

Family gatherings: Rules for hiring relatives

There are many reasons why hiring family can be a minefield for business owners, but taxes shouldn't be one them. Bringing a spouse, parent, kid, or other relative onto the payroll even on a part-time basis can generate big savings, especially if you're splitting income among family members who are in a lower tax bracket than you are.

Canada Revenue Agency has specific rules for hiring relatives. Basically, family members must

do the work for which they are paid.

The wage or salary must be in line with what you'd otherwise pay Joe Average to do the same job. And the work must be necessary and not some frivolous project that you wouldn't otherwise hire someone to do.

When you hire a relative, you can never lose sight of your responsibilities as an employer. You may have tax and legal obligations including source deductions like

Tax Talk

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Employment Insurance and/or Canada Pension Plan. Then again, you might not.

CRA defines a relative as someone who is connected by blood relationship (like a father and son), marriage, common-law partnership, or adoption. You also can be related to a corporation if you're related to one or more of the people who control the corporation, or when a corporation employs someone who controls more than 40% of the corporation's voting shares.

The Employment Insurance Act states that employees who are related to their employer – be that a sole proprietor or corporation – may not be eligible for EI benefits and should not have EI premiums deducted from their pay because they do not deal with each other “at arm's length.”

On the other hand, some employees who are relatives might indeed qualify for EI. For example, a related employee may be insurable if it's reasonable to conclude that you would have hired a non-related person to do the same

job at a similar rate of pay.

What is reasonable? Here are some of CRA's criteria:

Remuneration paid: When the amount of the remuneration and the manner of payment reasonably compare to those that a guy off the street would accept for similar work, an arm's length relationship is suggested. The pay you offer your related employee should be in line with what a non-relative would accept for similar work.

Terms and conditions: Are the terms and conditions of employment substantially similar to the ones in an arm's-length employment relationship?

Duration of work performed: The timing of a job – when it occurs and how long it lasts – should correspond reasonably to the length of time such work should take to perform, and to the employer's normal business cycle and history.

Nature and importance of the work: Are the services you hired your relative to perform necessary and important to the business operation? Have you historically hired an employee to perform this work?

How to request a ruling

If you're not sure whether to deduct EI premiums for your relative-employee, you can ask CRA to rule on your case. Rulings clarify your obligation as the employer and will define whether your employee is covered should he make an EI claim (due to lay-off, pregnancy, or sickness).

To request a ruling, send a letter or a completed Form CPT-1 to the nearest tax services office no later than June 30 of the year following the year in which the employment occurred. If you have a payroll account and are registered on My Business Account, you can use the “Request a CPP/EI ruling service” online.

Hiring family takes serious forethought.

Don't try to arrange a haphazard payment formula or job description after your year-end.

Do put an employment agreement in place at the beginning of your fiscal reporting period and be ready to defend the value and worth of your family members' contribution to the business and to the bottom line.

Speaking of family, I hope you're able to set aside work and enjoy time together at this time of year. Here's to you and yours during the holiday season, and to a successful, prosperous 2014. See you next year. □

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