Pay Day!

big money *Why owner-operators have to pay themselves a decent wage.*

By Scott Taylor

You wear a lot of hats as an owner-operator. You're the boss and an employee, the business manager and the guy holding the wheel, the chief cook and the bottle-washer. As the big cog at your operation, you deserve your fair share of grease, if you know what I mean. Then again, maybe you're intent on keeping your personal draw low so you can reinvest as much of your company's earnings back into the business.

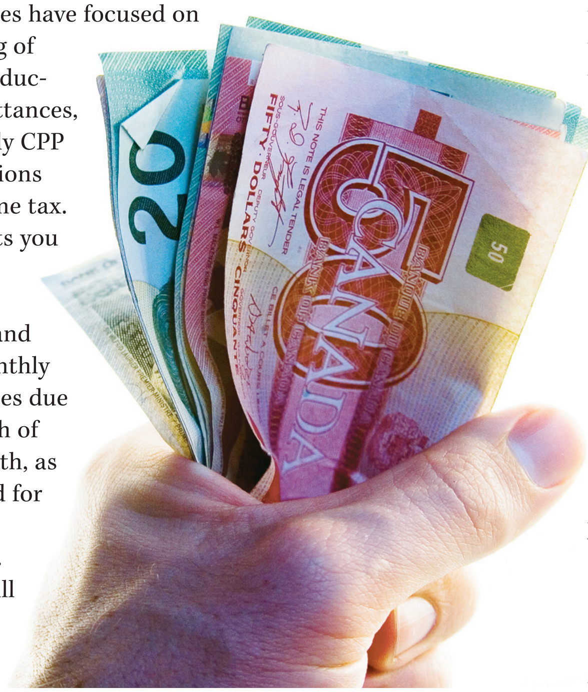
Our owner-operator clients have different philosophies about personal compensation, but they all need to have one thing in common: the rationale behind their ideas—and remittances for Canada Pension Plan (CPP) and income tax—have to pass muster with the Canada Revenue Agency.

For years, many small-business owners and their accountants would wait until the year's accounting was done to determine the owner's actual drawings and then decide what amounts were to be shown as wages or dividends. Then a tax and CPP payment would be made on Jan. 15 to legitimize the T4.

Others would simply put the "wage" portion directly on their tax return as self-employed income. By showing their income as self-employed on their T1, they paid all the correct tax and CPP as though they were on payroll—assuming of course, that due to their share ownership they are not EI eligible.

Well, guess what? The CRA doesn't like either method any more.

Recent CRA rulings on the deductibility of management wages have focused on the timing of source-deduction remittances, specifically CPP contributions and income tax. CRA wants you to pay yourself a T4 wage and make monthly remittances due by the 15th of each month, as you would for any other employee. You do still have the option of paying out a bonus, director fee, or dividend to yourself, but talk to your accountant about how to handle these correctly.



AUDIT EXPOSURE

CRA auditors are actively looking at how whether you're complying. They look for inaccuracies by pursuing active businesses reporting income on corporate tax returns that do not have any T4 summaries filed. If they audit your file and the T4s have not been filed, they can disallow your meal claim and assess GST/HST on the wage paid to you from the corporation. They also can issue T4s themselves and charge you late-filing penalties and interest. At their discretion, CRA may review previous years and assess penalties where T4s have not been filed.

Auditors also scan tax returns with self-employed income and use your SIN to find a matching business number registration. If they don't find one, you're going to get a call or letter and they'll be especially interested in your GST/HST administration. Remember, if you have more than $30,000 in self-employed income, your business must be registered for GST/HST.

As I suggested last month, set your annual compensation according to how much it costs to run your household each month. Tally up your personal expenses, mortgage payment, property taxes, and other outlays. Add it up and multiply by 12 to cover the year. That's your annual personal income target, one you can use as the basis for estimating the tax and CPP you'll owe and send in one-twelfth of it each month.

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To ensure that your payments are on time, you can pay your personal and/or business tax through your financial institution's telephone and Internet banking services. Of course, you can still use a bank teller on the due date, which is better than trusting Canada Post to deliver it on time. Depending on the financial institution, you may be able to future-date your payments. For that matter, you can mail CRA post-dated cheques.

CRA likes consistent reporting. Avoid the ups and downs, never miss a payment, and work with your accountant to set up a compensation plan that can satisfy your needs—as well as those of the taxman. ▲

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