



# business meeting

## MEETING THE PAYROLL

When an owner-operated small business hires its first employee, it marks a milestone in the life of that business. It's also a transition for the owner-manager, who must adjust from running a one-person shop to hiring, managing, and paying one or more employees. As well, whether there is one employee or one hundred, the owner-manager must take on all of the administrative obligations which go with his or her new status as an employer. This article outlines the detailed deduction, remittance, and filing obligations that go along with becoming "the boss".

**A. BERTUCCI**

COMPTABLE PROFESSIONNEL AGRÉÉ - CHARTERED PROFESSIONAL ACCOUNTANT

## Who's an employee?

The very first step in setting up a payroll system is to determine whether, in fact, you have an employee. It may seem obvious but, in fact, the determination of whether someone is an employee or what is called an independent contractor can be quite complex. In general, there is an employment relationship where you pay a salary or hourly wages to the person for services rendered and you have the right to "control and direct" the activities of the person who performs those services. Otherwise, the person is likely to be an independent contractor, and not an employee. For example, if you hire a person to clean your business premises each evening, provide them with the tools and materials to do the job, tell them what you want done and how, and pay them a fixed weekly salary for doing so, you probably have an employee. If, on the other hand, you contract with a cleaning service to do the same work, but that cleaning service provides the supplies and tools and hires and supervises the cleaners, those cleaners are likely not your employees.

It's important to note that it is the actual terms and conditions of the relationship which will determine whether an employer-employee relationship exists. Businesses are sometimes inclined to ascribe independent contractor status to those working for them, in order to avoid the sometimes onerous administrative burden and the costs which are involved in being an employer. Unfortunately for them, it doesn't work that way. Even if a contract (including a written contract) indicates that a person is an independent contractor, the Canada Revenue Agency (CRA) can and will characterize him or her as an employee if there is evidence of an employer-employee relationship. In such circumstances, the employer can be penalized for having failed to take the steps required where an employment relationship exists.

If you have brought someone into the business to work for you, and are genuinely uncertain as to whether that person is or is not an employee, you can seek a ruling on the question from the CRA. Such a ruling is obtained using Form CPT1, *Request for a Ruling as to the Status of a Worker under the Canada Pension Plan and/or the Employment Insurance Act*, which is available on the CRA Web site at <http://www.cra-arc.gc.ca/E/pbg/tf/cpt1/README.html>.

## Once you become an employer

Once you determine, either on your own or as a result of a ruling from the CRA, that you have an employee, you'll need to open a payroll account

with the Agency. Most if not all businesses will already have a 9-digit Business Number that identifies the business in all dealings with the federal government. (If your business hasn't yet acquired a Business Number, it's easy to obtain one – more information is available on the CRA Web site at <http://www.cra-arc.gc.ca/bn/>.)

If you already have a Business Number, opening a payroll account simply involves adding that account to the existing Business Number. All payroll accounts (and a business can have several) are designated as RP. So, if your Business Number is 12345 6789, and you're opening a single payroll account, that account would be designated as account 12345 6789RP 0001. Subsequent payroll accounts, if any, would be identified as 0002, 0003 etc. Note that no matter how many accounts are opened for different purposes (i.e., income tax, GST, payroll, import/export, etc.) the Business Number identifier will never change—all accounts are treated as sub-accounts for that particular Business Number, and identified by the particular sub-code used (i.e., RP for payroll accounts).

Actually opening the account can be done by different methods. The easiest is likely via the Internet, on the CRA's Web site. Or the account can be opened by telephone, via the CRA's Business Enquiries Line at 1-800-959-5525. Finally, any new account can be opened by mailing a completed copy of Form RC1, *Request for a Business Number (BN)*, to your Tax Services Office. (Even if you already have a Business Number, Form RC1 is used to open additional accounts.) A listing of the CRA's Tax Services Offices across the country is available at <http://www.cra-arc.gc.ca/cntct/tso-bsf-eng.html>. In addition to the federal registrations, it is possible to register for a number of different provincial accounts and programs, and those are listed on the CRA Web site at [www.cra-arc.gc.ca/tx/bsnss/tpcs/bn-ne/prtnrshps-eng.html](http://www.cra-arc.gc.ca/tx/bsnss/tpcs/bn-ne/prtnrshps-eng.html).

Once the necessary accounts have been set up with the CRA, the Agency will send a letter confirming the Business Number, the accounts registered, and the information provided with respect to those accounts. Finally, if any changes to the accounts are necessary in the future, those changes can be made by any of the methods used to set the account up originally.

Most businesses have one person who handles all payroll matters. In a small business, that person is usually the owner-manager. As the business grows, an office manager or bookkeeper may be hired,



# TAXES

or an outside service provider may be engaged to take care of the payroll. In all cases, the owner of the business will need to identify that person to the CRA as a person authorized to discuss with Agency representatives any payroll issues that might arise. If the authorized person is an employee of the business, he or she can be identified as an authorized contact when the payroll account is set up (or changes are made to the account). However, if the business owner wants to authorize an “outside” representative, then a specific form, RC59 (available on the CRA Web site at [www.cra-arc.gc.ca/E/pbg/tf/rc59/rc59-16e.pdf](http://www.cra-arc.gc.ca/E/pbg/tf/rc59/rc59-16e.pdf)), must be completed and filed with the Agency. It goes without saying that any changes in the identity of authorized contacts should be communicated to the CRA as soon as the change occurs, for the protection of the business.

## **When does a payroll account have to be set up?**

The simple answer, of course, is as soon as you have an employee. More specifically, the CRA requires an employer to set up a payroll account prior to the first “remittance due date”. The remittance due date is the date on which deductions made from the employee’s pay must be received by the CRA, and, for a new employer, that date falls on the 15th of the month following the month in which the deduction was made.

For example, where an employee is hired on October 15th and paid bi-weekly, the first pay date (and consequently the first date on which withholdings are made from the employee’s wages or salary) would fall on October 29th. The first remittance due date is therefore the 15th of the next month, being November 15th.

If by some chance the payroll account isn’t set up in time, the employer is still obliged to make the necessary deductions from the employee’s pay and remit those funds to the CRA by the due date. However, to avoid the bureaucratic nightmare which could result from forwarding funds to the CRA without a specific account to which the funds are to be credited, it’s always a good idea to set up the account first.

It should be noted that various circumstances, particularly the amounts remitted by the employer, and the employer’s payment history, can result in a change in the frequency of remittance dates (which could become more or less often). More information on such changes is available on the CRA’s Web site at [www.cra-arc.gc.ca/payroll](http://www.cra-arc.gc.ca/payroll).

## **What deductions have to be made?**

Generally, the three major categories of deductions which must be made from an employee’s pay are income tax, Canada Pension Plan contributions and Employment Insurance premiums. In all cases, the amount of the deduction made is based on the amount of the employee’s pay (to a specified maximum, in the case of Canada Pension Plan and

Employment Insurance amounts) and the frequency of the pay periods, and the CRA provides detailed tables to enable the employer to determine the appropriate deduction.

### *Income tax*

By far the largest deduction from most employees' pay is for federal and provincial income tax. Essentially, the CRA calculates the likely tax bill for the employee for the year, based on income level and on the various deductions and credits available to the employee, and ensures that a similar amount is deducted from the employee's pay and sent to the Agency by the end of the tax year. The good news for the employer is that income tax is the one statutory deduction for which there is no required employer contribution.

Very few types of remuneration escape the Canadian tax net, and so as a general rule virtually all amounts paid to an employee (including benefits, where those benefits are considered by the CRA to be taxable benefits) are included in remuneration when calculating income tax withholdings.

Note that there is no age limit – upper or lower – when it comes to paying income tax. Consequently, both employees who are under the age of 18 and those who are over the age of 65 will be required to have income tax withheld from their earnings.

### *Canada Pension Plan*

Every employee in Canada who is 18 years of age or older, but under the age of 70, who is engaged in “pensionable employment” and who is not already receiving a Canada Pension Plan (CPP) retirement or disability pension must pay CPP contributions by means of a regular deduction from his or her pay.

Deductions required for CPP differ from income tax deductions in two important respects. First, there is a “cap” on the amount of CPP contributions required. Such contributions are calculated as a percentage of each dollar of income, to a specified maximum. Thus, for 2016, each employee must remit contributions equal to 4.95% of pensionable income, after that income is reduced by a basic deduction of \$3,500. The maximum income (before the \$3,500 deduction) on which CPP contributions are payable is \$54,900. Consequently, for an employee whose pensionable earnings are \$20,000, the calculation of required contributions would be as follows.

$$\$20,000 - \$3,500 = \$16,500 \times 4.95\% = \mathbf{\$816.75}$$

As an employee's income increases, so too do the required contributions, to the specified maximum income of \$54,900. For an employee with pensionable income of that amount or higher, the calculation of required contributions looks like this for 2010.

$$\$54,900 - \$3,500 = \$51,400 \times 4.95\% = \mathbf{\$2,544.30}$$

The specified maximum income means that any employee having pensionable income of \$54,900 or more will pay CPP contributions of \$2,544.30 for 2016.

The other major difference between income tax deductions and CPP contributions is that, for CPP, the employer is required to make a contribution equal to that made by the employee. In the first example, therefore, the employer would be required to contribute \$816.75, making the total remittance in respect of that employee \$1,633.50. Where an employee earns \$54,900 or more, the total remittance will be  $\$2,544.30 \times 2$ , or \$5,088.60.

### *Employment insurance*

Deductions for Employment Insurance are calculated in much the same way as those for the Canada Pension Plan. Once again, premiums are calculated as a percentage of income. For 2016, that percentage is set at \$1.88 per \$100 of qualifying income, again to a specified maximum level of income. For 2016, that maximum income is \$50,800. Unlike the CPP, there is no basic deduction.

Continuing with the above example, an employee earning \$20,000 in income would pay EI premiums of \$376. Any employee earning \$50,800 or more would pay the maximum premium of \$955.04 for the 2016 taxation year.

Like the CPP, the EI program requires an employer contribution. However, in this case, the employer contribution exceeds that of the employee – specifically, the employer is required to contribute 1.4 times the amount contributed by the employee. Where the employee pays the maximum amount of premiums for the year (\$955.04), the employer contribution will be 1,337.06 ( $\$955.04 \times 1.4$ ), making the total remittance in respect of that employee \$2,292.10.

### *Remitting deductions to the CRA*

New employers are required to provide amounts deducted at source to the CRA on or before the 15th of the month following the month in which the deductions were made. So, for example, deductions made during the month of January must be received by the CRA by the 15th of February.

The CRA provides employers with personalized re-



mittance forms. However, an employer making his or her first remittance will not yet have received such a personalized form. Consequently, a new employer follows a slightly different procedure. Specifically, the employer sends a cheque or money order to any of the CRA's tax centres. (A listing of those centers is provided on the CRA Web site at <http://www.cra-arc.gc.ca/cntct/tso-bsf-eng.html>. The cheque or money order is made payable to the Receiver General, and the employer's Business Number must be written on the back of that cheque or money order, to ensure that the funds are credited to the correct account. It's also necessary to include a letter with the cheque or money order, indicating that the employer is a new remitter, the period which the remittance covers, your name, address and business telephone number and, finally, your Business Number. Once the first remittance is made, the CRA will send a personalized remittance form each month, and a letter will no longer be necessary. However, even with a personalized remittance form, it's a very good idea to continue to include your Business Number on the cheque or money order, to minimize the risk of the funds being applied to the wrong account.

Once you're on to a regular remittance cycle and using the personalized remittance forms, the monthly remittance can be made in a number of different ways. The easiest way to make certain that remittances are timely-filed is likely to actually pay them at a financial institution or at one of the CRA's Tax Services Offices. The CRA or financial institution employee who receives the payment will date-stamp the bottom part of the remittance form, and that date-stamped form serves as a receipt, for both the amount of the remittance and the date it was made. Remittances can also be made through an automatic teller machine, but two things must be kept in mind—first, the

remittance won't be considered received until it is processed by the financial institution and received by the CRA, which could take several days; and, consequently, the ATM receipt is not considered by the CRA to constitute proof of payment by the due date. Depending on the financial institution you deal with, it may be possible to remit deductions electronically through their telephone or Internet banking services. Once again, it's necessary to keep in mind the lag time which may be involved for processing of the payment by the financial institutions. Finally, mailing the payment to the CRA is always an option. Remember, however, that if you choose to send a payment in by mail, it must be received (not postmarked) by the due date, in order to avoid penalty and interest charges.

Note that larger companies (generally, those who must remit monthly amounts greater than \$50,000) will have a different set of requirements



with respect to remittance procedures, but these requirements are unlikely to apply to small businesses and/or new employers.

### **Penalty and interest charges**

No discussion of remittances to the CRA would be complete without reference to penalty and interest amounts which may be levied for late or insufficient payments.

The CRA can levy penalties and interest in a wide variety of circumstances related to payroll, but the most common situations in which penalties and interest are levied are for the employer's failure to make proper deductions and, especially, for a failure to remit those deducted amounts to the CRA.

Where an employer fails to deduct required amounts from an employee's salary or wages, the CRA can assess a penalty of 10% of the required deduction. If the same failure to deduct happens more than once in a calendar year, the penalty can be increased by the CRA to 20% of the required deduction, where the Agency believes that the failure to deduct was deliberate or the result of "gross negligence".

Unfortunately, in some cases, employers make the necessary deductions but then fail to remit the funds to the CRA. Especially where a business is facing a cash-flow crunch, employers have been known to "borrow" the deducted funds for use in the business until the cash-flow crisis eases. Whatever the reason or motivation, a failure to remit funds owed to the CRA never ends well for the taxpayer.

The rules that apply to the calculation of penalties for the late filing or failure to remit source deductions are as follows:

- 3% if the amount is one to three days late;
- 5% if the amount is four or five days late;
- 7% if the amount is six or seven days late; and
- 10% if the amount is more than seven days late.

The CRA's policy is generally to levy such a penalty only on the part of the late or absent remittance that is over \$500. However, the CRA will levy the additional penalty on smaller amounts where it believes that the late remittance or failure to remit was deliberate or the result of "gross negligence" on the part of the taxpayer. In addition, if the employer is assessed this penalty more than once in a calendar year, the CRA will apply a 2010 penalty on the second or later failures if they were made knowingly or under circumstances of gross negligence.

Where required amounts aren't remitted on time, or at all, the CRA will assess interest, at higher than commercial rates, on any deficiency, starting on the date that it was due. Such interest charges are also levied on penalty amounts assessed, for as long as those penalty amounts remain unpaid.

## Using a payroll service

Many employers, including small businesses, contract out the work of preparing payroll and taking care of the administrative requirements that go along with it. There's nothing wrong with that approach, which has the benefits of having the work done by those familiar with payroll requirements and freeing up time for the business owner to spend on core business functions rather than on administrative tasks. But, it's important to remember that what's being contracted out is the work, not the responsibility. An employer who uses a payroll service bureau or provider retains responsibility for ensuring that proper deductions are made and are remitted to the CRA on a timely basis. Where those obligations are not met, it's the employer who the CRA will hold responsible for any default.

## Conclusion

While the demands of running a payroll aren't complex in theory, there are a lot of detailed administrative requirements which must be adhered to, and the penalties for breaching those requirements can be substantial.

This article has outlined the basics of Canadian payroll systems, but there are an almost infinite variety of "special situations", including employment of family members, taxation of benefits, and infrequent or one-time payments to employees, in respect of which the general rules may not apply. The CRA payroll Web page, at <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/menu-eng.html>, has the information pertaining to virtually all payroll situations which may arise, basic or otherwise. Where more information is needed, or the question relates to a specific business account, the best course of action is a call to the CRA's business enquiries line at 1-800-959-5525.