



TIPS AND GRATUITIES

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As the calendar approaches the month of March, the minds of Canadians begin to focus on the daunting question of whether or not the ground hog's prediction for an early Spring will come true, and also to income taxes. With the April 30th personal tax filing deadline around the corner, we thought we would outline the rules applicable to a frequently asked question: are tips and gratuities taxable?

INCOME TAX

Tips and gratuities that employees receive are considered income earned in respect of employment for the purposes of the Income Tax Act. Where an employer is involved in the collection and distribution of the tips amongst the serving staff, such tips should be included on the employee's T4 slip as regular employment income. If the employee receives tips directly from a customer, the amount of such tips should be tracked by the employee during the year and included as other employment income on line 104 of their personal income tax return. In either case, income tax will be payable by the employee in respect of tips earned.

CANADA PENSION PLAN (CPP) AND EMPLOYMENT INSURANCE (EI)

Additional questions that must be addressed are whether tips received during employment are considered pensionable earnings for CPP purposes and whether they are insurable earnings for EI purposes. The answer depends on whether the tips are considered to have been paid by the employer or the customer, and whether they are declared tips in the province of Quebec.



Our goal is to provide updates on topical accounting and tax issues. Information contained in this newsletter is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients and readers. We would be pleased to discuss any questions that you, the reader, might have in greater detail.

Tips that an employer controls or possesses and then distributes to the employees are referred to as controlled tips. For example, assume a waitress is part of the serving staff in a restaurant. The waitress receives tips from the restaurant's customers. However, all such tips must go into a tip pool and are then distributed by the employer to all staff members who support the waitress in serving the client.

Controlled tips are part of the employee's total remuneration and the employer is considered to have paid these amounts to the employee. As a result, CPP contributions and EI premiums must be deducted at source if the employee is employed in pensionable or insurable employment.

“Direct tips” are paid directly by the customer to the employee. The employer has no control over the tip amount or its distribution. The employer is merely a conduit for the tip from the customer to the employee. Back to our example of a waitress receiving a tip from a customer, if there is no tip pool in place that must be shared with other staff, the receipt of such a tip would be a direct tip.

Direct tips are not subject to CPP contributions or EI premiums. An employee can voluntarily choose to make CPP contributions on direct tip amounts that are not otherwise subject to CPP contributions at source. To do so, the employee must complete Form CPT20.

It is possible for an employee to receive both controlled and direct tips. In such a situation, only the controlled tips would be subject to CPP and EI withholdings.

DECLARED TIPS IN QUEBEC

Employees working in a regulated establishment in Quebec must declare their direct tips to their employer. The employee must report his or her tips on the Register and Statement of Tips (form TP-1019.4-V) or an equivalent document to their employer at the end of each pay period. Quebec is the only province that has tax legislation that requires employees to declare their tips to their employer in this manner. There are specific rules which guide how tips are allocated in Quebec for these purposes. More information can be found in Revenu Quebec’s guide “Tax Measures Respecting Tips”. For Quebec Pension Plan (QPP) and EI purposes, the amount of any direct tips reported by the employee is included in their pensionable and insurable earnings, along with any controlled tips they receive from their employer. If the employer is unable to calculate source deductions and contributions on the tips reported by the employee because the necessary information is not available when doing the payroll for a given period, a catch up calculation can be completed in the following pay period.

CONCLUSION

The treatment of tips and gratuities would appear on the surface to be a straightforward matter. However, there are some important nuances in the rules to be aware of as outlined above. It is important for employees and their employers to understand their reporting requirements with respect to income tax, CPP and EI to ensure that all reporting is done correctly.

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