Tax Consequences of Providing IT Consulting Services

Presented By:

Mark T. Serbinski, CA, CPA

Certified Public Accountant

And

Serbinski Partners PC

Chartered Accountants

Offices in Toronto & Chicago

1-888- US TAXES

Canadian IT Contractors Can Work:

- As employees;

Mark T. Serbinski
Certified Public Accountant

Serbinski Partners PC
Chartered Accountants

Pros & Cons of Being an Employee

Benefits of Employment:

- Taxes withheld at source;
- Health, disability, life insurance plans;
- Pension plans;
- Unemployment insurance.
- Employee rights (ie. Wrongful dismissal) are available.

Disadvantages of Employment

- All income is taxable with few deductions;
- Cannot have an assistant (ie spouse) on payroll;
- Cannot deduct mortgage interest or any other item which self employed persons are able to deduct.

Canadian IT Contractors Can Work:

- As employees;
- As sole proprietors (or independent contractors);

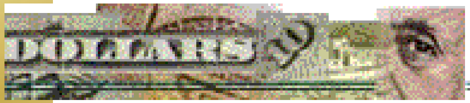
Pros & Cons of Being Self Employed

Benefits of Self Employment:

- May pay salary to assistant;
- May deduct normal business expenses;
- Can be exempt from U.S. taxation by Treaty;
- Lowest administrative cost of all organization alternatives.

Disadvantages of Self Employment

- May be considered an employee by taxing authorities anyway;
- Very little tax planning – income earned in year appears on tax return;
- Must pay quarterly installments of tax;
- Must collect and remit GST if working in Canada.
- Must buy own insurance
  - Health
  - Professional liability



Canadian IT Contractors Can Work:

- As employees;
- As sole proprietors (or independent contractors);
- Through a corporation.

Mark T. Serbinski
Certified Public Accountant

Serbinski Partners PC
Chartered Accountants

What is a Corporation?

- Separate legal entity – distinct from owners.
- Must maintain separate books & financial statements.
- Must file annual tax returns where it operates
- Can vote, be sued, & act like a separate person.

Why Incorporate?

- Reduce chances of being considered an employee.

Mark T. Serbinski
Certified Public Accountant

Serbinski Partners PC
Chartered Accountants

Being Considered an Employee

- Many sole proprietors are considered employees even with proper contract;
- CCRA wants to consider all persons employees;
- Difficult to distance self from “customer”;
- Consider nature of relationship.

Why Incorporate?

- Reduce chances of being considered an employee.
- Tax advantages available.

Mark T. Serbinski
Certified Public Accountant

Serbinski Partners PC
Chartered Accountants

Tax Advantages

- Lower rates of tax on first $200K per year;
- Must leave net income in corporation;
- Must be active business carried on in Canada;
- Choice of compensation – dividends vs salary;
- $500K capital gains exemption;
- Tax deferral and pay of family members possible.

Why Incorporate?

- Reduce chances of being considered an employee.
- Tax advantages available.
- Other advantages

Other Advantages of Incorporation

- Access to capital – can sell shares vs borrowing;
- Perpetual existence – corporation remains if owner dies;
- Limited liability – can only lose what you put in unless guaranteed.
- Anonymity – of owners.
- Ease in transfer of ownership;
- Decreased audit potential;
- Choice of fiscal year;
- Name protected;
- Estate planning – family trust ownership.

Incorporation Feasibility Checklist

- Conducting an active business?
- Not incorporating a job?
- Gross revenue test.
- Plan to leave some net income in corporation?
- Prepared to handle extra administration?

➢ If not – tax rates too high.
➢ Personal service corp.
➢ Generally over $100K
➢ If not, many tax advantages negated.
➢ Improper handling increases costs and creates a nightmare.

Pros & Cons of Working Through Your Own Corporation

Benefits of Incorporation:

- Benefits outweigh disadvantages
- Independent of customer;
- Limited liability to contractor;
- Highest degree of tax planning available;
  - Income splitting
  - Salary vs. dividends
  - Spanning calendar years through fiscal year planning.

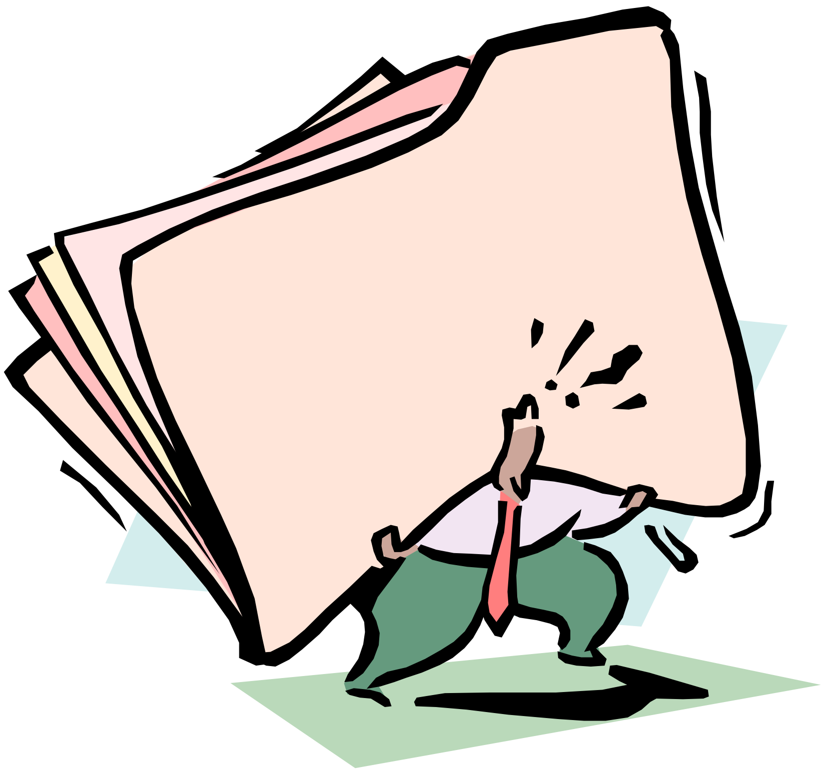
Disadvantages of Incorporation

- Higher set up cost;
- Higher annual administrative costs;
- More administrative work:
  - Must maintain books;
  - Must have a payroll;
  - Must file annual financial statements and tax returns;

Classic Canadian Corporate Tax Planning Model

- Corporation earns money carrying on an active business in Canada;
- Pays salary to shareholder (and others)- on payroll;
- Retains up to $200K each year at 23% “small business” tax rate.
- Retained earnings form “pension plan”- taxed as dividends when withdrawn;
- Personal & corporate taxes are minimized.

Some Basic Rules



- Family members must provide value to corp.;
- Only things required for earning income are deductible;
- Owner and spouse must be on payroll – with monthly remittances;
- "Small Business Deduction" only available for:
  - Active business
  - Earned in Canada

Basis of Taxation

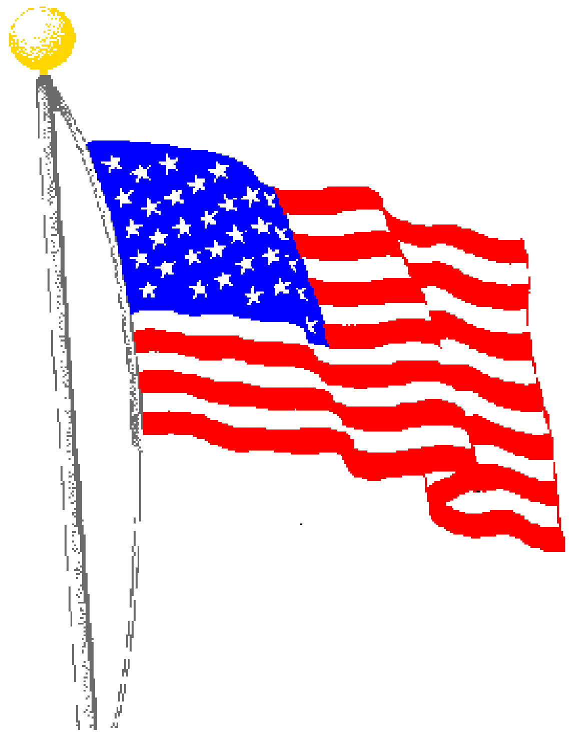
United States

- The U.S. Taxes citizens and residents.
- U.S. tax residents are subject to U.S. Tax law regardless of where they live.
- U.S. residents must file tax returns each year if they meet minimum income thresholds.
- Non residents with U.S. source income must file returns – but only declare the U.S. income.

Canada

- Canada bases taxation on residence.
- Canadian citizens cease to be taxable in Canada when they leave.
- Expatriate Canadian's need only file returns for Canadian income, rentals and RRSP's (elective).
- It is possible to be considered resident in both countries.

U.S. Taxation of Corporations



- U.S. taxes corporations with a fixed base in the U.S.
- Corporation tax rates are graduated.
- Subchapter S corporations available to U.S. residents only.
- Canadian corporation must file U.S. return if operating in the U.S.
- Canadians must report operations of Canadian corporations if living in the U.S. (form 5471).

Canadians Providing Self Employed Services in the U.S.A.

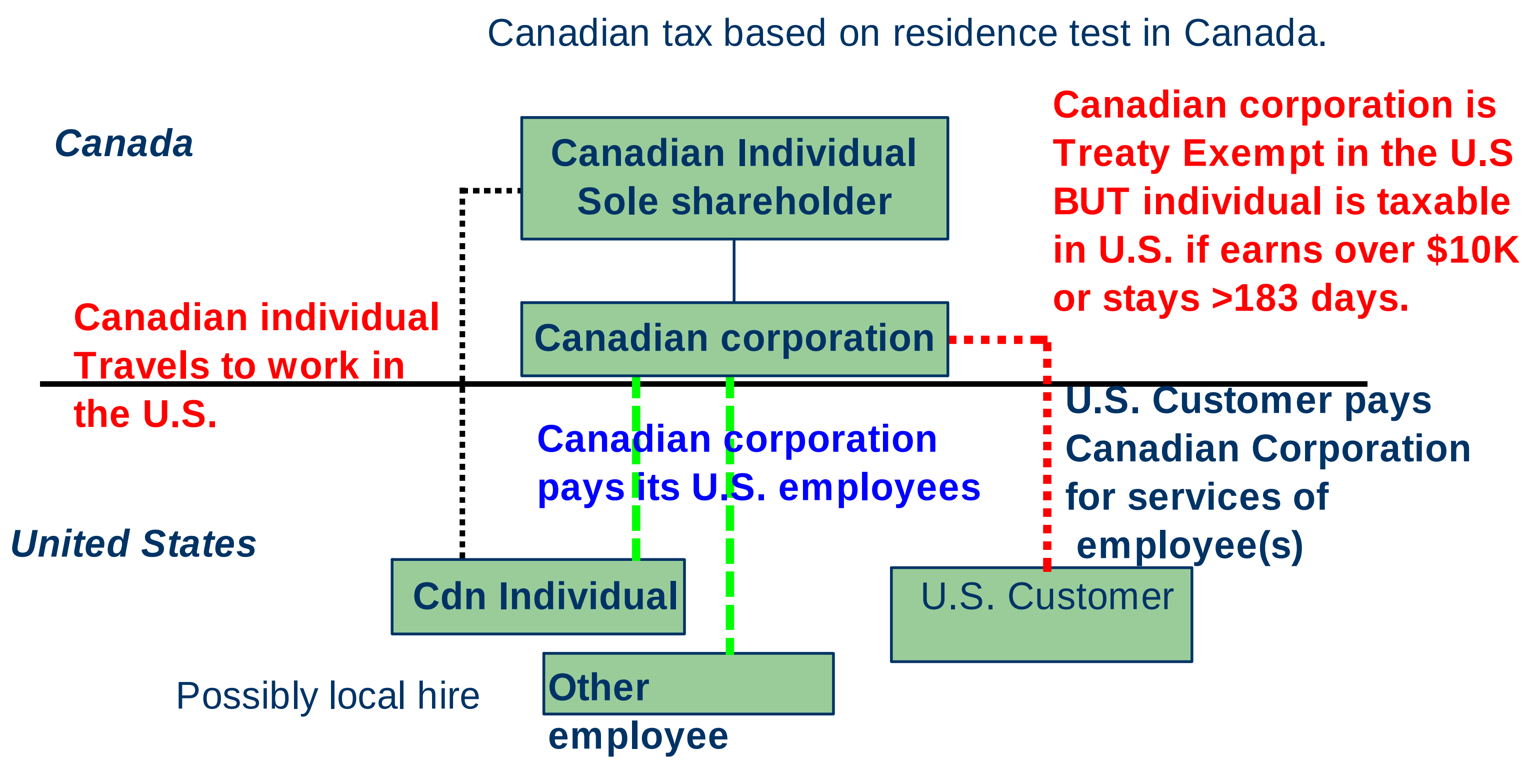
- Canadian travels to U.S to work as subcontractor.
- Treaty exempt regardless of amount earned or time spent in the U.S.A. unless fixed base in the U.S.;
- Must maintain Canadian residence;
- Presence in U.S. to work is NOT considered a fixed base or permanent establishment.

Canadians in the U.S.A.

- U.S. personal taxability is based on PLACE services are provided.
  - Not the payer
  - Not the place payment is received
- U.S. corporate taxability is based on fixed base or permanent establishment.

- Canadians may work in the U.S. in one of the following ways:
  - Employee (W-2);
  - Self Employed (1099);
  - Employed through a wholly owned Canadian corporation.

Working in the US Through a Canadian Corporation – Chart



Canadians Providing Services Through a Canadian Corporation

- Canadian individual performs personal services;
- U.S. customer pays the Canadian corporation;
- Canadian corporation pays the individual (on payroll);
- Canadian corp. is Treaty Exempt in U.S.;
- Canadian individual files personal taxes in U.S.;
- Canadian individual files taxes in Canada (if resident);
- Canadian Corp. files Canadian F/S and returns.
- Must reduce net corporate income to zero by salary:
  - No small business deduction available in Canada;
  - Net income is Subpart F income if left in Corporation.

Mark T. Serbinski
Certified Public Accountant

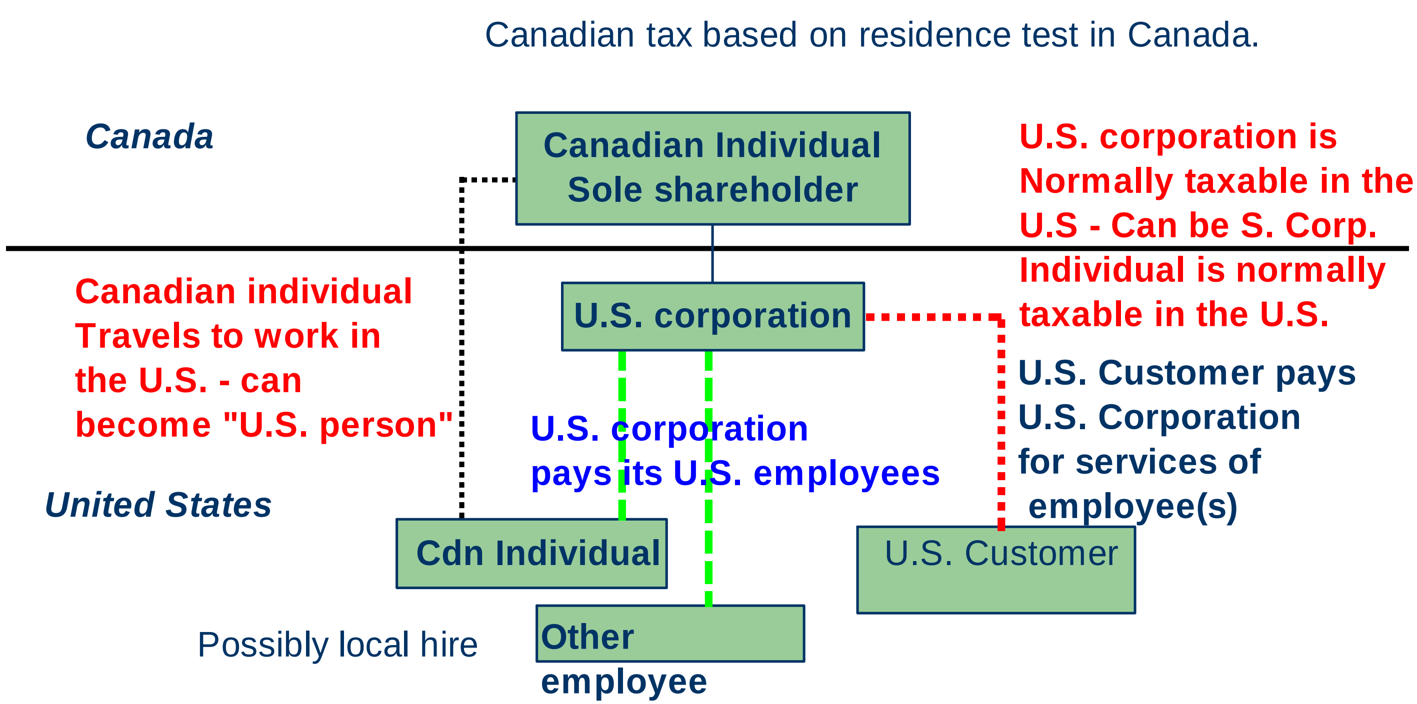
Serbinski Partners PC
Chartered Accountants

Canadians in the U.S.A.

- U.S. personal taxability is based on PLACE services are provided.
  - Not the payer
  - Not the place payment is received
- U.S. corporate taxability is based on fixed base or permanent establishment.

- Canadians may work in the U.S. in one of the following ways:
  - Employee (W-2);
  - Self Employed (1099);
  - Through Cdn. Corp. (“corp. to corp.”)
  - Employed through a wholly owned U.S. corporation.

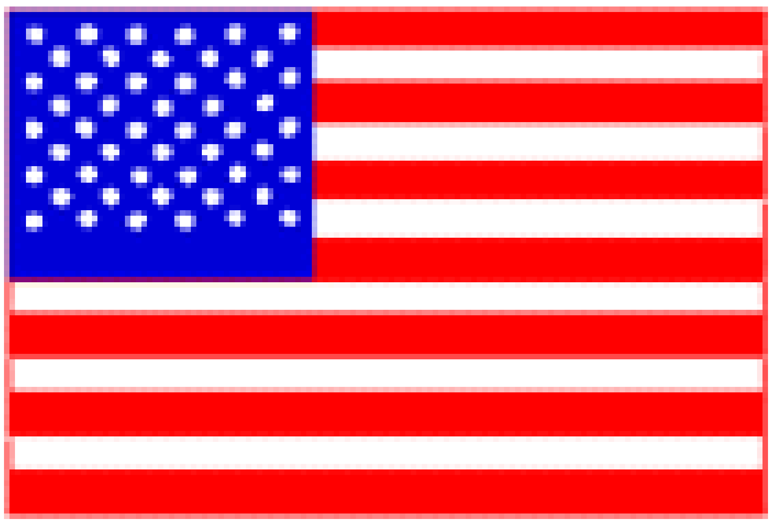
Working in the US Through a U.S. Wholly Owned Corporation – Chart



Mark T. Serbinski
Certified Public Accountant

Serbinski Partners PC
Chartered Accountants

Canadians → Employed by Own U.S. Corporation in the U.S.A.



- Canadian severs Cdn. residential ties;
- Employee of U.S. corporation;
- U.S. corporation taxed as usual in U.S.;
- U.S. corporation cannot sponsor TN visa for shareholder.
  - But can sponsor unrelated parties.

Treaty Article XIV Independent Personal Services

- Complete exemption from tax, regardless of amount earned or time spent in other country;
- Cannot have “fixed base or permanent establishment”;
  - **Self employed Cdn in U.S. deemed not to have fixed base;**
  - **Cdn corporation without U.S. office, agent, bank, etc., deemed not to have fixed base.**

Mark T. Serbinski
Certified Public Accountant

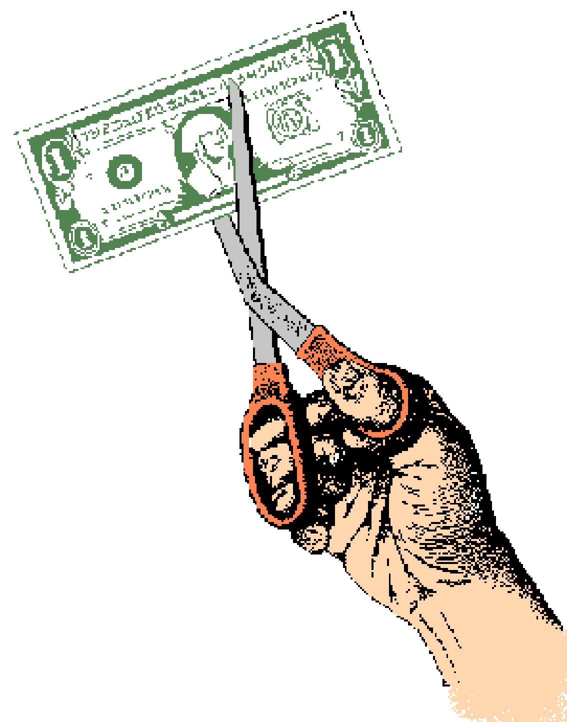
Serbinski Partners PC
Chartered Accountants

Treaty Article XV
Dependent Personal Services

- Exemption qualifications:
  - Earnings under $10,000;
  - Stay in U.S. < 183 days;
- Working as an employee of a Canadian corporation where salary is not “borne by” a U.S. entity.

Subpart F Income

- If U.S. persons control a foreign company, it is a CFC.
- (Canadian living in the U.S. is a U.S. person).
- Persons owning more than 10% of a CFC must file form 5471 to report Subpart F inc.
- Subpart F income is all passive income PLUS:
- Service Income earned by the corporation outside of its country of incorporation.
- Failure to file: $10,000 fine.

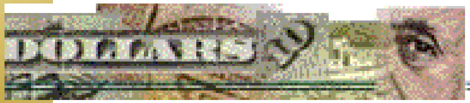


While You Are Away

- Per Diem Expenses;
- Ceasing to be taxable;

Mark T. Serbinski
Certified Public Accountant

Serbinski Partners PC
Chartered Accountants



Who We Are & What We Do

Who We Are:

- **Certified Public Accountants**
  - Licensed for all states & federal
  - IRS Certifying Acceptance Agents – to obtain ITIN and employer identification numbers.
- **Chartered Accountants**
  - Licensed throughout Canada

What We Do:

- Tax returns & financial statements
- Corporate & personal tax returns
- Incorporation (Canada & USA)
- Tax & financial planning.
- Representation before IRS & CCRA.

Thank You for Listening

This presentation has been made courtesy of:

Mark T. Serbinski

Certified Public Accountant

and

Serbinski Partners PC

Chartered Accountants

Creative Solutions to Cross Border Income Tax Issues

More information online: Serbinski.com

1-888-US TAXES