissions. During the year he had advertising costs of \$8,000 and expenditures for entertainment of clients of \$12,000. His travel costs for the year totaled \$13,100. He is required to pay his own expenses and does not receive any allowance from his employer. What is Mr. McMaster's maximum expense deduction for 2015?

Solution available in paper and eText Study Guide.

Other Expenses Of Performing Duties Under ITA 8(1)(i)

3-211. ITA 8(1)(i) contains a list of other items that can be deducted in the determination of employment income by all employees. The major items included here are as follows (see IT-352R2 for more detailed coverage):

- Annual professional membership dues, if their payment was necessary to maintain a professional status recognized by statute.
- Union dues that are paid pursuant to the provisions of a collective agreement.

In order to deduct the following amounts, the employee must be required to incur the costs under a contract of employment. This must be supported by Form T2200, signed by the employer and certifying that the requirement exists.

- Office rent, including in the case of work space in the home, an appropriate portion of the rent paid for the taxpayer's residence (see Paragraph 3-215).

Specific Deductions

- Salary paid to an assistant or a substitute.
- The cost of supplies consumed in the performance of employment duties. Supplies in this context include stationery, long distance telephone calls and cell phone airtime, but not the basic monthly charge for a telephone or amounts paid to connect or license a cell phone. Note that IT-352R2 indicates that the term supplies includes maintenance and operating costs associated with a work space in the home.

Automobile And Aircraft Expenses Under ITA 8(1)(j)

3-212. Under either ITA 8(1)(f) or ITA 8(1)(h.1) an employee can deduct the operating costs of an automobile used in employment duties. With respect to operating costs, this would include an appropriate share (based on the proportion the employment related kilometers are of the total kilometers driven) of such costs as fuel, maintenance, normal repair costs, insurance, and licensing fees.

3-213. In addition, under ITA 8(1)(j), an employee can deduct CCA and interest costs on an automobile or an aircraft that is used in employment related activities. The deductible amounts for CCA are calculated in the same manner as they would be for a business. CCA would be calculated on a 30 percent declining balance basis on automobiles and a 25 percent declining balance basis on aircraft, while deductible interest would be based on actual amounts paid or payable. (See Chapter 5 for complete coverage of CCA calculations.) With respect to interest calculations, there is a difference in that, while a business can deduct accrued interest, an employee can only deduct interest that has been paid.

3-214. However, there are limits on the amounts that can be deducted here for business purposes, and these limits are equally applicable to the calculation of employment income deductions. While these limits are discussed more completely in Chapter 6 on Business Income, we would note that for 2015 there is no deduction for CCA on the cost of an automobile in excess of \$30,000 (before GST/HST/PST), that deductible interest is limited to \$300 per month, and that deductible lease payments are limited to \$800 per month (before GST/HST/PST). With respect to employees, their deduction would be based on the fraction of these costs, subject to the preceding limits, that reflects the portion of employment related kilometers included in the total kilometers driven.

Work Space In The Home Costs For Employees

3-215. We have noted previously that any employee who is required by his employment contract to maintain a work space in the home can deduct a portion of the costs of maintaining or renting his home. Because of the obvious potential for abuse in this area, ITA 8(13) establishes fairly restrictive conditions with respect to the availability of this deduction. Costs of a work space in the home for an employee are only deductible when the work space is either:

- the place where the individual principally performs the duties of the office or employment, or
- used exclusively during the period in respect of which the amount relates for the purpose of earning income from the office or employment and used on a regular and continuous basis for meeting customers or other persons in the ordinary course of performing the duties of the office or employment.

3-216. Once it is established that work space in the home costs are deductible, it becomes necessary to determine what kind of costs can be deducted. We have noted previously that, for employees, the only assets on which CCA and interest can be deducted are automobiles and aircraft (CCA only can be deducted on musical instruments). This means that no employee can deduct CCA or mortgage interest related to an office that is maintained in their residence. (Chapter 6 contains a comparison of deductible home office costs for employees and for self-employed contractors.)

3-217. With respect to other costs, IT-352R2 indicates that under ITA 8(1)(i) an employee

can deduct an appropriate portion (based on floor space used for the work space) of maintenance costs such as fuel and electricity, light bulbs, cleaning materials, and minor repairs.

3-218. For commissioned salespersons who can deduct work space in the home costs, IT-352R2 indicates that, in addition to the items listed in the preceding paragraph, an appropriate portion of property taxes and house insurance premiums can be deducted under ITA 8(1)(f). This means that, for commissioned salespersons, the deduction for work space in the home costs is split between ITA 8(1)(i) and (f). The insurance and property tax components could be limited by commission income as they can only be deducted under ITA 8(1)(f).

3-219. If the home office is in rented property, the percentage of rent and any maintenance costs paid related to the work space are deductible.

3-220. The amount deductible for work space in the home costs is limited to employment income after the deduction of all other employment expenses. Stated alternatively, work space in the home costs cannot be used to create or increase an employment loss. Any work space in the home costs that are not deductible in a year can be carried forward to the following year. In effect, there is an indefinite carry forward of these costs as they are rolled forward and become part of the work space in the home costs for the following year. This continues until there is sufficient employment income from the same employer to deduct them.

We suggest you work Self Study Problems Three-10 through 14 at this point.

Additional Supplementary Self Study Problems Are Available Online.

Key Terms Used In This Chapter

3-221. The following is a list of the key terms used in this Chapter. These terms, and their meanings, are compiled in the Glossary Of Key Terms located at the back of the separate paper Study Guide.

Allowance	Operating Cost Benefit
Bonus Arrangement	Prescribed Rate
Canadian Controlled Private Corporation	Public Corporation
Employee	Salary
Employer/Employee Relationship	Self-Employed Individual
Employment Income	Standby Charge
Fringe Benefits	Stock Option
Home Relocation Loan	Taxable Allowance
Imputed Interest	Taxable Benefit
In-The-Money	

References

3-222. For more detailed study of the material in this Chapter, we would refer you to the following:

ITA 5	Income From Office Or Employment
ITA 6	Amounts To Be Included As Income From Office Or Employment
ITA 7	Agreement To Issue Securities To Employees
ITA 8	Deductions Allowed
ITA 80.4	Loans
ITA 80.5	Deemed Interest

S2-F3-C1	Payments from Employer to Employee
ITR 4301	Interest Rates [Prescribed Rate Of Interest]
IC 73-21R9	Claims for Meals and Lodging Expenses of Transport Employees
IT-63R5	Benefits, Including Standby Charge For An Automobile, From The Personal Use Of A Motor Vehicle Supplied By An Employer - After 1992
IT-85R2	Health And Welfare Trusts For Employees
IT-91R4	Employment At Special Or Remote Work Locations
IT-99R5	Legal And Accounting Fees (Consolidated)
IT-103R	Dues Paid To A Union Or To A Parity Or Advisory Committee
IT-113R4	Benefits To Employees - Stock Options
IT-158R2	Employees' Professional Membership Dues
IT-202R2	Employees' Or Workers' Compensation
IT-352R2	Employee's Expenses, Including Work Space in Home Expenses
IT-421R2	Benefits To Individuals, Corporations And Shareholders From Loans Or Debt
IT-428	Wage Loss Replacement Plans
IT-470R	Employees' Fringe Benefits (Consolidated)
IT-504R2	Visual Artists And Writers (Consolidated)
IT-514	Work Space In Home Expenses
IT-518R	Food, Beverages And Entertainment Expenses
IT-522R	Vehicle, Travel and Sales Expenses of Employees
IT-525R	Performing Artists
RC4110	CRA Guide - Employee Or Self-Employed?
	Income Tax Technical News No. 40, "Administrative Policy Changes for Taxable Employment Benefits"
	Guide T4044, "Employment Expenses"

Problems For Self Study

(The solutions for these problems can be found in the separate Study Guide.)

Self Study Problem Three - 1 (Bonus Arrangements)

Empire Inc. has an October 31 year end. On October 31, 2015, the Company accrues a bonus of \$250,000, payable to Joan Betz, the president of the Company.

Required: For each of the following cases, indicate the taxation year in which the Company could deduct the bonus, as well as the taxation year in which Ms. Betz would have to include it in her taxable income.

Case A The bonus is paid on November 1, 2015.

Case B The bonus is paid on January 1, 2016.

Case C The bonus is paid on June 30, 2016.

Case D The bonus is paid on January 1, 2019.

Self Study Problem Three - 2 (Employee Vs. Self-Employed)

Farnham Ltd. is interested in acquiring the services of a highly qualified engineering professional. This individual has agreed to become an employee at a salary of \$250,000 per year. For employees, the cost of providing benefits (pension plan and extended health care) is about 8 percent of gross wages. In addition to CPP and EI, the province levies a 2 percent payroll tax to provide for health care. The tax applies to all wages and salaries with no upper limit.

This individual's work is such that a contract could be arranged that would make him an independent contractor. However, because he likes the security and benefits associated with being an employee, the contract would have to provide income of \$280,000 in order for him to find it acceptable.

Required Advise the company as to the preferable alternative.

Self Study Problem Three - 3 (Taxable Automobile Benefits)

Ms. Tamira Vines is a salesperson for Computata Ltd., a Regina based software company. As her work requires her to travel extensively throughout southern and central Saskatchewan, the Company provides her with an automobile. Saskatchewan does not participate in the HST program and has a provincial sales tax which is assessed at a rate of 5 percent.

From January 1, 2015 through May 31, 2015, the Company provided her with an Acura TLX. This car was purchased by the Company on January 1, 2015 at a cost of \$39,000, plus \$1,950 in provincial sales tax and \$1,950 in GST. During the period January 1, 2015 through May 31, 2015, the car was driven 38,800 kilometers for employment related purposes and 3,400 kilometers for personal use. The Company paid all operating costs during the period, an amount of \$3,656, including applicable provincial sales tax and GST.

On June 1, 2015, following a late evening sales conference at the Shangri La Hotel in Moose Jaw, Ms. Vines was involved in an accident in which the Acura was destroyed. Ms. Vines was hospitalized and was not able to return to work until July 1, 2015. Computata's insurance company paid \$27,500 to the Company for the loss of the car.

When she returned to work on July 1, 2015, the Company provided Ms. Vines with a Ford Taurus. The Company leased this vehicle at a monthly cost of \$699 per month, including applicable provincial sales tax and GST. This monthly payment also includes a \$100 per month charge for insurance.

Problems For Self Study

For the period July 1, 2015 through December 31, 2015, operating costs, other than insurance, totaled \$3,456, including applicable provincial sales tax and GST. These were paid for by the Company. During this period, Ms. Vines drove the car 15,600 kilometers for employment related purposes and 14,600 kilometers for personal use.

Ms. Vines paid to the Company \$0.10 per kilometer for the personal use of the cars owned or leased by the Company for the year.

Required: Calculate the minimum taxable car benefit that will be included in Ms. Vines' employment income for the year ending December 31, 2015.

Self Study Problem Three - 4 (Taxable Automobile Benefits)

During the current year, the Carstair Manufacturing Company provides automobiles for four of its senior executives, with the value of the cars being in proportion to the salaries which they receive. While each of the individuals uses their car for employment related travel, they also use them for personal matters. The portion of personal use varies considerably among the four individuals. When the car is not being used by the employee, the Company requires that it be returned to the corporate premises.

The details related to each of these cars, including the amount of personal and employment related travel recorded by the executives, are as follows:

Mr. Sam Stern Mr. Stern is the president of the Company and is provided with a Mercedes which has been purchased by the Company at a cost of \$78,000. The car was new last year and, during the current year, it was driven a total of 38,000 kilometers. Of this total, only 6,000 kilometers were for employment related purposes, while the remaining 32,000 were for personal travel. Operating costs totaled \$.50 per kilometer and, because Mr. Stern made an extended trip outside of North America, the car was used by Mr. Stern for 8 months during the current year.

Ms. Sarah Blue Ms. Blue is the vice president in charge of marketing and has been provided with a Corvette. The Company leases this vehicle at a cost of \$900 per month. During the current year, the car was driven a total of 60,000 kilometers, with all but 5,000 of these kilometers being for employment related purposes. The car was used by Ms. Blue throughout the current year, and total annual operating costs amount to \$18,000.

Mr. John Stack Mr. Stack is the vice president in charge of finance and he has been provided with an Acura that was purchased by the Company in the preceding year at a cost of \$48,000. During the current year, Mr. Stack drove the car 42,000 kilometers for employment related purposes and 10,000 kilometers for personal travel. Operating costs for the year were \$20,800, and the car was used by Mr. Stack throughout the current year. In order to reduce his taxable benefit, Mr. Stack made a payment of \$7,000 to the Company for the use of this car.

Mr. Alex Decker Mr. Decker, the vice president in charge of industrial relations, chose to drive a Lexus. This car was leased by the Company at a cost of \$500 per month. The lease payment was significantly reduced by the fact that the Company made a refundable deposit of \$10,000 to the leasing Company at the inception of the lease. During the current year, Mr. Decker drove the car 90,000 kilometers for employment related purposes and 8,500 kilometers for personal use. The operating costs were \$0.35 per kilometer and, because of an extended illness, he was only able to use the car for the first 10 months of the year.

Required: Calculate the minimum amount of the taxable benefit for the current year that will accrue to each of these executives as the result of having the cars supplied by the Company. In making these calculations, ignore GST/HST/PST considerations. From the point of view of tax planning for management compensation, provide any suggestions for the Carstair Manufacturing Company with respect to these cars.

Self Study Problem Three - 5 (Employer Provided Vs. Employee Owned Car)

John Rush is a key employee of Megan Ltd. (ML), a Canadian public company. He is not required to use an automobile in carrying out his employment duties.

In 2013 and 2014, ML has provided John with a car with ML paying all of the operating costs of the car. John uses the car exclusively for personal travel.

On January 2, 2015, ML has indicated to John that, as an alternative to continuing to provide the car for him, they will sell the car to him at its current fair market value of \$20,000. If he chooses to purchase the car, ML will no longer pay the operating costs.

John expects that, whether he chooses to purchase the car or not, he will use the car for two more years, 2015 and 2016. If he purchases the car, the estimated sales price at the end of these two years would be \$12,000. He expects to drive the car about 40,000 kilometers in each of the two years.

Assume that operating costs will be \$0.20 per kilometer and the prescribed operating cost benefit will be \$0.27 per kilometre throughout both years.

John's combined federal/provincial marginal tax rate is 48 percent.

Required: On the basis of undiscounted cash flows, advise John as to whether he should purchase the car assuming:

- A. ML purchased the car for \$35,000.
- B. ML purchased the car for \$70,000.

Ignore GST/HST considerations.

Self Study Problem Three - 6 (Loans To Employees)

Mr. Thomas Malone is employed by Technocratic Ltd. in a management position. Because of an outstanding performance in his division of the Company, he is about to receive a promotion accompanied by a large increase in compensation. He is discussing various possible ways in which his compensation might be increased without incurring the same amount of taxation as would be assessed on an increase in his salary. He has suggested that it might be advantageous for the Company to provide him with a five year interest free loan in the amount of \$200,000 as part of any increase in compensation.

The funds will either be used to purchase a cottage in which case any interest on related loans will not be deductible to Mr. Malone, or used to purchase investments in which case any interest on related loans will be deductible to Mr. Malone.

Other relevant information is as follows:

- Given Mr. Malone's present salary, any additional income will be taxed at 45 percent.
- Technocratic Ltd. is able to invest funds at a before tax rate of 18 percent. It is subject to taxation at a 25 percent rate.
- Mr. Malone can acquire a similar term, \$200,000 loan at an annual rate of 5 percent.
- Assume that the relevant Regulation 4301 rate for imputing interest on various tax related balances is 2 percent.

Required: Evaluate Mr. Malone's suggestion of providing him with an interest free loan in lieu of salary from the point of view of the cost to the Company. How will the deductibility of the interest affect your conclusion?

Self Study Problem Three - 7 (Employee Stock Options)

During 2013, Ms. Sara Wu's employer, Imports Ltd., granted her stock options that allowed her to acquire 12,000 shares of the Company's common stock at a price of \$22 per share. At this time, the shares have a fair market value of \$20 per share.

Problems For Self Study

On June 1, 2014, Ms. Wu exercises all of these options. At this time, Imports Ltd. shares have a fair market value of \$31 per share.

On January 31, 2015, Ms. Wu sells the 12,000 Imports Ltd. shares at a price of \$28 per share.

Required For each of the following Cases, calculate the tax consequences of the transactions that took place during 2013, 2014, and 2015 on both the Net Income For Tax Purposes and the Taxable Income of Ms. Wu. Where relevant, identify these effects separately.

Case A Imports Ltd. is a public company.

Case B Imports Ltd. is a Canadian controlled private corporation.

Self Study Problem Three - 8 (Employee Stock Options)

During 2013, her first year as an employee of Borden Ltd., Ms. Marcia Balzac was granted options to purchase 2,500 of the Company's shares at a price of \$8.00 per share.

When Ms. Balzac exercises the options, the shares are trading at \$8.30 per share.

On November 1, 2015, Ms. Balzac sells all of her shares at a price of \$8.55 per share.

Required: Indicate the tax effect on Ms. Balzac of the transactions that took place during 2013, 2014, and 2015 under each of the following independent Cases. Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.

- A. Borden Ltd. is a Canadian controlled private corporation. At the time the options were granted, the Company's shares had a fair market value of \$7.50 per share. The options were exercised on October 1, 2014.
- B. Borden Ltd. is a Canadian public company. At the time the options were granted, the shares were trading at \$7.50 per share. The options were exercised on October 1, 2014.
- C. Borden Ltd. is a Canadian public company. At the time the options were granted, the shares were trading at \$8.25 per share. The options were exercised on October 1, 2014.
- D. Borden Ltd. is a Canadian controlled private corporation. At the time the options were granted, the Company's shares had a fair market value of \$9.00 per share. The options were exercised on October 1, 2013.

Self Study Problem Three - 9 (Employment Income - No Commissions)

For the last three years, Sam Jurgens has been employed in Halifax as a loan supervisor for Maritime Trust Inc. Maritime Trust is a large public company and, as a consequence, Mr. Jurgens felt that he did not have the opportunity to exhibit the full range of his abilities. To correct this situation, Sam decided to accept employment in Toronto effective July 1, 2015 as the general manager of Bolten Financial Services, a Canadian controlled private corporation specializing in providing financial advice to retired executives.

In April, 2015, prior to leaving Maritime Trust, Mr. Jurgens exercised options to purchase 5,000 shares of the public company's stock at a price of \$15 per share. At the time the Maritime Trust options were granted, the shares were trading at the option price of \$15 per share. At the time that he exercised these options, the shares were trading at \$16 per share. He is still holding these shares on December 31, 2015.

Mr. Jurgens had an annual salary at Maritime Trust of \$105,000, while in his new position in Toronto, the salary is \$90,000 per year. However, he has the option of acquiring 1,000 shares per year of Bolten stock at a price of \$20 per share. On July 1, when he was granted the option, Bolten stock had a fair market value of \$14 per share. On December 1, 2015, when the Bolten stock has a fair market value of \$22 per share, Mr. Jurgens exercises these options and acquires 1,000 shares. It is his intent to hold these shares for an indefinite period of time.

Because there is extensive travel involved in the position with Bolten Financial Services, the Company has provided Mr. Jurgens with a \$40,000 company car. Between July 1 and December 31, 2015, Mr. Jurgens drove this car a total of 25,000 kilometers, of which 15,000 kilometers were clearly related to his work with Bolten Financial Services. The operating costs associated with the car for this period, all of which were paid for by the Company, amount to \$5,000. Because of extensive repairs resulting from a manufacturer's recall, the car had to be returned to the Company for the months of October and November, 2015.

At the time of his move to Toronto, Bolten Financial Services provided Mr. Jurgens with a \$200,000 home relocation loan to purchase a personal residence near the center of town. No interest was charged on this loan.

During the year, Mr. Jurgens earned \$15,000 in interest and received \$45,000 in dividends from taxable Canadian corporations.

Assume that the relevant prescribed rate through all of 2015 is 2 percent.

Required: Compute Sam Jurgens' minimum net employment income for the year ending December 31, 2015.

Self Study Problem Three - 10 (Employment Income - No Commissions)

(This Problem Is Continued In Self Study Problem Four-4)

Mr. John Barth has been employed for many years as a graphic illustrator in Kamloops, British Columbia. His employer is a large publicly traded Canadian company. During 2015, his gross salary was \$82,500. In addition, he was awarded a \$20,000 bonus to reflect his outstanding performance during the year. As he was in no immediate need of additional income, he arranged with his employer that none of this bonus would be paid until 2020, the year of his expected retirement.

Other Information:

For the 2015 taxation year, the following items were relevant.

- Mr. Barth's employer withheld the following amounts from his income:

Federal Income Tax	\$16,000
Employment Insurance Premiums	931
Canada Pension Plan Contributions	2,480
United Way Donations	2,000
Registered Pension Plan Contributions	3,200
Payments For Personal Use Of Company Car	3,600
- During the year, Mr. Barth is provided with an automobile owned by his employer. The cost of the automobile was \$47,500. Mr. Barth drove the car a total of 10,000 kilometers during the year, of which only 4,000 kilometers were related to the business of his employer. The automobile was used by Mr. Barth for ten months of the year. During the other two months, he was out of the country he was required to leave the automobile with one of the other employees of the corporation.
- During the year, the corporation paid Mega Financial Planners a total of \$1,500 for providing counseling services to Mr. Barth with respect to his personal financial situation.
- In order to assist Mr. Barth in purchasing a ski chalet, the corporation provided him with a five year loan of \$150,000. The loan was granted on October 1 at an interest rate of 1 percent. Mr. Barth paid the corporation a total of \$375 in interest for 2015 on January 20, 2016. Assume that, at the time the loan was granted and throughout the remainder of the year, the relevant prescribed rate was 2 percent.
- Mr. Barth was required to pay professional dues of \$1,800 during the year.

Problems For Self Study

6. On June 6, 2015, when Mr. Barth exercised his stock options to buy 1,000 shares of his employer's common stock at a price of \$15 per share, the shares were trading at \$18 per share. When the options were issued, the shares were trading at \$12 per share. During December, 2015, the shares were sold for \$18 per share.

Required: Calculate Mr. Barth's minimum net employment income for the year ending December 31, 2015. Provide reasons for omitting items that you have not included in your calculations. Ignore GST and PST considerations.

Self Study Problem Three - 11 (Employment Income With Commissions)

Ms. Sandra Firth is a commission salesperson who has been working for Hadley Enterprises, a Canadian public corporation, for three years. During the year ending December 31, 2015, her gross salary, not including commissions or allowances, was \$72,000. Her commissions for the year totalled \$14,000. The following amounts were withheld by Hadley Enterprises from Ms. Firth's gross salary:

Federal and provincial income taxes	\$22,000
Registered pension plan contributions (Note One)	3,200
Payments for group disability insurance (Note Two)	250
Payments for personal use of company car (Note Three)	2,400
Payments for group term life insurance (Note Four)	450
Interest on home purchase loan (Note Five)	3,000
Purchase of Canada Savings Bonds	2,060

ote One Hadley Enterprises made a matching \$3,200 contribution to Ms. Firth's registered pension plan.

ote Two Ms. Firth is covered by a comprehensive disability plan which provides periodic benefits during any period of disability to compensate for lost employment income. Prior to 2015, Hadley Enterprises paid all of the \$500 per year premium on this plan. However, as of 2015, Ms. Firth is required to pay one-half of this premium, the \$250 amount withheld from her gross salary. During 2015, Ms. Firth was hospitalized for the month of March. For this period, the disability plan paid her \$500 per week, for a total of \$2,000.

ote Three Hadley Enterprises provides Ms. Firth with a Lexus that was purchased in 2014 for \$58,000. During 2015, she drove the car 92,000 kilometers, 7,000 of which were personal in nature. Ms. Firth paid all of the operating costs of the car, a total of \$6,200 for the year ending December 31, 2015. However, the Company provides her with an annual allowance of \$7,200 to compensate her for these costs. While Ms. Firth was hospitalized during the month of March (see Note Two), her employer required that the car be returned to their premises.

ote our Ms. Firth is covered by a group term life insurance policy that pays her beneficiary \$160,000 in the event of her death. The 2015 premium on the policy is \$1,350, two-thirds of which is paid by her employer.

ote i e On January 1, 2015, the Company provided Ms. Firth with a \$400,000 loan to assist with the purchase of a new residence. The loan must be repaid by December 31, 2015. All of the interest that is due on the loan for 2015 is withheld from Ms. Firth's 2015 salary. This loan does not qualify as a home relocation loan.

Other Information:

1. At Christmas, the Company gives all of its employees a mini iPad. Each mini iPad costs the Company \$350, including all applicable taxes. The Company deducts this amount in full in its corporate tax return.

Problems For Self Study

2. During 2014, Ms. Firth received stock options from Hadley to acquire 1,000 shares of its common stock. The option price is \$5.00 per share and, at the time the options are issued, the shares are trading at \$4.50 per share. In June, 2015, the shares have increased in value to \$7.00 per share and Ms. Firth exercises her options to acquire 1,000 shares. She is still holding them at the end of the year and has no intention of selling them.
3. The Company provides Ms. Firth with a membership in the Mountain Tennis Club. The cost of this membership for the year is \$2,500. During the year, Ms. Firth spends \$6,500 entertaining clients at this club. The Company does not reimburse her for these entertainment costs.
4. Ms. Firth had travel costs related to her employment activities as follows:

Meals	\$1,300
Lodging	3,500
<u>Total</u>	<u>\$4,800</u>

Her employer provides her with a travel allowance of \$300 per month (\$3,600 for the year) which is included on her T4 for the year.

5. Assume that the relevant prescribed rate for the entire year is 2 percent.

Required: Calculate Ms. Firth's minimum net employment income for the year ending December 31, 2015. Provide reasons for omitting items that you have not included in your calculations. Ignore any GST or PST implications.

Self Study Problem Three - 12
(Employment Income With Commissions, Car CCA)

Mr. Jones is a salesman handling a line of computer software throughout Western Canada. During 2015, he is paid a salary of \$25,800 and receives sales commissions of \$47,700. He does not receive an allowance from his employer for any of his expenses. During the year, Mr. Jones made the following employment related expenditures:

Airline Tickets	\$ 2,350
Office Supplies And Shipping Costs	415
Purchase Of Laptop Computer	2,075
Client Entertainment	1,750
Cost Of New Car	24,000
Operating Costs Of Car	7,200

The new car was purchased on January 5, 2015, and replaced a car which Mr. Jones had leased for several years. During 2015, Mr. Jones drove the car a total of 50,000 kilometers, of which 35,000 kilometers were for employment related purposes. The maximum capital cost allowance for the car (100 percent) is \$3,600.

In addition to expenditures to earn employment income, Mr. Jones has the following additional disbursements:

Alberta Blue Cross Medical Insurance Premiums	\$435
Group Life Insurance Premiums	665

Mr. Jones indicates that he regularly receives discounts on his employer's merchandise and, during the current year, he estimates that the value of these discounts was \$1,300.

One of the suppliers of his employer paid \$2,450 to provide Mr. Jones with a one week vacation at a northern fishing lodge.

Required: Determine Mr. Jones' net employment income for the 2015 taxation year. Ignore all GST and PST implications.

Self Study Problem Three - 13 (Commission Income And Work Space In Home)

Mr. Worthy is a commissioned salesman and has asked for your assistance in preparing his income tax return for the current year. He has provided you with the following information:

Employment Income		
Salary		\$65,000
Commissions		\$11,000
Telephone Charges		
Monthly Charge For Residential Line	\$ 250	
Long Distance To Clients		
From Work Space In Home	400	
Cellular Phone Airtime To Clients	<u>800</u>	\$ 1,450
Office Supplies And Postage At Home Office		\$ 295
Cost of Tickets To Basketball Games With Clients		\$ 2,550
Travel Expenses		
Car Operating Costs	\$2,700	
Meals	900	
Hotels	<u>2,850</u>	\$ 6,450
Capital Cost Allowance On Car (100%)		\$ 2,450
Cost Of Maintaining Work Space In The Home (Based On A Proportion Of Space Used)		
House Utilities	\$485	
House Insurance	70	
House Maintenance	255	
Capital Cost Allowance - House	750	
Capital Cost Allowance - Office Furniture	475	
Mortgage Interest	940	
Property Taxes	<u>265</u>	\$ 3,240
Interest		
On Loan To Buy Office Furniture	\$1,700	
On Loan To Buy Car	<u>2,300</u>	\$ 4,000

Mr. Worthy's car was purchased, used, several years ago for \$28,000. Twenty percent of the mileage on the car is for personal matters. He is required by his employer to maintain an office in his home and is eligible to deduct work space in the home costs. Mr. Worthy has received no reimbursement from his employer for any of the amounts listed.

Required: Ignore GST and PST implications in your solutions.

- Calculate Mr. Worthy's minimum net employment income for the current year.
- Assume Mr. Worthy had only \$4,000 in commission income in addition to his \$65,000 salary. Calculate Mr. Worthy's minimum net employment income for the current year.

Self Study Problem Three - 14 (Comprehensive Employment Income)

Mitch Lesner graduated from the University Of Alberta in early 2015 at the age of 28. He immediately applied for a number of jobs and accepted a position as a financial planner in the Ottawa office of Oxford Associates Ltd. Oxford Associates Ltd. is a large Canadian controlled private corporation (CCPC) employing more than two hundred people.

Prior to accepting employment with Oxford Associates, Mitch had lived in Red Deer, Alberta. Once he had signed the contract with Oxford Associates, plans were made to sell the house he owned in Red Deer. Unfortunately the home remained unsold when he moved on March 8,

2015. It was sold in late May, 2015 for \$125,000. He had purchased the home several years before for \$147,000.

He arrived in Ottawa on March 16 and moved into an apartment he had rented on a monthly basis until he could arrange to purchase a home. Rent payments were required from April 1.

Mitch began work on April 1, 2015 and eagerly awaited the arrival of his long-time girlfriend Janice Masters from Alberta. Shortly after her arrival in Ottawa, Mitch and Janice were married on November 29, 2015. Mitch had purchased a house just outside of Ottawa for \$235,000 that they moved into on December 1, 2015.

Mitch's new job requires him to meet with existing and prospective clients outside of regular office hours and, at times, on weekends. As a result, Oxford Associates will sign form T2200 stating Mitch is required to pay for certain employment expenses without reimbursement and use a portion of his home for work. He has set aside a small room in his rented apartment which is used exclusively to meet with clientele. Mitch is also provided with an automobile to use in his work.

Mitch is compensated by salary with a bonus and stock option arrangement. The bonus is based on overall company profits. The stock option is available to all employees depending upon level of service and overall job evaluation.

Other Information:

1. Given Mitch's high grades at the University Of Alberta, Oxford Associates offered Mitch \$10,000 to convince him to sign a five year employment contract. After Mitch accepted, he received the cheque in February, 2015. During the period April 1, 2015 through December 31, 2015, Mitch earned salary of \$63,700. Of these earnings, \$62,550 was paid during this period as Oxford Associates holds back one week's pay. The Company withheld the following amounts from his salary:

Income Taxes	\$11,400
CPP	2,480
EI	931
RPP Contributions	1,200
Payment For Personal Use Of Automobile	600

2. On December 16, 2015, a bonus of \$7,450 was accrued for Mitch. Mitch received \$2,000 of this bonus on December 21, 2015, with the remainder being paid on February 17, 2016.
3. A few months into the new job Mitch became quite depressed. His employer suggested he take advantage of the company assistance program. He went to four appointments in October and November and felt much better. Oxford Associates paid \$700 for Mitch's counselling services.
4. Oxford Associates provides group medical coverage to all of its employees. The premiums paid by Oxford Associates on Mitch's behalf cost \$410.
5. Oxford Associates contributed \$1,200 on Mitch's behalf to the Company's RPP.
6. Mitch is a Certified Financial Planner and paid \$785 in professional dues in 2015. Oxford Associates' policy is to reimburse 80 percent of such annual professional dues. Oxford Associates reimbursed him \$628 in November 2015.
7. When Mitch was married in November he received non-cash wedding gifts valued at \$850. Half of the amount was contributed by his employer and the balance from other employees.
8. Oxford Associates discovered years ago that many existing clients frequent certain recreational and sporting clubs. To encourage contacts with potential clients, employees have their choice among five such clubs. Since Mitch enjoys squash, he chose a free membership at a local squash club. The annual membership fee is \$915.

Problems For Self Study

9. Oxford Associates reimbursed Mitch for 80 percent of the \$22,000 (\$147,000 - \$125,000) loss that he experienced on the sale of his Red Deer home.
10. Mitch had \$35,000 for a down-payment on his new Ottawa home. Since he had no previous work experience, the banks were reluctant to provide him a mortgage at favourable terms. His employer stepped in and agreed to an interest-free housing loan of \$200,000 beginning on December 1, 2015. Mitch agreed to reduce his salary slightly with respect to this benefit. The loan requires annual payments of \$7,500 due at the end of November beginning in 2016. The loan is required to be paid if Mitch dies, sells the home or terminates his employment. Assume that the prescribed interest rates for such benefits are 2 percent in each of the first two quarters of 2015 and 1 percent in the third and fourth quarters.
11. Oxford instituted a stock option plan for its employees in 2014. The plan eligibility requires six months of service. Employees are permitted to acquire a limited number of option shares at 20 percent below their fair market value on either May 1 or November 1. The company hires valuers to determine the fair market value at each of those dates. Mitch acquires 200 shares November 1, 2015 for \$12,800. Low on cash and wanting to buy Janice a nice wedding ring, he is forced to sell 80 of the shares. He sells them on December 16, 2015 for \$8,960.
12. Oxford Associates has an arrangement with a local dealership to lease a minimum number of new automobiles each year at favourable rates. Mitch receives his leased automobile May 1, 2015. It has 162 kilometers on it when it is received. The odometer reads 19,414 kilometers on December 31, 2015. Mitch estimates that he drove 5,198 kilometers for personal purposes, including drives to and from home to the office. Oxford Associates pays monthly lease payments (including HST) of \$430. The cost of gas, oil, insurance, repairs and maintenance and other charges total \$2,175 for 2015. Oxford Associates requires each employee provided with an automobile to pay \$75 each month for the use of the automobile which is withheld directly from their pay.
13. Mitch prepared a separate room in his apartment to be used exclusively for a home office. He used the office space between June 1 and November 30, 2015. A home office was not ready in his newly purchased home until February, 2016. The apartment office space is exactly 100 square feet. The total apartment space is 1,176 square feet. Home office related costs are as follows:

Monthly Rent	\$ 960
Monthly Phone Line Charge (April to November)	41
Employment Related Long Distance Calls (June to November)	74
Total Electricity Charge (March 16 to November 30)	870
Property Insurance (March 16 to November 30)	175
Paint For Apartment	253
Office Furniture	1,344
Computer Purchase	1,739
Stationery And Office Supplies Purchased	129

14. Mitch received an allowance of \$250 per month for six months to cover the costs of maintaining an office in his home.

Required: Determine Mitch's net employment income for the year 2015. Provide explanations for all amounts including reasons for omitting items not included in your calculations.

Supplementary Self Study Problems (Online)

If you would like more practice in problem solving, there are additional Supplementary Self Study Problems, with detailed solutions, on the Companion Website.

- SSS Problem Three - 1 (Taxable Automobile Benefits)
- SSS Problem Three - 2 (Loans To Employees)
- SSS Problem Three - 3 (Employee Stock Options)
- SSS Problem Three - 4 (Employment Income)

Assignment Problems

(The solutions for these problems are only available in the solutions manual that has been provided to your instructor.)

Assignment Problem Three - 1 (Bonus Arrangements)

Each of the following independent Cases involves a Canadian public company paying a bonus to a key executive named Christine Lane.

Case A The company's year end is August 31. The bonus is declared on August 31, 2015 and paid on December 31, 2015.

Case B The company's year end is July 31. The bonus is declared on March 2, 2015 and paid on January 1, 2016.

Case C The company's year end is December 31. The bonus is declared on December 1, 2015 and paid on July 1, 2016.

Case D The company's year end is September 30. The bonus is declared on October 31, 2015 and paid on October 31, 2019.

Required: For each of these Cases, indicate the taxation year in which the Company can deduct the bonus, as well as the taxation year in which Ms. Lane will include it in her taxable income.

Assignment Problem Three - 2 (Employee Vs. Self-Employed)

The Alberta Motor Association (the Payor) carried on a business of training and providing instruction to individuals who wanted to obtain vehicle operator's licenses. Mr. Bourne (the Appellant) had an arrangement with the Payor to provide such instruction.

The Payor had treated Mr. Bourne as an independent contractor from 2013 to 2015. Mr. Bourne was claiming that he was an employee of the Alberta Motor Association in 2015.

The facts in this case are as follows:

- the Payor operated as a membership based association; (admitted)
- the Payor had clients who wanted to obtain motor vehicle operator's licences; (admitted)
- the Appellant was hired as a driving instructor; (admitted)
- the Appellant entered into a written contract with the Payor which stated that the Appellant was a contractor and not an employee;
- the Appellant had been under contract with the Payor since 2013;
- the Appellant earned a set fee of \$26 per hour;
- the Appellant also received fees for new bookings, student home pickups and a fuel subsidy;
- the Appellant invoiced the Payor;

Assignment Problems

- the Appellant did not receive any employee benefits such as health, dental or vacation pay;
- the Payor did not guarantee the Appellant a minimum amount of pay;
- the Payor's hours of operation were from 8:00AM to 5:00PM, Monday to Saturday;
- the Appellant set his own schedule of hours and days of work;
- the Appellant could work anytime between 8:00AM and 10:00PM, Monday to Sunday;
- the Appellant did not have a set minimum number of hours of work required;
- the Appellant kept a record of his hours worked;
- the Payor provided the Appellant with the names of the students;
- the Appellant contacted the students and scheduled the road instruction;
- the Payor provided the Appellant with an in-vehicle lesson guide;
- the Appellant chose the routes for the lessons;
- the Appellant was able to hire his own helper for administrative tasks;
- the Appellant provided the major tool which was the vehicle;
- the Payor provided vehicle signage, mirrors, traffic cones and an emergency brake;
- the Appellant paid for the installation and removal of the emergency brake provided by the Payor;
- the Appellant incurred operating expenses including vehicle expenses, liability insurance and a driver training endorsement;
- the Appellant's vehicle expenses included insurance, maintenance and fuel;
- the Payor's intention was that the Appellant was a contractor and not an employee;
- the Appellant had a GST number;
- the Appellant charged the Payor GST;
- the Appellant had operated his own taxi business since 1997;
- the Appellant maintained his own business books and records;
- the Appellant declared business income and business expenses on his 2013, 2014 and 2015 income tax returns.

Required: Should Mr. Bourne be viewed as an employee of the Alberta Motor Association or, alternatively, an independent contractor? List all of the factors that should be considered in reaching a conclusion.

Assignment Problem Three - 3 (Employer Provided Vs. Employee Owned Car)

Jerry Field was hired by Larson Wholesalers at the end of 2014 to fill an executive position in the company. He is scheduled to begin work on January 2, 2015. Larson Wholesalers plans to transfer him to their Hong Kong office after two years.

As part of his compensation package, Jerry has considered having the Company provide him with a car for his personal use. He does not require the vehicle for his employment duties and, as a consequence, it will be used for personal activities only.

Jerry anticipates that he will drive the car about 80,000 kilometers in both 2015 and 2016.

He is considering two different cars and has collected the following information on them:

	Lexus ES	Lexus LS
Purchase Price	\$45,000	\$100,000
Estimated Operating Costs Per Kilometer	\$0.30	\$0.40
Estimated Trade In At The End Of 2 Years	\$20,000	\$40,000

The Company has agreed to provide an additional \$100,000 in compensation and they offer Jerry the following alternatives.

Option 1 They will purchase either car and allow Jerry to use it for the calendar years 2015 and 2016. If Jerry prefers the Lexus ES, the Company will provide a signing bonus of \$55,000, the difference in the cost of the two cars. The bonus will be paid when the car is delivered on January 2, 2015.

Assignment Problems

Option 2 They will provide Jerry with a \$100,000 signing bonus. This bonus will be paid on January 2, 2015. He will use the funds to purchase one of the cars personally.

If the Company buys either car, Jerry will pay his own operating costs and the Company will take possession of the car after the 2 years.

Jerry's combined federal/provincial marginal tax rate is expected to be 48 percent in both 2015 and 2016.

Assume that the prescribed operating cost benefit will be \$0.27 per kilometer for both 2015 and 2016.

Required: Advise Jerry as to which option he should choose if decides that he wants:

- A. the Lexus ES.
- B. the Lexus LS.

In both parts of this question your advice should be based on undiscounted cash outflows. Ignore GST and HST considerations in your solution.

Assignment Problem Three - 4 (Taxable Automobile Benefits)

Klaxton Inc. provides an automobile to Ms. Roxanne Smith for her to use in carrying out her employment duties. Ms. Smith is given full possession of the car and is allowed to use it for personal needs. However, when she is not using it for employment or personal activities, it must be returned to Klaxton's premises so that it can be used by other employees.

The automobile was purchased in 2013 for \$42,000 and, during the years 2013, 2014, and 2015, the Company has deducted maximum CCA.

During 2015, Ms. Smith drove the car 48,000 kilometers, with the Company paying for all of the operating costs. These costs totaled \$9,850 during the year.

Required: Ignore all GST/PST/HST implications. Indicate the minimum taxable benefit that would be allocated to Ms. Smith in each of the following Cases:

Case A Ms. Smith has use of the car for 11 months of the year. Personal use during the year totals 4,000 kilometers.

Case B Ms. Smith has use of the car for 10 months of the year. Personal use during the year totals 23,000 kilometers.

Case C Ms. Smith has use of the car for 8 months of the year. Employment use during the year totals 4,000 kilometers.

Assignment Problem Three - 5 (Taxable Automobile Benefits)

It is the policy of Dorsey Ltd. to provide automobiles to four of their senior executives. The cars may be used for both employment related activities, as well as personal travel. When it is not being used by the employee, the Company requires the cars to be returned to the Company's garage.

For the current year, the details regarding the use of these cars is as follows:

Ms. Marianne Dorsey Marianne is the president of the Company. She is provided with a Bentley Flying Spur Sedan. The Company paid \$185,000 for this car two years ago. During the current year, the car was driven 53,000 kilometers, of which 18,000 could be considered to be employment related travel. Operating costs, all of which were paid by the Company, totaled \$27,500 for the year. The car was available to Marianne for 11 months of the year.

Assignment Problems

Mr. John Dorsey John is the vice president in charge of finance. His car is a BMW 528 purchased by the Company for \$71,500. During the 10 months that the car was available to John during the current year, he drove a total of 93,000 kilometers, of which 22,000 involved personal travel. Operating costs, all of which were paid by the Company, total \$18,600.

Ms. Misty Dorsey Misty is the vice president in charge of design. She is provided with an Infiniti Q60 IPL which the Company leases for \$620 per month. This amount includes a \$100 per month payment for insurance. The car is available to Misty throughout the current year, during which she drives a total of 51,000 kilometers. Of this total, only 14,000 kilometers involve employment travel. Operating costs, all of which were paid by the Company, total \$11,300. Because of her extensive personal use of the vehicle, Misty pays the Company \$200 per month.

Mr. Saul Dorsey Saul is the vice president in charge of marketing for the Company. He is provided with a Tesla Model S which the Company leases for \$1,200 per month. No insurance is provided for through this payment. During the current year, Saul drives the car a total of 31,200 kilometers, of which 29,500 are employment related. The operating costs average \$0.25 per kilometer and are paid for by the Company. The car is available to Jean for 8 months during the current year.

Required: Calculate the minimum taxable benefit that will accrue to each of these executives as the result of having the cars supplied by the Company. Ignore all GST/PST/HST implications.

Assignment Problem Three - 6 (Loans To Employees)

Albert Lee is an employee of a large Canadian company. As he has performed exceptionally well in recent years and has become sought after by competitors, the Company is planning to increase his compensation in an effort to retain him.

Mr. Lee has developed a growing interest in investing in options and, in order to finance this activity, he is looking to borrow \$500,000. His bank has indicated that they would be prepared to loan this amount to him at a rate of 6 percent. This is attractive in that he anticipates that his activity in the options market will generate a pre-tax return of at least 15 percent.

Given this situation, Mr. Lee has indicated to his employer that, instead of additional remuneration in the form of salary, he would be prepared to accept a \$500,000 interest free loan for 3 years. He would fully invest this sum in options.

The Company is subject to tax at a combined federal/provincial rate of 27 percent. When funds are available, the Company has alternative investment opportunities that earn a pre-tax rate of 9 percent. Because of Mr. Lee's current high salary, any additional compensation will be taxed at a combined federal/provincial rate of 46 percent.

Assume that the prescribed rate for the current year is 2 percent.

Required:

- A. Determine the tax consequences to Mr. Lee and the cost to the Company, in terms of lost after-tax earnings, of providing Mr. Lee with a \$500,000 interest free loan for the first year of the loan.
- B. Determine the amount of additional salary that could be provided to Mr. Lee for the same after tax cost to the Company that you calculated in Part A.
- C. Which alternative would you recommend that Mr. Lee accept? Explain your conclusion.

Assignment Problem Three - 7 (Loans To Employees)

Ms. Teresa Monson is employed by Elmwood Inc. She has asked the employer for a \$300,000 interest free loan that will be used to acquire a summer cottage in Huntsville, Ontario. The cottage will be used exclusively as a recreational property. As she is a highly valued employee, Elmwood Inc. is considering her request.

Ms. Monson can acquire a regular mortgage at a rate of 4.5 percent. Assume that the relevant prescribed rate is 2 percent for all periods that the employee loan will be outstanding.

Ms. Monson's tax rate on any additional income is 46 percent. Elmwood Inc. has alternative investment opportunities that earn a before tax rate of 7 percent. Elmwood Inc. is subject to a tax rate of 36 percent on additional amounts of income.

Required: Evaluate Ms. Monson's suggestion of providing her with an interest free loan in lieu of salary from the point of view of the cost to Elmwood Inc.

Assignment Problem Three - 8 (Employee Stock Options)

Ms. Patricia Martin is employed by a Canadian public company. In 2013, she was given options to acquire 1,500 of the company's shares at a price of \$45 per share. At this time the shares are trading at \$47 per share.

During 2014, Patricia exercises all of the options. At this time, the shares are trading at \$50 per share.

During 2015, Patricia sells the shares for \$55 per share. The commission on the sales price is 1 percent.

Required:

- A. Indicate the tax effect of the transactions that took place during each of the years 2013, 2014, and 2015. Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.
- B. How would your answer change if the shares had been trading at \$44 per share at the time that the options were issued in 2013?
- C. How would your answer change if Patricia's employer was a Canadian controlled private company?

Assignment Problem Three - 9 (Employee Stock Options)

Opting Inc. has a very generous stock option plan that allows all of their long term employees to participate. Sandra has worked for the Company for over 10 years and has participated in this plan on a regular basis. With regards to the last options granted to her, the following information is relevant:

- On January 1, 2013, Sandra was granted options to acquire 275 of the Company's shares at a price of \$15.00 per share.
- At a later point in time, when Sandra exercises these options, the Company's shares have a fair market value of \$17.50 per share.
- On December 1, 2015, all of the shares acquired with the options are sold.

Required: Indicate the tax effect on Sandra of the transactions that took place during 2013, 2014, and 2015 under each of the following independent Cases. Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.

Assignment Problems

Case A Opting is a Canadian controlled private company. At the time the options were granted, the Company's shares had a fair market value of \$16.00 per share. The options are exercised on February 28, 2013. When the shares are sold, the proceeds of disposition are \$20.25 per share.

Case B Opting is a Canadian public company. At the time the options were granted, the Company's shares were trading at \$16.00 per share. The options are exercised on February 28, 2013. When the shares are sold, the proceeds of disposition are \$16.00 per share.

Case C Opting is a Canadian public company. At the time the options were granted, the Company's shares were trading at \$14.00 per share. The options are exercised on July 1, 2014. When the shares are sold, the proceeds of disposition are \$19.75 per share.

Case D Opting is a Canadian controlled private company. At the time the options were granted, the Company's shares had a fair market value of \$14.00 per share. The options are exercised on July 1, 2014. When the shares are sold, the proceeds of disposition are \$21.50 per share.

Assignment Problem Three - 10 (Employment Income)

On January 2, 2015, Ms. Shirley Kantor moves from London, Ontario, to Thunder Bay, Ontario, in order to begin employment with Northern Enterprises Ltd. (NEL). Her salary for the year was \$142,000. NEL withheld the following amounts from her earnings:

Federal And Provincial Income Tax	\$32,500
Registered Pension Plan Contributions (NEL Makes A Matching Contribution)	3,200
EI Premiums	931
CPP Contributions	2,480
United Way Donations	450
Professional Association Dues	1,250

Other Information:

- Shirley's moving expenses total \$6,800. NEL reimbursed Shirley for 100 percent of these costs.
- For the year ending December 31, 2015, Shirley was awarded a bonus of \$32,000. Of this total, \$25,000 was paid during 2015, with the remainder payable in January, 2016.
- NEL provided Shirley with a car to be used in her employment activities and paid the operating costs for the year that totalled \$8,100. The cost of the car was \$39,550, including HST of \$4,550. The car was available to Shirley throughout 2015. She drove a total of 63,000 kilometers. This included 8,000 kilometers of personal use.
- In negotiating her new position with NEL, Shirley had asked for a \$50,000 interest free loan as one of her benefits. NEL's human resources department indicated that the CEO would not approve any employee loans. However, they agreed to advance \$50,000 of her 2016 salary as of November 1, 2015.
- In her employment related travels, Shirley has accumulated over 100,000 Aeroplan points. During 2015, she and her partner Diane used 50,000 of these points for a weekend flight to New York City. If she had purchased them, the tickets would have cost a total of \$940.
- NEL provided Shirley with the following additional benefits:

Allowance For Acquiring Business Clothing	\$4,800
Squash Club Membership (No Employment Related Usage)	2,800
Financial Advisor Fees	1,200

Assignment Problems

7. Shirley's previous employer was a Canadian controlled private corporation. In 2014, she was granted options to buy 500 of the company's shares at \$20 per share. This option price was higher than the estimated fair market value of the company's shares at the time the options were granted. On January 2, 2015, Shirley exercised these options. At this time the fair market value of the shares was \$28 per share. Shirley immediately sells the shares for \$28 per share.
8. Shirley was required by her employer to acquire a laptop computer to be used in her employment duties. At the beginning of 2015, she purchased a computer at a cost of \$1,356, including HST of \$256. During 2015, her expenditures for computer related supplies totalled \$150.

Required Determine Shirley's net employment income for the year ending December 31, 2015.

Assignment Problem Three - 11 (Commission Income And Work Space In Home)

Curt Robinson is employed by a Canadian public company in Toronto and lives downtown. During 2015, he has a base salary of \$183,000. In addition to his salary, he earns commission of \$22,310. Additional information relevant to Curt's 2015 employment income is as follows:

1. Curt is a member of his employer's registered pension plan. During 2015, \$3,750 was withheld from his salary as a contribution to this plan. His employer made a matching contribution of \$3,750.
2. For his employment related travel, Curt drives a car that he purchased on January 1, 2015 for \$38,000. During 2015, he drives 45,000 kilometers, of which 38,000 are employment related. Curt had financed the car with a loan from a local bank and, during 2015, he had paid interest of \$2,300.

The costs of operating the car during 2015 were \$11,420. He has been advised by his accountant that, if the car were used 100 percent for employment related activities, the maximum CCA for 2015 would be \$4,500.

3. Curt's employer requires him to pay all of his employment related expenses, as well as provide his own office space. Curt has the required Form T2200 from his employer.
4. During 2015, he pays dues to his professional association of \$375.
5. At the beginning of 2015, Curt's employer grants him options to buy 250 of the Company's shares at a price of \$11.25 per share. This was the market price of the shares at the time the options were granted. During July, 2015, when the shares are trading at \$14.75 per share, he exercises all of these options. In order to buy Christmas gifts for his family, he sells 100 of these shares in early December, 2015. The proceeds are \$16.50 per share.
6. His employer has a policy of rewarding employees with gifts for exceptional performance. During 2015, Curt received the following gifts:
 - A weekend for him and his wife at a local hotel. The value of this gift was \$375.
 - A \$200 gift certificate at a local hardware store.
 - A basket of fruit, nuts, and cheeses, with a value of \$175.
7. Curt uses 25 percent of his personal residence as an office. During 2015, the costs associated with his home were as follows:

Interest Payments On Mortgage	\$ 8,700
Property Taxes	3,850
Utilities	1,875
Insurance	960
Roof Repairs	3,640
Total	\$19,025

Assignment Problems

8. Curt's travel costs for 2015, largely airline tickets, food, and lodging, total \$24,600. This includes \$10,300 spent on meals while traveling for his employer. This total includes meals with clients of \$2,400.
9. During 2015, Curt was billed a total of \$9,600 by his golf club in Toronto. Of this amount, \$2,250 was the annual membership fee, with the remaining amount for meals and drinks with clients. He uses the club only when he is with clients.
10. During 2015, Curt purchased tickets to Toronto football games for a total of \$845. He used these tickets to attend these games with key personnel from an important client. He also purchased tickets to a Cirque du Soleil performance in Montreal for \$275. He used these tickets to attend the show with the owners of a prospective client located in Montreal.

Required: Calculate Curt's minimum net employment income for the 2015 taxation year. Ignore GST and PST considerations.

Assignment Problem Three - 12 (Employment Income)**(This Problem Is Continued In Assignment Problem Four - 4)**

For the past 5 years, Mr. Brooks has been employed as a financial analyst by a large Canadian public firm located in Winnipeg. During 2015, his basic gross salary amounts to \$63,000. In addition, he was awarded an \$11,000 bonus based on the performance of his division. Of the total bonus, \$6,500 was paid in 2015 and the remainder is to be paid on January 15, 2016.

During 2015, Mr. Brooks' employer withheld the following amounts from his gross wages:

Federal Income Tax	\$3,000
Employment Insurance Premiums	931
Canada Pension Plan Contributions	2,480
Registered Pension Plan Contributions	2,800
Donations To The United Way	480
Union Dues	240
Payments For Personal Use Of Company Car	1,000

Other Information:

1. Due to an airplane accident while flying back from Thunder Bay on business, Mr. Brooks was seriously injured and confined to a hospital for two full months during 2015. As his employer provides complete group disability insurance coverage, he received a total of \$4,200 in payments during this period. All of the premiums for this insurance plan are paid by the employer. The plan provides periodic benefits that compensate for lost employment income.
2. Mr. Brooks is provided with a car that the company leases at a rate of \$678 per month, including both GST and PST. The company pays for all of the operating costs of the car and these amounted to \$3,500 during 2015. Mr. Brooks drove the car a total of 35,000 kilometers during 2015, 30,000 kilometers of which were carefully documented as employment related travel. While he was in the hospital (see Item 1), his employer required that the car be returned to company premises.
3. On January 15, 2014, Mr. Brooks received options to buy 200 shares of his employer's common stock at a price of \$23 per share. At this time, the shares were trading at \$20 per share. Mr. Brooks exercised these options on July 6, 2015, when the shares were trading at \$28 per share. He does not plan to sell the shares for at least a year.
4. In order to assist Mr. Brooks in acquiring a new personal residence in Winnipeg, his employer granted him a five year, interest free loan of \$125,000. The loan qualifies as a home relocation loan. The loan was granted on October 1, 2015 and, at this point in time, the interest rate on open five year mortgages was 5 percent. Assume the relevant ITR 4301

rate was 2 percent on this date. Mr. Brooks purchases a house for \$235,000 on October 2, 2015. He has not owned a home during any of the preceding four years.

5. Other disbursements made by Mr. Brooks include the following:

Advanced financial accounting course tuition fees	\$1,200
Music history course tuition fees (University of Manitoba one week intensive course)	600
Fees paid to financial planner	300
Payment of premiums on life insurance	642

Mr. Brooks' employer reimbursed him for the tuition fees for the accounting course, but not the music course.

Required: Calculate Mr. Brooks' net employment income for the taxation year ending December 31, 2015.

Assignment Problem Three - 13 (Alternative Employment Offers)

Alicia Arden has established herself as a very effective sales representative for products related to health care services. While she has worked independently for a number of years, she has received two very attractive offers of employment. Both of these offers would require that she begin work on January 2, 2015.

Offer One

This offer would provide her with a fixed salary of \$225,000 per year with no commissions on her sales. The employer would provide an allowance of \$30,000 per year to cover hotel, meals, and airline costs. The employer believes that the CRA will consider this allowance to be reasonable in the circumstances. With respect to advertising and promotion expenses, no allowance or reimbursement would be provided.

This employer would provide her with an automobile which would be leased at a cost of \$850 per month, including a \$75 per month payment for insurance. The employer will pay all of the operating costs of the automobile.

This employer would provide her with a \$200,000 interest free loan in order to facilitate her investment activities. The loan will have to be repaid after five years.

Offer Two

This offer would provide her with a fixed salary of \$175,000 per year, plus a commission on all of her sales. Ms. Arden estimates that for 2015, these commissions will total \$85,000. The employer would reimburse her hotel, meal, and airline costs. With respect to advertising and promotion expenses, no allowance or reimbursement would be provided.

While this employer will not provide her with an automobile, the business will provide her with an allowance for using her own automobile of \$1,500 per month. Ms. Arden estimates that for 2015 the total costs associated with driving her own vehicle will be as follows:

Operating Costs	\$10,600
Capital Cost Allowance (Tax Depreciation) (100%)	4,500
Financing Costs	1,800
Total	\$16,900

Other Information

The following information is applicable to either of the alternative offers.

Assignment Problems

1. She estimates that her employment related expenses during 2015 would be as follows:

Travel Costs (Hotel And Airline Costs)	\$18,000
Travel Costs (Meals)	8,500
Advertising And Promotion	23,000

2. Whether it is the employer's automobile or her own personal vehicle, she would use the car throughout 2015. She expects to drive this vehicle a total of 53,000 kilometers during 2015, with 37,000 of these kilometers required by her employment activities.
3. Both offers include a group disability insurance plan for which the company will pay all of the premiums. The plan provides periodic benefits that compensate for lost employment income. This will cost the employer \$4,500 per year.
4. Both offers include a \$1,000,000 face value life insurance policy. All of the premiums, which will total \$3,800 per year, will be paid by the employer.
5. Assume that the prescribed rate is 2 percent throughout 2015.

Required:

- A. Based on the estimates made by Ms. Arden, calculate Ms. Arden's minimum 2015 net employment income for each of the two offers. Ignore PST and GST considerations.
- B. Discuss the factors that Ms. Arden should consider in deciding between the two alternatives.

Assignment Problem Three - 14 (Comprehensive Employment Income)

Ms. Matilda Bracken is a Certified Financial Planner (CFP) with many years of successful experience. In 2014, she decided that she was not adequately appreciated in her current position with a large financial institution in Windsor, Ontario. Given this, she resigned on November 1, 2014.

After several months of investigation, she decided to take a position with Retirement Planners Ltd. (RPL), a Canadian controlled private corporation located in London, Ontario. She commenced working for RPL on May 1, 2015.

She owned a home in Windsor which she had acquired several years ago for \$375,000. Because of the depressed real estate market in this area, she was eventually forced to sell the property for \$275,000, resulting in a \$100,000 loss on this property.

Because of the uncertainty surrounding the sale of her Windsor property, she moves into an apartment when she arrives in London on May 1, 2015. The apartment is rented on a monthly basis until November 30, 2015. After she accepts an offer to purchase her Windsor house, she finds a home in London that she purchases on November 1, 2015 for \$420,000. She moves into this new home on December 1, 2015.

Matilda's new job requires her to meet with clients outside of regular office hours, seven days a week. She has set aside space in her home to be used exclusively to meet with clients. RPL will sign form T2200 stating that she is required to pay for certain employment expenses without reimbursement and use a portion of her home for work. Matilda is also provided with an automobile to use in her work.

Matilda is compensated by salary with a bonus and stock option arrangement. The bonus is based on overall company profits. The stock option is available to all employees depending upon level of service and overall job evaluation.

Other Information:

1. Because of her strong professional reputation, RPL paid her a signing bonus of \$12,000. The signing bonus was paid on June 1, 2015.

Assignment Problems

2. During the period May 1, 2015 through December 31, 2015, Matilda earned salary of \$124,000. Of these earnings, \$120,125 was paid during this period with the remainder paid in the first pay period of 2016. The Company withheld the following amounts from her salary:

Income Taxes	\$18,650
CPP	2,480
EI	931
RPP Contributions	3,700
Payment For Personal Use Of Automobile	880

3. RPL contributed \$3,500 on Matilda's behalf to the Company's RPP.
4. RPL provides group medical coverage to all of its employees. The private health plan premiums paid by RPL on Matilda's behalf cost \$562.
5. On December 12, 2015, a bonus of \$10,600 was accrued for Matilda. Matilda received \$5,300 of this bonus on December 29, 2015, with the remainder being paid on January 17, 2016.
6. As was RPL's policy, Matilda received non-cash gifts during the year. The total value of the gifts was \$650.
7. Because of the need to invest some of her additional income, RPL provided Matilda with financial counseling services. The value of these services was \$1,200.
8. In order to assist her move, RPL agreed to compensate her for one-half of the \$100,000 loss on the sale of her Windsor home. The \$50,000 payment was made on December 1, 2015.
9. RPL has a stock option plan for its employees. Under this plan, employees are permitted to acquire a limited number of option shares at 10 percent below their fair market value on December 1 of each year. The company hires valuers to determine the fair market value at each of those dates. Matilda acquires 200 shares on December 1, 2015 for cash of \$7,200. On December 15, she sells 100 of these shares for \$4,100.
10. Matilda paid \$1,600 in CFP dues in 2015. RPL's policy is to reimburse 50 percent of such professional dues. RPL reimbursed her \$800 in December, 2015.
11. RPL provides its professional employees with a membership in the London Curling Club. They believe this is a useful venue for entertaining clients of the Company. The cost of this annual membership was \$1,300.
12. In order to help Matilda with financing her new London residence, RPL provided her with a \$220,000 interest free housing loan. The funds are provided to Matilda on November 1, 2015. Assume that the prescribed rate for all of 2015 is 2 percent.
13. Matilda received an allowance of \$325 per month for eight months to cover the costs of maintaining an office in her home.
14. RPL provides Matilda with a vehicle that was purchased in 2015 for \$45,200, including HST. The vehicle was used by Matilda for all months during the period May 1, 2015 through December 31, 2015. During this period, she drove the vehicle a total of 52,000 kilometers, of which 40,000 were related to her employment duties. RPL pays all operating and maintenance costs, a total of \$8,900 during the period that Matilda used the car. RPL withheld \$110 per month from her salary to pay for her personal use of the vehicle.
15. Matilda used a separate room in her apartment exclusively as a home office. She used this office space between May 1 and November 30, 2015. This home office occupied 150 square feet of the 1,250 square feet available in her apartment. The home office in the residence she moved into on December 1, 2015 will not be available for use until 2016. Home office related costs are as follows:

Assignment Problems

Monthly Rent	\$2,200
Office Furniture	3,400
Computer Purchase	896
Stationery And Office Supplies Purchased	147
Monthly Phone Line Charge (For 7 Months)	210
Employment Related Long Distance Calls (For 7 Months)	110
Electricity Charge (For 7 Months)	350
Paint For Apartment	165
Property Insurance (7 Months)	175

Required: Determine Matilda's net employment income for 2015.