

EMPLOYEES PROFIT SHARING PLANS

An Employees Profit Sharing Plan (EPSP) is an arrangement that allows an employer to share profits with all, or a designated group of, employees. Under an EPSP, amounts are paid to a trustee to be held and invested for the benefit of the employees who are beneficiaries of the plan. Each year, the trustee is required to allocate to such beneficiaries all employer contributions, profits from trust property, capital gains and losses, and certain amounts in respect of forfeitures. These allocated amounts, with certain exceptions, are included in computing the taxable income of the beneficiaries for the year in which they are allocated and are not subject to tax when actually received by the beneficiaries.

One of the essential requirements of an EPSP, contained in Income Tax Act subsection 144(1), is that payments from the employer to the trust must be computed by reference to profits. This means that there has to be a binding obligation by the employer to make payments in accordance with a realistic formula in which profits are the principal variable and the employer has to make these payments in the event of profits. It is not enough that profits are used only as a means of calculating the employer's contribution; the amount so computed must also be paid under the plan when a profit is realized. Contributions computed by reference to profits have to be expressed as a percentage of profits for the year and the minimum contribution permitted cannot be less than 1% of profits.

Key Issues

- ◆ The plan must be for a specified group of employees (i.e more than one).
- ◆ There must be a Trust Deed establishing the Plan terms.
- ◆ There must be a legal obligation on the employer to make the contribution. This is usually found in an Employment Contract with each employee and the EPSP Plan Documents.
- ◆ Each year the company must make a resolution in the corporate minutes with regards to the contribution and the allocation to the beneficiaries.
- ◆ Payments are paid to a Trustee each year.
- ◆ The company deducts the contribution in a particular taxation year and must make the contribution to the Trustee within 120 days of the year end.
- ◆ The employee must include the contribution in their income in the year the contribution is made.

EMPLOYEES PROFIT SHARING PLANS

(continued)

Key Issues continued

- ◆ The Trustee must file a T4PS Summary and Supplementary reporting the allocation to the beneficiary of contributions and income earned on previous contributions. Interest, dividends and capital gains earned by the EPSP will keep their character when they are allocated to the beneficiaries.
- ◆ No Source Deductions are withheld from the employee, consequently, the employee will have to make a personal tax payment to cover the additional personal tax that will be owing. In future years, instalments may be required.
- ◆ There are no restrictions on the investments of the EPSP except that it may not invest in shares of the payor corporation.
- ◆ Allocations to the EPSP are considered to be Earned Income for purposes of RRSP entitlement.

When would an EPSP be beneficial?

- ◆ When a corporation has a large one-time increase in income due to the sale of a division or business resulting in significant recapture or capital gains to the corporation, a contribution to an EPSP could reduce the corporation's income to the Small Business Limit and defer the personal income tax on the payment until April 30th of the year following the EPSP contribution. **This is, at best, a one year deferral.**
- ◆ An individual who does not wish to make CPP or EI contributions could take their remuneration primarily in EPSP contributions.

COSTS

In the initial year, costs to establish an EPSP could range from \$3,000 to \$5,000.

Annual costs to calculate the income of the EPSP and prepare the T4PS annual return allocating the contributions and the investment income to the beneficiaries would depend on the complexity and size of the investment portfolio.