Introduction to Payroll

The Canadian payroll system is a rather complex process, requiring employers to make proper distinctions between workers, collecting deductions from their income, remitting those deductions (along with their share) to the CRA, creating correct information reports and filing within the rigid deadlines. This article outlines the basics of creating a payroll account and the employer's responsibilities.

If you are an employer, trustee, or payer, you must make deductions on amounts you pay, and remit them (along with your share) to the Canada Revenue Agency. You also have to report your employee's income and deductions on the appropriate return.

Employer, Payer, or Trustee

The first step is to determine whether you are a payer, a trustee, or an employer. If you are neither of the three, then payroll is not needed.

You are a payer if you pay any of the following:

- Pension, superannuation, or annuity
- Lump-sum payment or retiring allowance
- Self-employed commissions
- Patronage allocations
- RESP accumulated income payments or educational assistance payments
- Fees or other amounts for services
- Group term life insurance taxable benefit for former employees or retirees
- Other income: research grants, wage-loss replacement benefits (certain exemptions apply), certain benefits paid to partnerships or shareholders

If you are a payer but you made payments of less than $500 per individual for the calendar year and did not have to pay income taxes, then you do not need payroll.

You are a trustee if you:

- Authorize or make payment for another person
- Control and manage another person's property, business, estate, or income

You are an employer if:

- You pay salaries, wages, bonuses, vacation pay, or tips to your employees
- You provide taxable benefits, such as a car, to your employees

If you are an employer, the next important step is to determine whether your worker is an employee or a self-employed worker.

Employee vs. Self-Employed

This is a very important distinction because if determines whether you, the employer, will make deductions for CPP, EI and income taxes, and remit them to the CRA. Should you make an error and neglect to make the deductions, you will be responsible for your share, the employee's share and penalties and interest!

You must make the distinction carefully, as the CRA looks at each criteria individually, and then as a whole. The final decision is purely circumstantial, as there is no set regulation. The following are the general criteria:

1. Contract of Services vs. Contract for Services

You must ask what the intent of the contract was when entered into the working arrangement. Contract of services constitutes an employer-employee relationship. Contract for services constitutes a business relationship.

2. Control or Autonomy

Typically, the greater the right to exercise control, the greater the probability that the worker is self-employed. Examples of control include working independently with no oversight, working when and for whom the worker chooses, having the ability to refuse or accept work from the payer, and no sign of relationship continuity once the work is completed.
However, you must be careful when determining the degree of control of professionals, such as engineers and doctors. Because of their expertise, the may be given plenty of rights to exercise control, regardless of whether they are employees or self-employed workers.

3. Tools and Equipment

Self-employed workers typically supply the tools and equipment required to complete the contract, and are responsible for their maintenance and repairs. Although employees are sometimes required to provide the tools as well, they are usually reimbursed for their use.

4. Subcontracting work or hiring assistants

Employees are usually not allowed to hire helpers or assistants; they must perform the work themselves. Self-employed workers can choose whomever they want to perform the work to be done; the payer has no say in who the self-employed worker hires.

5. Financial Risk

Employees are usually not financially liable for incomplete work and operating costs. Self-employed workers are responsible for paying any assistants, incomplete work and operating costs (when operating out of their own workspace). Furthermore, self-employed workers may incur advertising and marketing costs.

6. Responsibility for investment and management

Employees will have no capital investment in the payer's business or business presence. A self-employed worker has capital investment, hires and pays his staff, and has a business presence in his own business.

7. Opportunity for Profit

Employees typically do not have the opportunity for profit or loss, even though their remuneration can vary (example: commission-based salary). Self-employed workers will have the opportunity for profit/loss because they set the price for their services and incur costs. Although self-employed workers are usually paid a flat-rate, they may be paid on an hourly basis.

Payroll Account

If you are an employer, a payer, or trustee, you must open a payroll account with the CRA. This number will consist of your 9-digit Business Number (BN), followed by the letters **RP** (to identify the account as a payroll account), and a 4-digit account reference (usually 0001).

You have to open a payroll account before the first remittance due date. This date is the 15th day of the month following the month in which you began withholding deductions.

You can register for a payroll account in the following ways:

- **CALL:** 1-800-959-5525
- **ONLINE:** using the Business Registration Online service on the CRA website
- **MAIL:** to your tax services office (TSO)
  If you live in Barrie, St. Catherines, Hamilton, Kitchener, London, Toronto, Windsor:
  451 Talbot Street London ON N6A 5E5
  If you live in Belleville, Peterborough, Kingston, Ottawa, Sudbury, Thunder Bay, Nunavut:
  31 Hyperion Court Post Office Box 2600 Kingston ON K7L 5P3

Hiring Employees

Once you have you payroll account, you can start hiring employees. You will need two pieces of information from them:

1. Social Insurance Number (SIN)
2. Completed Form TD1, Personal Tax Credits Return, which determines the amount of tax to be deducted from the employee's employment income or other income.

Deductions

You will have to deduct Canada Pension Plan (CPP), Employment Insurance (EI), and income taxes from each employee's employment income. You will also need to calculate your share that you will remit to the CRA.

Canada Pension Plan (CPP)

CPP is deducted for each employee who:

1. Is 18-70 years old
2. Earns pensionable income during the year
3. Does not receive CPP or QPP retirement or disability pensions

Age

If an employee turns 18 or 70 during the year, you must prorate the maximum for that year and begin or cease deductions on the first of the following month.

Pensionable earnings vs. non-qualifying earnings

The following earnings are **INCLUDED** in the calculation of CPP deductions:

- All salary, wages, and bonuses
- Value of table benefits
- Executive fees received
- Certain tips and gratuities
- Earnings received while on leave
- Wage-loss benefits
- Stock option benefits
- Salary from any worker's compensation claim

The following earnings and benefits are **NOT** included:

- Earnings less than $250 from agriculture, fishing, hunting, or logging if employed less than 25 days
- Casual labour
- Teachers on exchange from a foreign country
- Employment of a spouse if you do not deduct the amount as an expense from your income
- Employment of a member of a religious order
- Employment of a child where no cash remuneration was paid
- Employment for a disaster or rescue operation
- Employment by a government body as a census taker or election worker
- Pension payments
- Retiring allowances and severance payments
- Wage-loss benefits paid by an insurance company
- Payments made after the death of an employee
- An advance or loan by the company to cover a worker's compensation claim. The amount must be repaid or CPP must be deducted.
- An amount equal to a worker's compensation award for a self-insured employer
- Benefits for clergy members

CPP is calculated using pensionable earnings, up a maximum contribution amount. For 2010, the maximum contribution is $2,163.15, which is calculated as:

	$47,200	Maximum pensionable earnings
Less:	3,500	Yearly basic exemption
	43,700	Maximum contributory earnings
Multiplied by:	4.95%	Yearly contribution rate
	2,163.15	Maximum contribution

Employer's Share and Penalties
The employer must remit the same amount as he deducted from his employers.

Failure to remit CPP deductions results in a penalty of 10% for the first incident and 20% for each subsequent incident in the same year. Interest is also charged at 2% above prime rate on the due date.

Employment Insurance (EI)

As an employer, you must deduct EI premiums from your employer's insurable earnings and remit them to the CRA. You must also track insurable earnings and insurable hours by pay period for each employee.

The following is a list of income and benefits that are **NOT** insurable:
- Casual employment
- Non-arm's length employment
- Employment of someone who controls more than 40% of the corporation's share
- Employment that constitutes an exchange of work or service
- Employment in agriculture where the person receives no cash or works less than 7 days/year
- Employment of a person in a rescue operation
- Employment by a government body as an election worker for less than 35 hours/year
- Employment of a member of a religious order
- Supplementary Unemployment Benefit (SUB) plan payment
- All taxable benefits (except value of board and lodging if paid cash and employer contributes to an employee's 'non-locked in' RRSP
- Retiring allowance and severance pay
- Director's fees
- Maternity/paternal benefits supplement
- Advance/loan payment for worker's compensation claim, as long as it is paid back
- Worker's compensation benefits supplement
- Wage-loss replacement plan supplement

For 2010, the maximum EI premium is calculated as follows:

	$43,200	Maximum insurable earnings
Multiplied by:	1.73%	Yearly EI rate
	$747.36	Maximum premium

Employer's Share and Penalties

The employer rate is 1.4% times the employee's contribution, which is 2.422%. Some employers can have their EI rate reduced to less than 1.4 times the employee's premium if they provide a wage-loss replacement plan for short term disability to their employees. The plan, however, must meet strict criteria, which can be found on the CRA website.

Failure to deduct and remit EI results in a penalty of 10% for the first incident and 20% for each subsequent incident in the same year. Interest is also charge at 2% above prime rate on the due date.

Insurable Hours

Each hour worked to earn insurable income is an insurable hour. They are reported as worked (not rounded up). For salary employees, insurable hours are the expected hours of work. Bonuses have no insurable hours (they are insurable for dollars, not hours).

Income Tax Deduction

The last deduction an employer must make is income tax, which is calculated based on the employee's net taxable income. Net taxable income is:

- Salary, wages, commissions
- Bonuses
- Vacation pay
- Pensions and retiring allowances
- Death benefits
- Value of taxable benefits and taxable allowances

The following is a list of income **NOT** used in calculating net taxable income:

- RPP and RRSP employee contributions
- Union dues
- Prescribed living zone deduction
- Authorized deductions by CRA

The best method to calculate income taxes by yourself is to you the Table Method provided by the CRA on its website.

Employer's Share and Penalties
For income tax deductions, the employer does **NOT** making any contributions in addition to those deductions from the employee.

The penalties for late or withheld remittances are 10% for the first incident and 20% for each subsequent incident in the calendar year. Penalties are applied to amounts in excess of $500, except in the case of wilful delay, where penalties are applied regardless of the amount.

Remitting Payroll Deductions

Once you take the deductions from the employee's income, you must submit, or remit, them to the CRA. There are four types of remitters, which depend on your Average Monthly Withholding Amount (AMWA). The AMWA is calculated by adding up all the CPP, EI, and income tax deductions you had to send two calendar years ago, then dividing the total by the number of months (maximum 12) that you had to make payments in that year. Depending on your remitter type, you will have different remittance deadlines and remittance forms sent to you:

1. Regular remitter
    - New employers and employers with an AMWA less than $15,000.
    - Must submit their remittance on **the 15th day of the month following** the month you made the deductions.

2. Accelerated remitter – Threshold 1
    - Employers, including those with associated corporations and multiple payroll accounts with an AMWA between $15,000 - $49,999.99
    - For remuneration paid before the 16th day of the month, must submit your remittance **before the 25th of the same month**.
    - For remuneration paid after the 15th day of the month but before the first day of the following month, **by the 10th day of the following month**.

3. Accelerated remitter – Threshold 2
    - Employers, including those with associated corporations and multiple payroll accounts with an AMWA greater than $50,000.
    - Must submit your remittance electronically or in person to your Canadian financial institution no later than **the third working day after the end of the following periods**:

- from the 1st through the 7th day of the month;
- from the 8th through the 14th day of the month;
- from the 15th through the 21st day of the month;
- from the 22nd through the last day of the month.

4. Quarterly remitter

- Employers with a perfect compliance record and an AMWA less than $3,000.
- No application needed; the CRA sends a notification by mail to eligible employers.
- The quarters are: (1) January – March, (2) April to June, (3) July to September, and (4) October to December

Submitting your Remittances

Aside from an accelerated remitter - threshold 2, an employer can submit using the following methods:

1. **ONLINE:** Through “My Payment” on the CRA website
2. **ONLINE BANKING:** through your financial institution
3. **IN PERSON:** at your financial institution
4. **MAIL:** to the address listed in your remittance form booklet. Make cheque payable to **Receiver General**. Do not send cash in the mail.

Completing and Filing Information Returns

Aside from deducting and remitting CPP, EI, and income taxes, you, as an employer, must complete the proper information returns for your employees. These include:

- T4 – for each employee
- T4A – if you are a payer
- T4A-RCA – if you are a custodian who makes distributions out of an RCA trust
- T4A-NR – if you made payments to non-resident individuals, partnerships, or corporations
- T5108 – for payments to construction businesses
- T1204 – for payments to federal departments, agencies, and Crown corporations

You also need to file T4, T4A, and T4A-NR summaries, which sum up the totals that have been reported on the respective information slips.

Deadlines and Penalties

The deadlines are as follows:

- T4, T4A, T4A-RCA – last day of February following the calendar year in which the information return applies to
- T4A-NR – before the last day of March following the calendar year to which the information return applies to.
- T5018 – 6 months after the end of the reporting period you have chosen
- T1204 – before March 31 of the year following the calendar year to which the information return applies.

The penalties are as follows:

Number of information returns (slips)	Penalty (per day)	Maximum penalty
50 or less	$10	$1,000
51 - 500	$15	$1,500
501 - 2,500	$25	$2,500
2,501 - 10,000	$50	$5,000
10,001 or more	$75	$7,500