GEIB & COMPANY
PROFESSIONAL CORPORATION
CHARTERED PROFESSIONAL ACCOUNTANTS

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JUNE 2019

TAX NEWSLETTER

EMPLOYEE OR INDEPENDENT CONTRACTOR?

If you "do work" for a company, are you an employee or an independent contractor? And why does it matter?

For tax purposes, it matters a lot. Generally, being an independent contractor is preferable from a tax point of view, though there are some drawbacks.

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If your relationship to the company is that of **independent contractor** (i.e., you are carrying on your own business and providing services to the company), then:

- You can deduct for tax purposes all legitimate **business expenses**, except those that are specifically prohibited by the *Income Tax Act*. Essentially, the way you calculate income is no different than General Motors or Apple: total revenues minus the expenses of doing business.
- You will not have tax withheld at source. Instead, you can keep all the funds you collect until you have to pay your income tax to the Canada Revenue Agency, next April 30. (However, by September 15 of the second year of doing this, you will normally have to start paying quarterly instalments.)
- You are more likely able to deduct the costs of a "home office", which will be considered your principal place of business. (The company's office, at which you do some or much of your work, is not *your* place of business, so it doesn't prevent you from claiming home office expenses.)
- Your income tax return filing deadline will be June 15 instead of April 30. (However, any balance you owe must still be paid by April 30, or interest will run on the balance.) But if you miss the filing deadline, a penalty of 5% (escalating by 1% per month to 17% for 12 months) automatically applies to any unpaid balance of tax.
- You will not be required to pay Employment Insurance premiums. (The downside is that you will not be eligible for EI if you stop working.) However, you will be required to pay double Canada Pension Plan (CPP) contributions, which are collected on your tax return. For 2019, assuming your earnings are over $47,400, you'll save $860 in EI premiums but will pay $2,749 extra CPP contributions. (In Quebec, you pay Quebec Pension Plan (QPP) instead of CPP.) You do get a deduction and/or partial credit on your income tax return for the CPP or QPP contributions, however.
- Your income for tax purposes will include amounts that you have invoiced, even if you have not yet received payment, and may also include "work in progress".
- You are usually required to register for GST/HST and charge GST/HST on your services, in which case you can normally claim input tax credits to recover all GST/HST you pay on your business purchases.

On the other hand, if you are an **employee** of the company, then:

- You will normally have income tax, CPP (or QPP) contributions and Employment Insurance premiums withheld at source by your employer. If too much tax is withheld, you will receive a refund after you file your tax return in the spring.
- You can only deduct for tax purposes the expenses that are specifically allowed by the *Income Tax Act*. Very few expenses are allowed to employees (certain work-related travel expenses, for example). However, you can claim the Canada Employment Credit on your tax return; this credit, which is worth $183 in 2019, is available only to employees.
- You generally cannot deduct expenses of a home office, unless the company requires you to have such an office and you spend *most* of your work time at home rather than at the company.

- Your income tax return filing deadline will be April 30 (unless you have a spouse or common-law partner who is self-employed). If you miss the deadline, a penalty of 5% (escalating by 1% per month to 17% for 12 months) automatically applies to any unpaid balance of tax.
- You must pay tax on all employment income you receive in the calendar year, but not on amounts that you have earned (worked) but not yet been paid for.
- You are usually eligible for Employment Insurance, and required to pay EI premiums.
- You do not charge or collect GST or HST on your income.
- You are subject to tax on most employment benefits. As an independent contractor you generally will not receive such benefits.

Being an employee or an independent contractor doesn't just depend on what you and the company call your relationship. If you want to be an independent contractor, you have to establish that you are *in fact* independent and not an employee.

Not surprisingly, the CRA will often take the position that you are really an employee. This is especially likely if there is only a single company paying you income (i.e., you only have one "client"). However, you may be still able to show that you are not an employee.

There is no clear or definitive test to apply. The Courts have come up with a number of guidelines, but each case depends on its facts.

The following criteria are important:

- Do you receive typical **employee benefits**, such as sick leave, termination pay, a pension plan, group health plan coverage, life insurance and/or stock options? If so, you are more likely to be considered an employee.
- Who **controls** your work environment, what you do and when you do it? Are you required to be at a particular office from 9-5 each business day, or are you paid more for getting a task done than for putting in time? If the former, you are more likely an employee.
- **Whose equipment** or tools do you use? Do you provide your own? If not, you are more likely an employee.
- Are you **allowed to hire other people** to do part of the work? If you are required do the work personally and are not permitted to delegate it to others that you hire, then you are more likely an employee.
- Do you personally have any **chance of profit** or bear **risk of loss**, or will you simply be compensated for your time? For example, if you make a mistake in your work, are you required to fix it on your own time? If you are simply paid for your time regardless of the results, you are more likely an employee.
- How have you and the company classified your relationship? If you have a **contract** stating that you are an independent contractor, the Courts are more likely to accept that, provided the other criteria do not point strongly in favour of an employment relationship.

You should decline the traditional employment benefits (e.g., pension plan, drug plan, dental plan, sick leave, vacation time, life insurance, stock options, use of a company car), and simply opt to issue regular invoices to the company to pay for your services, plus disbursements such as travel or long-distance phone charges that you incur.

You should have a contract signed by both parties that states that you are an independent contractor and not an employee. As well, you should avoid having a business card with the company's name on it, and appearing on the company's internal telephone list. That makes you look more like an

employee of the company, and less like an outside consultant or contractor.

Finally, if you are an independent contractor and your total billings exceed $30,000 per year, don't forget to **register for and invoice the GST or HST**.

FOREIGN TAX CREDIT — MAKE SURE THE FOREIGN TAX IS MANDATORY

As you may know, Canada provides a **"foreign tax credit"** (FTC) to Canadian residents, to reduce double taxation on foreign-source income.

The FTC rules are complex. In general terms, Canada allows a credit to a Canadian resident for **foreign income tax paid on foreign-source income**, up to a limit of the Canadian tax payable on the same income.

The effect is that you pay total tax equal to the higher of the two rates of tax (Canadian and foreign) on the foreign-source income.

Thus, for example, suppose you earn $1,000 in dividends on a U.S. stock, and the U.S. company withholds $150 as withholding tax. (We'll ignore exchange rate issues for this example; assume all amounts are in Canadian dollars.) Assume you are in a 40% tax bracket, so you pay $400 of Canadian tax on the same $1,000 of dividend income.

In this example, Canada will grant you a foreign tax credit of $150 on your Canadian tax return, so that you only pay $250 of Canadian tax on the dividends. The total tax burden ($150 to the U.S. and $250 to Canada) will thus equal the $400 of Canadian tax you would have paid if there had not been any foreign tax. (Most developed countries have similar rules.)

The FTC has many complexities and traps. One trap you should be aware of is that the **foreign tax must be mandatory**. If you could have avoided paying the foreign tax, or recovered it from the foreign government, then you cannot claim it as a foreign tax credit.

Thus, for example, suppose your U.S.-source income is interest rather than dividends, and the interest is exempt from U.S. tax under the Canada-U.S. tax treaty. If the U.S. payor withheld U.S. tax, and you can recover that tax from the U.S. government by claiming relief under the treaty, then the U.S. tax you paid is not eligible for the foreign tax credit, because **Canada will consider it to be a "voluntary" payment** to the U.S. rather than a foreign tax. So instead of claiming a foreign tax credit, your only option may be to claim back the wrongly-charged tax from the U.S. Internal Revenue Service.

This interpretation was confirmed in the *Meyer* (2004) and *Marchan* (2008) decisions of the Tax Court of Canada.

Note also that the foreign tax credit applies only to an "income or profits tax". It is not available for social security taxes other than paid to the U.S. Most U.S. "FICA" (Federal Insurance Contributions Act) payments do qualify, due to a specific provision in the Canada-U.S. tax treaty.

Finally, note that the foreign tax credit for "non-business-income tax" is based on the amount of foreign tax you actually paid, but net of any refunds such as a U.S. child tax credit. This was confirmed by the Federal Court of Appeal in the *Zhang* case (2008).

GST/HST — RISKS OF DEALING WITH A SHADY SUPPLIER

If your business purchases goods or services from other businesses, and you think some of them may not be complying with their tax obligations, there is a serious risk that you need to address. The risk is primarily in the GST/HST area.

This comes up in everything from construction services, to agencies that supply temporary personnel, to garment work, scrap metal sales, building cleaning services, and many other areas.

Surprisingly, the risk is primarily where the supplier charges you GST/HST. If it does not charge you GST or HST that you should be paying, your risk is far lower, because the worst that can happen is that you have to pay the GST or HST down the road, and will normally be able to claim an offsetting input tax credit at that time.

BACKGROUND

Assuming your business makes "taxable supplies" for GST/HST purposes, you are normally entitled to input tax credits (ITCs) to recover all GST or HST you pay on purchases.

However, as you probably know, these ITCs are available only if the supplier provides you with an invoice or receipt that meets detailed documentation requirements. Those requirements normally include the supplier's name and GST/HST registration number, the price paid, a "description of the supply sufficient to identify it", the amount of GST or HST, the date, the purchaser's name, the terms of payment and certain other details.

These documentation requirements are mandatory; if they are not met, you cannot claim the ITCs to recover the tax you have paid to your supplier. You can check online that a supplier's GST/HST registration number is valid, using the CRA's "GST/HST Registry" at ***www.rca.gc.ca***.

THE PROBLEM

The Canada Revenue Agency has been dealing for many years with the problem of companies that bill GST or HST for goods or services, collect the money and then disappear. Quite apart from not paying corporate income tax on their profits, these companies are literally **stealing the sales taxes**, which they collect on behalf of the government and are supposed to hold in trust for the government.

This problem has also shown up in Quebec, where Revenu Québec (RQ) administers the GST together with the Quebec Sales Tax.

INNOCENT BUSINESSES ARE DENIED ITCS

In recent years, the CRA and RQ have aggressively pursued businesses that have dealt with these unscrupulous companies. Not being able to find the thieves, the auditors instead go after the businesses that *purchased* these suppliers' goods and services, and have denied the ITCs that those innocent businesses have claimed.

Both the CRA and RQ have actually had a lot of success in the Courts when the innocent businesses have appealed.

Despite the fact that a business has **no legal obligation to "police" its suppliers** to ensure that they remit GST/HST they have collected, the Courts have found ways to make innocent businesses responsible.

One way that the government and the Courts have nailed the innocent businesses is by ruling that the **invoice was not from the "real" supplier**. Even though the invoice was from a numbered company that was properly GST-registered (and you checked the online GST/HST Registry), and

otherwise met the documentation requirements, the Courts have ruled in some of these cases that the supplier named on the invoice was not the "real" supplier, and thus the documentation requirements were not met.

HOW CAN A BUSINESS PROTECT ITSELF FROM THIS RISK?

A way to address this problem is to take steps to **document that the business named on the invoice you pay is the same legal entity that you are dealing with**, and is properly registered with the CRA (or RQ) for GST/HST (and, in Quebec, for QST).

(1) To check that a supplier is GST/HST-registered: For any new supplier, go to the CRA's GST/HST Registry at www.rca.gc.ca, before you pay them any GST/HST, and enter their name and the GST/HST registration number they give you. The online registry will tell you if the person is indeed registered under that name as of the current date.

(2) For identity:

- If the invoice is in a personal name, get a copy of the person's driver's licence or other government-issued photo ID, and check that it's the same name as the GST/HST registration on the registry you checked in (1) above, and that is the name that appears on the invoice you are paying.

- If it's a company name, especially if it's a numbered company, the only way you can ensure that the entity identified on the invoice is the one you're actually contracting with is to ask the supplier for documentation that shows who the directors of the company are (this information is also available online from the provincial government, at a cost); and check the identity of the person you're dealing with as being a director of the company, by getting a copy of their driver's licence or other photo ID.

Of course, every business will have to determine whether it's worth going through these procedures, or whether the risk of suppliers being tax-thieves is low enough that these steps are not worth the cost and effort. But for those seriously at risk of being reassessed to have substantial ITCs denied, these steps can prove to be a lifesaver.

AROUND THE COURTS

CHANGE OF ADDRESS NOTIFICATION TO CRA FOR INCOME TAX WAS ENOUGH FOR GST/HST

The recent *Kirschke* decision of the Tax Court of Canada (2019 TCC 68) was an application for extension of time to file a late notice of objection. The application was technically dismissed, but for reasons that made it clear that the applicant won her case.

(Normally an objection to an income tax or GST/HST assessment must be filed within 90 days of the date on the Notice of Assessment. In certain cases an extension of up to one year is possible. Without a valid Notice of Objection filed on time, one cannot appeal the assessment.)

Ms Kirschke had been registered for GST/HST, but her business (a restaurant) stopped operating before 2010. She continued to file nil GST/HST returns for 2010-2014, not cancelling her registration because she thought she might reopen a restaurant in a new location. (She was still carrying on another business, but it was a mortgage broker business supplying only exempt financial services, so she did not need to collect any GST/HST.)

When she moved in 2015, Ms Kirschke **notified the CRA of her move for income tax purposes**. However, she did not think to notify the CRA of the change for GST/HST purposes.

In June 2016, the CRA assessed Ms Kirschke for not collecting and remitting HST for five years, based on her reported business income on her income tax returns. CRA officers had previously contacted her by telephone and had her telephone number, but they did not realize that they did not have her current address. When her accountant was unhelpful in providing information over the phone (he dealt only with her income tax returns), the CRA sent a proposal letter to Ms Kirschke's old address, which she never received. When she did not reply, the **assessments were issued, again to the old address**. Ms Kirschke did not find out about them until March 2018 when CRA Collections wrote to her at her new address demanding payment.

Ms Kirschke wanted to object to the assessments. She first filed an application for extension of time, which was rejected by the CRA as having been filed too late. She then applied to the Tax Court for the extension of time.

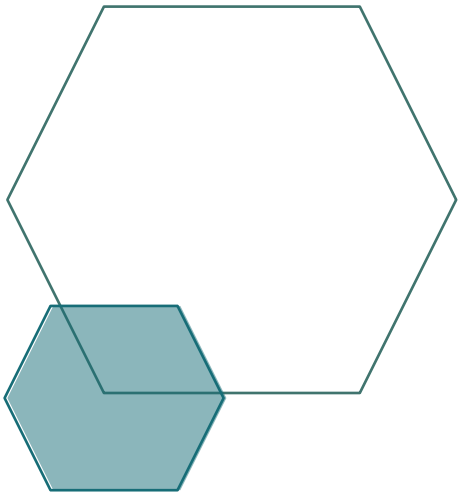
The Tax Court ruled that the Notices of Assessment had not been correctly mailed. Ms Kirschke had notified the CRA of her change of address, and could not have known that her notification for income tax purposes would not be valid for GST/HST purposes.

The tax legislation deems anything mailed by first-class mail to be received on the day it is mailed; but the case law has established that this rule applies only if the mail is sent *to the correct address*, and a taxpayer who moves is responsible to ensure that the CRA has their correct address.

The Court found Ms Kirschke credible, and believed that she indeed did not receive the proposal letter or the Notices of Assessment in 2016.

In the circumstances, the judge found that the Notices of Assessment were never validly sent. However, this did not mean that the extension of time should be granted. Instead, the Court *dismissed* Ms Kirschke's application, while ruling that when she filed a Notice of Objection in May 2018, that was within the 90-day objection period, because she did not find out about the assessments until March 2018. In other words, she did not need an extension of time because her objection was filed on time.

Chalk one up for common sense!



This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.

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