

Tax Issues for employed members

CANADIAN ACTORS' EQUITY ASSOCIATION



INTRODUCTION

A number of tax consequences flow from the characterization of a taxpayer as employed or self-employed. The Canada Revenue Agency (CRA) has the right to determine whether a taxpayer is self-employed or is an employee. It is also possible for an individual to be both employed and self-employed in the course of a single year, even for similar work, depending on the terms of each job or contract. This briefing is intended to serve as a general guide to the taxation of those members who are determined by CRA to be employees. Specific questions with respect to the completion and filing of tax returns should be referred to a tax professional who is familiar with the particular individual's tax and employment situation.

From a tax perspective, there are both benefits and costs to being an employee. The costs which employees can deduct from income are much more limited than those which may be claimed by self-employed taxpayers. Generally, self-employed taxpayers are entitled to deduct any reasonable expenses which were incurred for the purpose of earning self-employment income, while employed taxpayers may claim only those deductions which are specifically identified in and authorized by the Income Tax Act. However, employed taxpayers may be able, during periods of unemployment, to receive employment insurance benefits which are not available to the self-employed. In addition, half of the Canada Pension Plan (CPP) premiums payable by employed taxpayers are paid by the employer, while self-employed taxpayers must pay both the employer and employee portion of CPP premiums themselves. As well, income tax is deducted from an employee's paycheque and sent to the CRA on his or her behalf.

This "pre-payment" of tax over the year means that employees do not generally have to pay the quarterly tax installments which are usually required of the self-employed. Finally, some

employees may be eligible for "fringe benefits", such as private medical insurance, many of which may be received tax-free.

WHAT TO FILE AND WHEN?

Employed taxpayers are required to file an annual federal and a provincial tax return by April 30 of the following year. If any tax is owed when the return is filed, it must also be paid by April 30. The CRA will charge interest on late or deficient payments starting May 1, at rates which are generally higher than commercial loan rates. As well, where a return is not filed on time, a penalty equal to a percentage of any tax owed at the time of filing is charged by the CRA.

EMPLOYMENT INCOME - WHAT'S INCLUDED?

Generally, an employee is taxed on his or her employment income from all sources. Every employer is required to provide the employee with a summary of employment income for the year on a T4 slip, which must be sent to the employee at the end of February of the following year. Employment income would include wages and salary, honoraria, gratuities, tips and bonuses, as well as any taxable benefits received by the employee.

WHAT'S NOT INCLUDED IN EMPLOYMENT INCOME?

Some amounts may be received by employees free of tax and would not be included on the T4 or reported on the employee's tax return.

Car allowances

Where an employee uses his or her own car for work-related purposes, and the employer gives an employee a car allowance, that

allowance is not taxed as long as it meets the following conditions:

- ▶ the allowance is based on the number of work-related kilometers driven by the employee, and the per kilometre rate is reasonable; and
- ▶ the only other car-related amounts received by the employee from the employer are reimbursements for the costs of toll charges, parking and any supplementary business insurance.

The amount that is considered reasonable is updated annually. At the present time, a reimbursement rate less than 45 cents per kilometer would be likely to satisfy the CRA's reasonableness criteria. An employee who receives such a per kilometre allowance will need to keep a log of kilometres driven for work-related purposes (as distinct from personal use).

Other non-taxable benefits

In addition to the tax-free car allowance, an employee may receive certain other "fringe benefits" free of tax. Contributions made by an employer on an employee's behalf to a private health services plan for extended health care coverage (generally, things like prescription drugs, eyeglasses and dental costs) do not create a taxable benefit for the employee. Meal or travel allowances provided to employees who work three or more hours of overtime on an occasional basis are generally not taxed. No taxable benefit arises from employer-sponsored social events (unless the per-employee cost exceeds \$100.). Where an employee is required to be a member of a professional association as a condition of his or her employment, and the employer pays the fees or dues for that professional association, there is no taxable benefit to the employee.

Per diem and allowances - special work-site rules

It is frequently necessary for members to take temporary work at locations to which they cannot realistically commute on a daily basis from their homes. In such circumstances, any reasonable housing allowance provided to the employee to offset the additional housing expenses he or she must incur is tax-free. As is usually the case, certain conditions must be met in order to make any such allowance tax-free. Specifically:

- ▶ the employee must be working at a special work site where the work performed was of a temporary nature;
- ▶ the employee must maintain a principal place of residence in another location to which, because of distance, he or she cannot commute on a daily basis, but which was not rented out during his or her absence; and
- ▶ the time spent at the special work site must have lasted at least 36 hours.

For example, a stage manager who lives in Toronto is required to work for an eight week period in Vancouver. He or she would not be taxed on any reasonable housing allowance received while working in Vancouver, assuming that the Toronto home remains available for occupancy (i.e. is not rented out) during that eight week period. Where the required conditions are met and there is the potential to negotiate the terms of the compensation for the Vancouver engagement, it would be beneficial for the stage manager to receive some portion of that compensation as a housing allowance which would not be taxed. The alternative, of course, would be to receive all compensation as fully taxed employment income.

Assuming that the conditions outlined above are met, artists who receive a per diem to cover additional accommodation and meal expenses incurred when a production goes on tour should similarly be able to exclude such amounts from income for tax purposes.

In order for a qualifying employee to exclude such amounts from income, it is necessary for the employer to complete Form TD4, Declaration of Exemption - Employment at Special Work Site - a link to that form on the CRA website is provided below. Where the form is completed, the employer can then exclude any qualifying amounts from the employee's T4 slip.

DEDUCTIONS FROM EMPLOYMENT INCOME

All employment income identified on the T4 must be reported on the employee's tax return for the year. The ability to deduct expenses in the calculation of taxable income is much more circumscribed for employees than it is for the self-employed - nonetheless, some deductions are available. Some of the more common deductions are outlined below: a more detailed listing of the possible expense deductions available to employees can be

found in the CRA publication Employment Expenses (T4044(E)), and a link to that publication on the CRA's website is provided below.

Artists' employment income deduction

Taxpayers who meet the CRA definition of "Artists" may deduct from employment income any employment-related expenses, to a maximum of 20% of related employment income or \$1,000, whichever is less. To qualify for this deduction, the employment income must have been earned for certain specified types of activity, which includes performing a dramatic or musical work as an actor, dancer, singer or musician or performing an artistic

activity as a member of a performing artists' association or union that the Minister of Heritage has certified, such as Equity. For a performing artist, qualifying expenses would likely include such costs as amounts paid for music, acting or other lessons incurred for a particular role, the cost of wardrobe used for performances, publicity costs, agent's commissions etc.

Income can fluctuate greatly from one year to the next, so it is important to remember that qualifying expenses paid in a given year which cannot be deducted because of the 20% or \$1000 limitation may be "carried over" and deducted in any subsequent year. (This rule applies only to costs incurred after 1990). For example, a dancer who incurs employment-related costs of \$1,800 in 2003 and earns \$20,000 would be allowed to deduct only \$1,000 on his or her 2003 tax return. However, if the actor earns at least \$4,000 in 2004, the remaining \$800 of expenses paid in 2003 could be carried forward and deducted from income on the 2004 tax return.

Car Expenses

A taxpayer who receives a car allowance which is not tax-free under the rules outlined above must include that allowance in income. However, such an employee may then be able to deduct certain car-related expenses. Generally, car-related expenses may be deducted by employees who satisfy the following tests:

- ▶ the employee is ordinarily required to work away from his employer's place of business, or in different places;
- ▶ the employee does not receive a tax-free allowance (i.e. the allowance is taxable, perhaps because it was paid as a lump sum rather than as a per-kilometre allowance or because the per-kilometre rate paid did not meet the CRA's "reasonableness" test)
- ▶ the employee is required to pay his own car expenses;

Employees who meet these conditions may deduct the cost of gas, oil, maintenance and repairs, license and registration fees and insurance which are attributable to work-related travel. In order to determine the percentage of such expenses which may be deducted, it is necessary for the employee to maintain a log which identifies work-related and personal travel.

Other employment expenses

While less common than car-related expenses, there are other costs which employees are sometimes required to incur. For example, employees may have to pay for the cost of supplies used in their work or may have to use a portion of their home as an office.

Where an employee is required by the terms of employment to shoulder such expenses and the requisite conditions are met, a deduction may be claimed.

Whatever the nature of the expenses, the employer will have to complete and sign Form T2200E, Declaration of Conditions of Employment, indicating whether the employee received an allowance, providing details with respect to the amount and calculation of any allowance and any reimbursements paid to the employee and verifying that the terms of employment required the employee to incur the expenses in question. The T2200E is not filed with the employee's tax return, but must be kept on hand in case the CRA asks to see it. Like virtually all CRA prescribed forms, the T2200E can be found on the CRA's website - a link is provided below. To claim the expenses, the employee must complete Form T777 E - again, a link to that form on the CRA website is provided below.

RECEIPTS AND RECORDS - WHAT TO KEEP?

The "cost" of eligibility for the various deductions available to both employed and self-employed taxpayers is the paperwork needed to support those deduction claims. Particularly where one's employment status may change from self-employed to employed and back again in the course of a single year, depending on the terms of each job, it can be hard to know whether a receipt for a particular expenditure will be needed at tax filing time. The rule of thumb is, when in doubt, keep it, as a deduction which cannot be supported by the related receipt is likely to be disallowed by the CRA.

IMPORTANT TAX DATES

February 28 - date by which employers must send employees T4 slips for employment income earned during the immediate prior year

March 1 - deadline for making of RRSP contributions which will be deducted on the immediate prior year's tax return

April 30 - deadline for filing of tax return and payment of any balance of taxes owed for the immediate prior year

June 15 - deadline for filing of tax return for the immediate prior year for a taxpayer who is self-employed or whose spouse is self-employed

WHERE TO GO FOR MORE INFORMATION?

The CRA maintains a website at www.cra-arc.gc.ca which contains a wealth of tax information on various topics, including the taxation of employees, the taxation of artists and writers, tax

rates and filing deadlines. Most of the forms and publications issued by the CRA are also available on that website. The list of forms and publications which follows, together with weblinks to the CRA site, are of particular relevance to employees. The CRA also maintains a telephone information service where you can obtain general information about tax or information concerning your specific tax records. The telephone number for that service is 1-800-959-8281. As well, any of the CRA's forms or publications can also be ordered by mail by calling 1-800-959-2221.

Employers' Guide to Taxable Benefits (T4130)

<http://www.cra-arc.gc.ca/E/pub/tg/t4130/README.html>

Employment Expenses (T4044)

<http://www.cra-arc.gc.ca/E/pub/tg/t4044/README.html>

Statement of Employment Expenses (T777 E)

<http://www.cra-arc.gc.ca/E/pbg/tf/t777/README.html>

Declaration of Conditions of Employment (T2200)

<http://www.cra-arc.gc.ca/E/pbg/tf/t2200/README.html>

Declaration of Exemption

Employment at Special Work Site (TD4)

<http://www.cra-arc.gc.ca/E/pbg/tf/td4/README.html>

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