



Self-Employment

Things to consider...

The entrepreneur who decides to become self-employed has many things to consider in making the move from a secure employer/employee relationship to the world of self-employment. The intention of this brochure is to highlight the many tax considerations of being self-employed.

Being self-employed has many advantages:

- being your own boss
- flexible work hours
- deciding who you will work with
- how you will operate
- for tax purposes the ability to deduct any reasonable expense incurred to earn business income.

The disadvantages to being self-employed include:

- No Employment Insurance (EI) protection since you don't have to pay EI premiums.
- Increased Canada Pension Plan (CPP) costs because you must pay all CPP contributions yourself.
- Loss of job security.
- Loss of tax-free benefits such as dental and medical plans.
- No company pension.
- Loss of social aspects of a job.
- Difficulty in getting credit.

Employee or Self-Employed?

The distinction between employees and self-employed individuals is sometimes a difficult one. If you want to be considered self-employed, it is important that the Canada Revenue Agency (CRA) also views your

arrangement in this light. To determine if a worker is an employee or a self-employed individual (independent contractor), and thus if there is an employer-employee relationship or a business relationship, you have to examine and analyze the terms and conditions of the worker's employment as they relate to the following factors:

Control

- The relationship between you and the person paying for your services reflect the control factor. Generally, the payer exercises control if he has the right to hire or fire, determines the wages or salary to be paid, and decides on the time, place, and manner in which the work is to be done. The payer usually exercises control if he has the right to decide where, when, and how the work will be done. If you are hired to perform services and you have the flexibility to decide how and when the services are to be performed, this would indicate that you are an independent contractor, and thus self-employed.

Ownership of Tools

- The economic reality of your relationship with your hirer may determine whether you are an employee or self-employed. The main points to consider are the amount invested, the value of equipment and tools, and the rental and maintenance of equipment and tools. In an employee-employer relationship, the employer generally supplies the equipment and tools required by the employee. In addition, the employer typically covers the following costs related to their use: repairs, insurance, transport,

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rental, and operation (e.g., fuel). In some trades, however, it is customary for employees to supply their own tools such as garage mechanics, painters, carpenters, scientists, architects, and surveyors. In a business relationship, workers generally supply their own equipment and tools and cover costs related to their use.

- ✓ Work for more than one hirer.
- ✓ Establish yourself as a business.

Tax Advantages of Being Self-Employed

Deducting Expenses

- Self-employed individuals can deduct any reasonable expense they incur to earn their business income, unless the expense is specifically denied in our tax law. Personal expenses are not deductible. The following expenses are deductible:
 - ✓ Accounting and legal fees, including the cost of having your income tax return prepared.
 - ✓ Annual fees such as licence fees, dues, membership fees and business taxes.
 - ✓ Half of CPP/QPP contributions (the other half is a non-refundable tax credit).
 - ✓ Capital Cost Allowance (CCA) on office furniture, equipment, etc. used in business (if you only use an asset partially for business purposes, then you have to prorate the expense between business and personal use).
 - ✓ Cost of attending up to two conventions a year that relate to your business.
 - ✓ Insurance, unless it is life insurance which is only deductible if a financial institution required the policy as collateral for a business loan.
 - ✓ Interest expense on money borrowed for the purpose of earning or producing income from your business.
 - ✓ 50% of the amount you pay for meals and entertainment, excluding amounts for the use of a golf course, a yacht, a camp or a lodge; however, the payments for the use of a golf club for a business meal or other business purpose would be deductible.
 - ✓ Office rent.
 - ✓ Private health services plan premiums where your primary source of income is

Chance of Profit and Risk of Loss

- What is the worker's financial involvement? You must determine whether the worker has the chance of making a profit, risks incurring losses due to bad debts, damage to equipment or materials, or unforeseen delivery delays, and covers operating costs. Generally, in an employee-employer relationship, the employer alone assumes the risk of loss. The employee does not assume any financial risk, and is entitled to his full salary or wages regardless of the financial health of the business. In a business relationship, the self-employed individual may make a profit or incur a loss. He also covers operating costs. There is no guarantee of a steady income.

Integration

- Your relationship with your hirer is another factor to consider. Where the worker integrates the payer's activities to his own commercial activities, a business relationship probably exists. Where the worker integrates his activities to the commercial activities of the payer, an employer-employee relationship probably exists.
- There are a number of steps that you can take to improve the likelihood that you'll be considered an independent contractor in CRA's eyes, which include the following:
 - ✓ Document your situation in a contract.
 - ✓ Use your own equipment.
 - ✓ Consider penalties for failing to complete a project on time.
 - ✓ Invoice your hirer.
 - ✓ Do not accept fringe benefits.

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from self-employment or income earned from other sources does not exceed \$10,000.

- ✓ Professional membership dues.
- ✓ Rental costs of equipment.
- ✓ Salary paid to an assistant.
- ✓ Supplies.

Home Office Expenses

- As long as your home office is your principal place of business (more than 50% of your time) and your home office is used exclusively for business purposes and is used on a regular and continuous basis for meeting clients, customers or patients, you can deduct home office expenses.
- You must prorate the expenses related to home office between its use for business and personal purposes.
- You can deduct the business portion of the following amounts that relate to your home office:
 - ✓ Insurance.
 - ✓ Maintenance and repairs.
 - ✓ Mortgage interest.
 - ✓ Property taxes.
 - ✓ Rent.
 - ✓ Utilities.
- You cannot create a business loss by claiming home office expenses, but you can carry forward the un-deducted amount indefinitely and deduct it from business income in the future.
- Your entire house will continue to qualify as your principal residence, after a conversion of a portion of the property to a business uses, as long as you meet the following conditions:
 - ✓ Business portion is reasonably small when compared with the size of the entire house,
 - ✓ You do not make any structural changes, such as an addition, in creating your home office space, and
 - ✓ You do not claim any CCA on the business portion of your home.

Travelling Expenses

- The most common type of travelling expenses is automobile expenses. Your tax deduction for these expenses is usually calculated as the business portion of your total automobile expenses, calculated by prorating your total automobile expenses by your business kilometres divided by your total kilometres. You must maintain an automobile log to document the business kilometres you have driven. In determining your total automobile expenses, include the following:
 - ✓ Fuel.
 - ✓ Repairs and maintenance such as tune-ups and oil changes.
 - ✓ Insurance.
 - ✓ License and registration.
 - ✓ Interest incurred on a car loan, limited to \$10 per day for vehicles purchased after 2000.
 - ✓ CCA or leasing costs.
- For income tax purposes, traveling from your home to your place of business is not usually business travel.

Conclusion

There are many tax considerations when an entrepreneur decides to become self-employed. Please contact your Collins Barrow business advisor in order to maximize the tax advantages available to you in this new world of self-employment.

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