TAX-EFFECTIVE EMPLOYEE COMPENSATION

Creating a work environment that will ensure both the retention of valued employees and the ability to attract new ones is a concern of every employer, and an attractive compensation package is a key to both. Furthermore, while an employee's salary is the cornerstone of any compensation structure, it can sometimes be the benefits included in the position that tip the balance in favour of one employer over another. This is especially true if those benefits can be structured in a manner which minimizes the tax bite faced by the employee. This article reviews some of the more common employee benefits and the tax treatment of those benefits in the hands of the employee.

Cooper & Company
CHARTERED PROFESSIONAL ACCOUNTANTS

The good news—what's not taxed

While it may seem as though there is virtually nothing that escapes the grasp of Canadian tax authorities, there are actually a number of benefits which can be provided to employees free of tax. Some of the more common ones are outlined below.

Public and private health care premiums

The availability of extended health care plans, to cover part or all of such costs as prescription eyeglasses, prescription drugs and dental and orthodontic costs, is a benefit highly valued by most employees. For that reason alone, they are provided by most employers. Fortunately, it is also a benefit which enjoys beneficial tax treatment. Specifically, contributions made to private health services plans by an employer for employees (such as medical or dental plans), does not result in a taxable benefit to those employees. However, premiums paid by an employer under provincial hospitalization or medical care insurance programs are treated as a taxable benefit, and the benefit is equal to the amount paid.

Overtime meals and travel allowances

Employers frequently provide meal and/or travel allowances to employees who are working late. The Canada Revenue Agency (CRA) is prepared to view such allowances as non-taxable, if they are in the Agency's view, "reasonable". Of course, reasonableness is often in the eye of the beholder (or the recipient), but the CRA has set out specific guidelines. Where an employee works three or more hours of overtime and that overtime occurs less than three times a week, a meal allowance provided to the employee will not be taxed. Similarly, where an employee works three or more hours of overtime and that overtime is occasional in nature, the CRA will not tax any travel allowance extended to the employee to cover his or her costs of getting home. However, in the case of the travel allowance, the CRA imposes an additional condition; that public transportation not be available, or that the physical safety of the employee be at risk at the time of travel.

Moving expenses

Especially in industries with high transfer rates, an employer will often cover the considerable cost of moving an employee (his family and their household) to the new location. Since the move is almost always made at the behest and for the benefit of the employer, the employee is not assessed a taxable benefit for moving costs paid by the employer. The CRA provides a listing in its publications of the kinds of expenses which qualify for non-taxable benefit status. In addition, the CRA will treat any "non-accountable" allowance of up to $650 provided by the employer for incidental relocation or moving expenses as non-taxable, provided that the employee certifies that he or she did indeed incur such expenses for at least the amount of the allowance. If the allowance is greater than $650, the employee will be assessed a taxable benefit only for the portion that is more than $650.

In some cases, where employees must sell their homes in a bad real estate market and incur a loss on the sale, the employer will reimburse the employee for that loss. Generally, in such circumstances, only one half of the reimbursement amount that is over $15,000 is taxable to the employee. For example, an employee who moves and has to take a $50,000 loss on the sale of his or her house, will be considered to have received a taxable benefit of $17,500, if the full amount of that loss is covered by the employer. The calculation of the taxable benefit is as follows:

($50,000 - $15,000) × 50% = **$17,500**

Finally, an employee who is not reimbursed for moving costs or receives only partial reimbursement can often deduct the non-reimbursed costs of moving.

Subsidized meals

In some cases where a workplace is located in an area which makes it impractical for employees to go out for lunch and return within the time limits imposed by the employer (e.g., an industrial park), an on-site dining room or cafeteria may be provided to supply meals to employees, with the cost of such meals subsidized by the employer. Once again, the CRA is prepared to treat the subsidy element of such meals as a non-taxable benefit to the employees, as long as the amount charged to the employees covers the employer's cost of providing the meals – meaning the cost of the food, its preparation and service. Where the meals are provided at less than cost, there will be a taxable benefit to the employee equal to the difference between the employer's cost and the amount paid by the employee.

Merchandise discounts

Employers whose business involves the manufacture of consumer goods (e.g., clothing or electronics manufacturers), often make such goods available to employees of the business at a discount from the usual retail price. The CRA is prepared to view these kinds of discounts as a non-taxable employment benefit, as long as the goods are not provided at less than cost, and that the privilege of making such purchases is extended to all employees, and not, for instance, restricted to only management level employees, or employees working at a certain location. In addition, more creative arrangements, such as a reciprocal arrangement between employers allowing the employees of each to purchase goods at a discount from the other employer, will be viewed by the CRA as resulting in a taxable benefit.

Where goods are sold to employees at less than cost, the taxable benefit assessed will be equal to the difference between the fair market value and the price the employees pay.

Employer-sponsored social events

The office Christmas party or summer picnic is an annual event in most workplaces. Where the employer pays the costs associated with the event, and all employees are included, there will be no taxable benefit if the per-employee cost (excluding any ancillary costs, such as taxi fare or overnight accommodation) is less than $100. However, where the total per-employee cost exceeds the $100 limit, the entire cost (including any ancillary costs) becomes a taxable benefit to the employee.

Gifts to employees

As a starting point, gifts or awards from an employer to an employee are a taxable benefit. However, the CRA is prepared to provide a limited exception to that rule under which the employer can provide an employee with up to two non-cash gifts each year, and up to two non-cash awards. Gifts would normally be given on occasions such Christmas or Hanukkah, or on the celebration of a personal milestone like a birthday, wedding or birth of a child. On the other hand, awards are usually provided to mark employee accomplishments, like the attainment of a certain number of years of service or the meeting of a particular workplace goal or standard. Not surprisingly, there are caveats and limits to the exception. First, in order to be non-taxable, any such gifts or awards must be non-cash. For the CRA, a non-cash gift or award also means one which cannot be easily converted into cash. In other words, a gift or award like a gift certificate would be considered to be a near-cash gift and would always be treated as a taxable benefit. In addition, the total value of non-cash gifts given in the course of a year must be less than $500, and the CRA applies the same valuation rule to employee awards.

Employee counseling

Many employers, particularly larger companies, provide needed counseling services to their employees, often through an out-sourced Employee Assistance Program. If those counseling services relate to the employee's wellness or physical or mental health, then the cost of counseling is not a taxable benefit to the employee. Examples of counseling that would qualify would include counseling for tobacco, drug or alcohol abuse, or stress management programs. In addition, where an employer provides counseling in respect of an employee's retirement or re-employment, no taxable benefit will be assessed to the employee. However, where the employer pays for services such as financial counseling or income tax return preparation, those services are usually treated as a taxable benefit to the employees.

Recreational facilities and club dues

Recognizing that a healthier work force generally pays off in terms of fewer sick days and disability leaves, many employers now provide employees with either an on-site exercise facility or membership in a local fitness club. Once again, where the benefit is made available to all employees, either through the provision of in-house facility or the payment of fees at a commercial club, then there is no taxable benefit. Where use of the in-house facility or payment of external membership fees is limited to a select group of employees, the employee recipients will be assessed a taxable benefit.

The second requirement imposed by the CRA for the benefit to remain non-taxable is that the membership in the club or the availability of the in-house facility must be principally for the benefit of the employer. It's important to note that the way in which the fitness club membership is paid for can turn a non-taxable benefit into a taxable one, or vice-versa. If the employee chooses a recreational facility or fitness club, pays for his or her membership and then submits the bill to the employer for reimbursement, the employee will be assessed a taxable benefit. On the other hand, when the employer makes an arrangement with a facility to pay fees for the use of the facility by employees, then the membership is the employer's, and there is no taxable benefit to employees.

Professional fees

If an employer pays professional membership fees on behalf of employees, there will be no taxable benefit to the employee as long as the employer is the primary beneficiary of the membership. Once again, the CRA uses a number of tests to determine where the primary benefit of the membership falls, as follows.

If membership in the professional organization is a condition of the employee's job – for example, lawyers or accountants employed in their professional capacity would be required to maintain their membership in their respective professional organizations – then the CRA considers that the employer is the primary beneficiary, and the employee receives no taxable benefit. Where professional organization membership is not a condition of employment, the employer is required to determine who the primary beneficiary is, and to include a taxable benefit on the employee's T4 where necessary. Needless to say, an employee whose professional fees are paid for or reimbursed by the employer cannot deduct those fees from their employment income.

Inevitably, there are benefits provided by employers to employees part or all of the value of which must be included in income, and taxed at the employee's ordinary tax rate. However, even here there are ways to minimize the tax bite.

Income maintenance/wage loss replacement plans

In recent years, the need for employees in their prime earning years to ensure themselves a continued income should they become ill or disabled, has received considerable attention. The cost of the insurance coverage needed to ensure such income protection on an individual basis can be steep, and group plans provided by employers have in many cases been put in place to meet that need on a more affordable basis.

Usually, such income maintenance or wage-loss replacement plans provide for the payment of all or, more frequently, a specified percentage of an employee's usual wages, in the event that the employee becomes ill or is disabled. Where the premiums paid by an employer for such coverage for an employee are paid to a group plan, there is

no taxable benefit to the employee. However, a taxable benefit will arise when the premiums are paid to a non-group or individual plan. Most often, this would be the case where coverage is sought for a senior, high-income employee whose needs cannot be met by the terms of any available group plan.

Employer-paid tuition fees

The pace of technological change has resulted in a workforce where the need to upgrade and update work-related skills is almost constant. The rule of thumb, where training or education is provided or paid for by the employer, is that no taxable benefit will arise if such training or education is related to the employee's work and is therefore for the employer's benefit. In this case, the "related to the employee's work" requirement encompasses both specific employment-related training and more general business or business-related training (for example, language courses or employment equity courses). It is only if courses paid for by the employer are taken for personal interest and are not related to the employer's business that the employee will be assessed a taxable benefit for the value of the training.

Parking

Especially in larger urban centers, the provision of a parking space close to the office is often a valued benefit for employees who must endure a long commute. Generally, employees who receive such employer paid parking are considered to have received a taxable benefit equal to the fair market value of the parking minus any portion of the cost paid by the employee.

In some situations – such as employer-paid parking pass for a commercial parking facility beneath a large office tower – it is easy to determine the fair market value of the benefit. In other cases – for example, where the employer's business operates in an industrial park where there is parking available to anyone – the determination of the value of the parking space is more problematic. Perhaps in recognition of the difficulty or impossibility of making that determination, the CRA concedes that no taxable benefit will arise in such circumstances. The CRA is also prepared to acknowledge that where there is first-come, first-served employer-provided parking, but there are fewer parking spaces than there are employees who need parking, no taxable benefit is to be assessed. Finally, employer-paid parking will not result in a taxable benefit where the employer provides parking to employees for business purposes and where employees regularly have to use their own automobiles, or automobiles supplied by the employer to perform their employment duties.

Low interest on interest-free loans

Where an employer loans funds to an employee at a favourable interest rate, the employee will have to include a taxable benefit in income, equal to the difference between interest calculated at the "prescribed rate" and the actual interest paid. The "prescribed rate" is the rate published by the CRA four times a year, which generally approximates commercial interest rates in effect at the time. For example, an employee who received a $10,000 loan at 2%, in a year in which the prescribed rate was 6% throughout the year, would be assessed the following taxable benefit for the year:

Interest at prescribed rate:
$10,000 × 6% = **$600**

Interest actually paid:
$10,000 × 2% = **$200**

Taxable benefit assessed = **$400**

There is some leeway provided within these rules, where an employer loans money at below market rates so the employee can purchase a home. The prescribed rate used to calculate the taxable benefit to an employee who receives such a loan, is set at the time the loan is made, and is effective for the next five years. If the loan described in the example above was a housing loan, the taxable benefit to the employee would, for the five-year period after the loan was made, be equal to 4% per year of the loan amount, regardless of any fluctuations in interest rates that might occur during that five-year period. At the end of the five-year period (assuming that the repayment term for the loan was more than five years), the prescribed rate then in effect would be used to calculate the taxable benefit for the next five years.

Conclusion

The inclusion of benefits in an employee's compensation package may provide the employee and his or her family with access to services that might not be obtainable individually on a cost-effective basis. As is often the case, when those benefits can be provided on a non-taxable basis, it's a win-win situation for the employee. And, from the employer's perspective, being able to offer an attractive compensation package which is also tax-effective can mean the retention of valued long-term employees and an edge over the competition in successfully recruiting new ones.