

# Taxation LAWYERS

James Rhodes  
james@taxationlawyers.ca  
226.499.9797

## TIPS AND TAXATION

November 16, 2023

# WELCOME

## This does not constitute legal advice

If you are looking for legal advice on your situation – please contact me directly or another tax professional

This presentation does not apply to Quebec as it has a Reporting/Declared Tip System in place

# Federal “Taxation” Statutes to Consider if your staff receive Gratuities

## **Employment Insurance Act (“EIA”)**

- Are the tips received by employees ‘insurable earnings’?

## **Canada Pension Plan (“CPP”)**

- Are the tips received by employees ‘pensionable earnings’?

## **Income Tax Act (“ITA”)**

- Are source deductions required to be withheld from tips?
- Did you have obligation to report total tip amounts paid to employees on their T4 slips?

## **Excise Tax Act (GST/HST) (“ETA”)**

- Were you required to charge/ collect HST/GST on mandatory\* tips paid by patrons?

## Provincial Taxation Statutes to Consider

### **(Ontario) Workplace Safety and Insurance Act (“WSIA”)**

- Are tips paid to employees ‘insurable earnings’?
- Per WSIB Operational Policy 14-02-08, insurable earnings include: “Gratuities that are verifiable by the employer”

### **(Ontario) Employer Health Tax Act (“EHTA”)**

- Are tips received by employees ‘remuneration’ under section 1 of EHTA?
- Doesn’t apply unless payroll over \$5m, exemption threshold increased to \$1m
- Per Ontario publication 2-96-OLD ‘Remuneration’:  
Remuneration generally includes gratuities paid through an employer

# Provincial POLICING Statutes

## (Ontario) Employment Standards Act, 2000 (“ESA”)

- All tips must be paid to employees
- If tips not paid to employees, deemed to be owed as if wages
- Tips can only be paid to owner if they are doing same or similar job as employees
- Only permitted deduction is for credit card processing charge
- MOL investigates alleged infractions

REMEMBER – under ss 1(1) of ESA ‘wages’ does not include ‘tips or other gratuities’

\*important if MOL is investigating you on tip complaints

\*\*On Monday – Province tabled *Working For Workers Four Act, 2023* (“W<sub>oo</sub>F W<sub>oo</sub>F”) – in part makes changes to ESA regarding gratuities

## Don't Confuse your Legislation

- Provincial statutes and federal statutes have different purposes and different auditors that can lead to different conclusions as to your compliance
  - I.e. Employer sets up acceptable tip pool for ESA purposes, but creates controlled tip system
- Ensuring compliance under one statute doesn't guarantee compliance under another statute
- Compliance under one statute can mess up your compliance under another statute

## CPP + EIA Issues

**The True Legal Question under EIA and CPP:**

**Whether the employer has 'paid' the gratuities to the employee**

**CRA's distinction of "Direct Tips" versus "Controlled Tips" is made-up.**

**It is not the law. It is an administrative position.**

**Why is this distinction important to understand?**

**Because of gratuities paid thru credit cards and debit cards that end up in your merchant account.**

- You 'pay' those electronic gratuities over to the Employees**
- This is where the risk really starts**

**\$100k Question -> Have you 'paid' those electronic gratuities over to employees?**

**If you have paid them by electronic transfer the next day – you have – FCA decision *Ristorante A Mano***

**If you have paid them by cheque within 3 days – you have – TCC decision *Andrew Peller***

**If you have paid them to employees by end of employees shift? Never been decided.**

**This is where CRA's administrative policy of direct tips vs. controlled tips comes in**

**The judge might find that you paid them to the employee – but if you follow the CRA's rules, you will never have to face that judge**

**This is why we scrupulously follow the CRA's direction on what is a direct tip system!**



# Starting Question for your Organization

Do you want to Control the Tips?

- Change what goes between BOH and FOH depending on your labour needs?
- Move more tips to managers to get servers to take on that role?

You are allowed to do this by CRA and the MOL

Per CRA you have a 'controlled tip' system

Consequence:

1. Must pay employer CPP and EIA premiums on gratuities received from patrons

And

2. Withhold source deductions from gratuities for employee premiums of CPP, EIA, and ITA

# If you want to control the gratuity pool

1. No Employee Committee Needed
  - you make the decision – but must follow ESA rules / MOL guidelines
2. Set up the gratuity pool and decide:
  - Who is included or excluded from the pool
  - What is each employee's share under the pool
  - When the gratuities held by the restaurant are to be paid out
3. Can pay out gratuities under your choice of method\* WoofWoof
4. Can change pool when it doesn't work for the restaurant

# Remember ESA compliance if you control tip pool

## Per Ontario.ca website (MOL administering ESA)

1. There is no requirement under the Employment Standards Act, 2000 (ESA) for employers to establish a regular period for distributing tips or other gratuities to employees. **However**, the failure of an employer to distribute tips or other gratuities within a **reasonable time frame** may constitute the withholding of those tips or other gratuities. – **Don't pay out once a year!**
2. The ESA\*\* does not specify the methods by which an employer must distribute tips or other gratuities to employees. **However**, the method used cannot constitute a withholding of, or a deduction from, tips or other gratuities in contravention of the ESA. **WooFWoof will change this**
3. Employers can decide if there will be tip pooling terms in the workplace, including **who** will participate, and **how** it will be distributed. For example, the employer can determine:
  - i. how much each employee is entitled to—for example, whether the amount received is based on number of hours worked or the employee's position
  - ii. when and how the tip pool shares will be distributed to employees—for example, weekly or daily, in cash or direct deposit (which includes Interac e-Transfer)
  - iii. how and when tip pooling terms should be changed or varied—for example, adding or removing employees to and from the tip pool, changing the percentage received by employees, or cancelling the tip pool, etc.

# Don't want to pay EIA and CPP on gratuities transferred to employees?

CRA Administrative Policy looks to see whether employer has either: 'control' or 'possession' -only need one to fail

Where employer controlled or possessed the tip before it was paid to the employee → it's a "controlled tip" = "paid" = EI + CPP

Where employer did **not** control or possess the tip before it was paid to the employee → it's a "direct tip" ≠ "paid" ≠ EI + CPP

# Controlled Tips

## Examples of controlled tips:

1. the employer adds a **mandatory** service charge or percentage to a client's bill to cover tips [**talk on what is left out**]
2. tips that an employer includes in his business income, then expenses and redistributes to employees in the form of pay [**control and possession**]
3. cash tips that are deposited into the employer's bank account and become, or are even commingled with, the property of the employer and then paid out to the employees [**control and possession**]
4. tips that are allocated to employees using a tip-sharing formula determined by the employer [**control**]
5. tips that the employees turn over to their employer who then distributes them to the employees [**possession**]

# Direct Tips

## Per CRA, to be a 'direct tip':

- 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.

The following are some examples of direct tips:

- a customer leaves money on the table at the end of the meal and the server keeps the whole amount
- a guest gives a tip directly to a bellhop, door person, car attendant, porter, etc.
- the employees and not the employer decide how the tips are pooled or shared among employees
- a customer includes an amount for a tip when paying the bill by credit or debit card and the employer returns the tip amount in cash to the employee at the end of the shift. In exceptional situations the cash tips could be paid out the day after, for example, if there was not enough available cash on hand

## SO HOW DO I CREATE A DIRECT TIP SYSTEM

### **#1. Establish Employee Committee**

To be direct tip – the distribution of tip pool amongst employees must be decided by the employees

- Need employees to certify that they made that decision
  - Recommended to be done every year
  - Get that decision in writing and laminate for the future CRA audit

## How to Establish Employee Committee

- there is no law on the set up a committee by CRA or MOL or any other govt agency
- While ultimate grat pool decision to be made by employees for employees – you can set up the committee to get that decision rolling
- start the system by first determining the who should be on the committee by considering all the roles in the Front of House (FOH), Back of House (BOH), Management (M)\* that contribute to the ‘dining experience’
  - Recommend NOT to include any owners on Committee or GM level
  - Examples to include:
    - (FOH) = server, bartenders, server assistants
    - (BOH) = head chef, sous chef, CDP, line cook, prep cook, dishwasher
    - (M) = (?GM), AGM, Service M, Floor M, (?Operations M), (?Executive Chef)
- Consider size of committee for restaurant operation: 3 vs 5 vs 7 [but always odd #]
- Of the roles for FOH, BOH and M, consider the major players to put on committee
  - i.e. server (FOH rep), bartender (FOH rep), sous chef (BOH rep), line cook (BOH rep), Floor manager (M rep)



# SO HOW DO I CREATE A DIRECT TIP SYSTEM

## #2. Establish Gratuity Pool

- Best solution - work out what the previous gratuity sharing arrangement was and determine what the comparable gratuity pool will be
- Can be completely different - just needs to be decided upon by the employee committee
- Remember to stay out of the final decision!
  - In both *Andrew Peller* and *RAM* an employee or employees told the CRA the final decision was made by management or owner of restaurant
- Intervention in the tip pool is permitted, but its like you pulling out three blocks at once. Its fine at the start of Jenga but as it gets going its sure to cost you the game

## MAJOR COMPONENTS OF DIRECT TIP SYSTEM

### #3. Establish the Committee's Governance Rules

Establish governance rules for Employees to have an idea of what to do

For instance:

1. Committee will meet at least once a year to ratify the tip sharing
2. The Committee will produce a signed statement to the employer on their agreement as to the gratuity sharing for the upcoming year
3. Committee will hold elections with employees at some point in the year to establish that's employees running the show
4. Committee makes judicial determinations of tip sharing – no longer let management or owners make these decisions!

# Major Components Continued

## #4 Do not have a Mandatory Gratuity unless it is clearly separate

- i.e. tables of 8 or more have 15% tip added
- Rental of banquet room has mandatory 15% tip added
- CRA's view is that a mandatory gratuity is automatically a controlled gratuity – regardless if no control or possession over the tips received!
- CRA's view is that HST has to be collected on a mandatory gratuity
- While CRA's official policy is that you can have direct and controlled tips in the same restaurant, my experience is that the factor that makes a tip controlled is used for the single determination of whether all tips are controlled tips unless clear segregation exists
  - Further, I find that any confusion and uncertainty about whether a mandatory gratuity exists or existed is not fully investigated by the CRA. The situation is interpreted to support a finding of controlled tip for all tips

# Major Components Continued

## #5. Remove all Promises of a share in gratuity pool

- larger establishments sometimes make it a term of employment that the position [usually manager] gets a share of the gratuity pool or tip-out
- CRA will view this as the employer forcing the employees to give up tip share to managers on tips that might not have been received
- Managers can be included in the tip pool but don't make it a term of employment with the employer
- Managers can be included in the pool if they are part of the patrons' dining experience

# Major Components Continued

## #6. Use Employee Agreements to reflect that a Direct Tip System

- Create clause setting out direct tip system for new employees in employment agreement
- Consider whether amending current employee agreements to add a clause that they operate under a direct tip system
  - Remember – they are already operating under a direct tip system so it is not a new change to the agreement. It is changing an implied term to an express term
- I have been involved in case where the auditors used T4s to trace employees and then call them and ask them who determined their share of the tips two years ago when they worked at RHODES Burger
  - After they remember how much they loved working there, they say something like ‘I was just given my share of the tip, I never had the ability to ask for more – which I so so so deserveeeeee....’
  - What does the auditor hear? The tip shares were determined by the employer
- Employment Agreement is your safety net

# Timing and Method of Gratuity Payout

In final Gratuity System remember distinction between Courts and CRA

This is where it gets messed up

- Under CRA's position:
  - Employer can pay cash gratuity to employee and long as employee gets the **FULL** gratuity (both cash and electronic) at the end of the shift, it's considered direct tip = not paid = not insurable or pensionable earnings
- Under Court's position:
  - If employer had possession of the gratuity before it was paid to the employee = paid = insurable and pensionable earning
  - When you review APL + RAM – the employer made the direct transfer of funds to the individual employee

# W<sub>oo</sub> F W<sub>oo</sub> F Act, 2023

New Changes have occurred:

- 1: Disclosure of Policy for Employees
- 2: Retention of Policy for Employees
- 3: Method of Payment to Employees

# W<sub>oo</sub> F W<sub>oo</sub> F Act, 2023

## Method of payment

**14.1 (1) An employer shall pay** an employee's tips or other gratuities,

- (a) by cash;
- (b) by cheque payable only to the employee;
- (c) by direct deposit in accordance with subsection (3); or
- (d) by any other prescribed method of payment.

## Place of payment by cash or cheque

(2) If payment is made by cash or cheque, the employer shall ensure that the cash or cheque is given to the employee at his or her workplace or at some other place agreeable to the employee.

## Direct deposit

(3) **An employer may pay** an employee's tips or other gratuities by direct deposit into an account of a financial institution if,

- (a) the account is selected by the employee and is in the employee's name;
- (b) no person other than the employee or a person authorized by the employee has access to the account; and
- (c) the account meets the prescribed criteria, if any.



Thank you!  
Go to my website  
[taxationlawyers.ca](http://taxationlawyers.ca) to subscribe  
for my free newsletter updates

Checkout LinkedIn Group:  
“Canadian Taxation Professionals”  
→ more than 12, 😊😊😊 members

**Taxation**  
**LAWYERS**

James Rhodes  
[james@taxationlawyers.ca](mailto:james@taxationlawyers.ca)  
226.499.9797