

Employment Insurance, Who is Exempt?

COPYRIGHT © Ledgers Canada

All rights reserved. No part of this manual may be reproduced in whole or in part, stored in a retrieval system, or transmitted, in any form or by any means (photocopying, faxing, electronic, mechanical, recording or otherwise) without the prior written permission of the copyright holder and publisher.



Table of Contents

Table of Contents	2
Overview	3
What is EI?	4
Types of Benefits	4
Determining Eligibility	5
EI Benefits Available.....	6
Excluded Employment and Earnings	7
Employer – Employee Relationships.....	7
Employee or Self-Employed?	7
Factors used to Determine Status	8
Personal Services-Corporation.....	8
Excluded Earnings and Occupations.....	9
EI for Related Parties	10
Requesting a Ruling from CRA	11
Completing form CPT1	11
Appealing a CRA Ruling	14
Who can file an appeal?	14
When must an appeal be filed?	14
Other Considerations:.....	14
Refunds of Overpayments	15
Who can apply for a refund?	15
When must the application be filed?.....	15
Other Considerations:.....	15
Reducing EI Premiums.....	16
Basic Requirements of the Plan	16
What are the Savings?	16
Other Information:.....	17
EI and Income Splitting	18
Other Guides and Information available from Ledgers:.....	20



Overview

This information circular will outline the rules and requirements relating to the treatment of Employment Insurance (EI) premiums and benefits for individuals that could be exempt or otherwise ineligible. Determining eligibility in advance of making payroll deductions and remittances could save a business a considerable amount of time and money as well as preventing the individual concerned from being deemed ineligible for benefits when they make their application.

This Guide will be separated into the following sections:

- What is EI?
- Types of EI Benefits
- Determining Eligibility
- Employee or Self-Employed?
- Excluded Earnings and Occupations
- EI for Related Parties
- Request for Ruling
- Filing an Appeal
- Refunds of Overpayments
- Reduced EI premiums

The information contained herein is intended for reference purposes only, when a question arises, you should always consult the appropriate CRA Guides or other resources as may be necessary.

This guide is divided into sections for each relevant topic, ***The Table of Contents references are active links***, in other words, if you click on a line in the Table of Contents, it will take you to that page.

Sections of this manual may refer to Interpretation bulletins, CRA tax guides, Forms and other materials. When possible, a referred guide or form may be accessed by clicking on the referenced hyperlink. These links in most cases will refer you to a web page; therefore, your Internet connection should be active.

Example link: ([CRA Interpretation Bulletin IT-221R3](#))



What is EI?

[\(more information\)](#)

Employment Insurance is a temporary financial assistance program administered by Human Resources and Social Development Canada (HRSDC). This agency, formerly known as Human Resources Development Canada (HRDC) is responsible for making EI payments and determining the type of benefits an individual may be entitled to, they do not however determine eligibility for coverage. Eligibility (Insurable Earnings) is determined by The Canada Revenue Agency (CRA). [\(see determining eligibility section of this guide for more information\)](#)

EI is designed to provide assistance to individuals that have become unemployed for a number of reasons or have left employment due to illness or to upgrade their skills.

Types of Benefits

[\(more information\)](#)

There are 6 types of benefits potentially available to an individual that meets eligibility requirements:

- Regular Benefits
- Illness or Injury Related Benefits
- Maternity and Parental Benefits
- Fishing Benefits
- Benefits for Specific Situations
- Compassionate Care Benefits **** New Legislation****

Regular Benefits – are paid to individuals that lose their jobs due to no fault of their own. Examples of qualifying individuals would be:

- Loss of employment due to a shortage of work with the employer
- Business closes for a specific time period (seasonal employment)
- The business closes permanently due to bankruptcy
- The business discontinues the position for which the individual was employed

Illness or Injury Benefits – are paid to individuals that cannot work due to illness, injury or quarantine. Benefits will be paid to qualifying individuals that provide a medical certificate that documents the nature of the injury / illness and the expected duration. In addition, the individual must be able to prove they would be otherwise available for work if they were not ill or injured. Examples of qualifying individuals would be:

- An individual unable to work due to an injury from an automobile collision
- An individual suffering a heart attack or other serious health condition
- An individual quarantined by the Department of Health due to their contact with a communicable disease

Maternity and Parental Benefits – Maternity benefits are paid to individuals that are the birth mother (or surrogate mother) of a newborn child. Parental benefits may be paid to an individual that is either the biological parent or the adopted parent of a child (either newborn or newly adopted). In most cases, parental benefits can be shared between the parents or taken entirely by one individual.

Fishing Benefits – are paid to individuals that are 'Self-Employed' in the fishing industry (see Employee or Self Employed Section of this guide for determination). If an individual is not self-employed but works in the fishing industry, they may qualify for one of the other types of benefits.



Benefits for Specific Situations – Persons employed in specific situations may qualify for benefits depending upon very certain terms and conditions, examples of special circumstances include:

- Teachers ([more information](#))
- Self-Employed Farmers and Independent Workers ([more information](#))
- Workers and Residents Outside of Canada ([more information](#))

Compassionate Care Leave – **NEW as of January 4th, 2004.** An individual that must be absent from work to care for or to provide support for a member of their immediate family may qualify for benefits. The family member must be at risk of death within the following 26 weeks. 'Family Member' has different definitions under the Employment Standards Acts in Canada, however, for the purposes of claiming benefits, HRSDC defines a family member as:

- Your Child, or the child of your spouse
- Your spouse
- Your Mother/Father
- Your spouses Mother or Father

In all instances, spouse includes common-law partners

Although this is a Federal Program, most provinces are in the process of introducing similar legislation under their respective Employment Standards Acts.

Determining Eligibility

There are a considerable number of eligibility requirements for each type of benefit. Eligibility is determined by examining a number of criteria including:

- Insurable Employment / Earnings
- Insurable Hours
- Qualifying Period

Insurable Employment – CRA has specific rules of determining whether or not an individual's employment is insurable. Insurable employment includes most employment in Canada providing there exists an employee / employer relationship. However, there are situations where a review of the conditions of employment will have to take place in order to determine eligibility, including:

- Employee or Self-Employed
- Employment with Related Parties
- Owners and Shareholders
- Special employees including Taxi Drivers, Hairdressers and Fishermen

Each of these situations is discussed later in this guide.

Insurable Earnings – are the amount of pay received for the number of hours worked in insurable employment for the qualifying period. Insurable earnings generally include:

- Wages, salaries and other similar types of compensation
- Tips and Gratuities
- Benefits Paid to an employee in cash or in kind (taxable benefits)



Insurable Hours – An individual must generally work a predetermined number of hours during the qualifying period to be eligible for EI benefits. The number of hours varies depending upon:

- The type of employment
- The location of the employment
- The type of benefits being applied for

The location (province) of employment has a significant impact upon the number of insurable hours required for eligibility, all dependant upon the Regional Rate of Unemployment. The hours may vary between 420 hours and 700 hours and in some instances the hours required may be as high as 910 hours.

Qualifying Period – Is the length of time an individual must work in insurable employment before being eligible for benefits. The qualifying period may vary, but is generally 52 weeks (1 year). In a few specific instances, a qualifying period may extend to 104 weeks.

EI Benefits Available

The following table illustrates the MAXIMUM amount of benefits available to an individual

Description	Max Term	Max Amount
Maternity Benefits	15 Weeks	Per Week \$413.00
Parental Leave	35 Weeks	Per Week \$413.00
Compassionate Care Leave	6 Weeks	Per Week \$413.00
Illness or Injury	15 Weeks	Per Week \$413.00
Regular Benefits	45 Weeks	Per Week \$413.00
Note: Benefits may be combined, such as maternity, parental and sickness to extend the maximum claim period to 50 weeks		Regular Benefits may be reduced depending on the length of continuous employment and total insurable hours worked.

The EI Benefits available to an individual are calculated as 55% of the average weekly income (based upon income during the qualifying period) to the maximum amounts noted above.



Excluded Employment and Earnings

In determining whether a person may make a claim for EI benefits, one must take into account a number of specific circumstances or employment situations that would render the individual ineligible for benefits. If an individual would be deemed ineligible, it follows that they should not have to pay EI premiums.

The main factor in determining eligibility is whether or not CRA would recognize a person as an employee (an employer / employee relationship exists) or self-employed (work as an independent contractor).

Employer – Employee Relationships

Determining the status of a relationship between parties is essential to determine the treatment of money or other consideration exchanged. CRA considers a business, person or other entity to be an employer if they:

Pay salaries, wages, bonuses, vacation pay or other amounts to individuals in return for services rendered
Pay taxable allowances or benefits to individuals in return for services rendered

In addition, an employer-employee relationship exists if the business, person or other entity has the right to exercise control, and the ability to direct the person performing the services. Although a written contract may be present stating the individual is self-employed, CRA may not consider the individual to be self-employed and may determine the person is in fact an employee. If this determination is made by CRA, there can be significant consequences.

Employee or Self-Employed?

[\(CRA Guide RC4110\)](#)

Before discussing what is included in employment income, the distinction between an employee and an independent contractor must be made. This is an important distinction as it affects the deductions allowed in computing net income.

If a person is not an employee, it follows that they are self-employed. Sometimes the distinction is an obvious one, however, in some instances it may not be obvious and the individual circumstances must be considered.

The most common scenario is that of an employee who wants to be treated as self-employed. This classification would offer several advantages:

- Self-employed individuals are allowed to deduct all reasonable expenses incurred in earning income while employees are more strictly limited
- Self-employed individuals avoid paying E.I. premiums (of course, they are also unable to collect benefits)
- The employer does not have to make contributions to C.P.P. or E.I., Provincial Health Taxes or Workers Compensation Premiums.

It is not enough for an individual to classify himself or herself as self-employed. It is not even enough if both employer and employee agree on the classification, similarly any written agreements will not override the facts of the situation.



Factors used to Determine Status

The following tests can be used to determine if an individual is an employee or self-employed:

1) Control

- Is there a master/servant relationship
- Can the master select and dismiss the servant
- Does the master control the method in which the work is carried out and set the terms of payment

2) Degree of Integration

- Is the individual an integral part of the payor's organization
- Would an ordinary person view the relationship as that of employer and employee

3) Economic Reality

- Is the individual carrying on business for personal gain or for the benefit of someone else
- Does the worker have an opportunity for profit (in an accounting sense) from the services provided?
- Does the worker bear any risk of loss with respect to the activity?
- Does the worker provide his or her own tools or equipment
- Is there a lasting or permanent relationship between the parties?
- Is the worker permitted to provide similar services to other parties and does the worker actively search out other business opportunities

Generally, if the worker receives direction from the business, supplies no capital (tools or equipment), bears no financial risk or liability, has a lasting relationship with the business and does not have the opportunity to provide services to others, they would be considered to be an employee.

4) Specific Result

- Is the work performed to achieve a specific result or for an indefinite period of time
- Is the contract such that the individual worker must provide the service or just ensure that the task is completed and not necessarily do the work themselves

Commission salespeople or traveling salespeople present another type of situation. Canada Revenue Agency considers three main factors in determining their status:

1. Salesperson is not restricted to the supplier's product and can sell other products whether or not they are competitive
2. Salesperson is not required to personally sell the product
3. Salesperson is given no instruction about what territory to cover, what client to approach or when and how to perform the work

All three factors together indicate self-employed status, if one of these factors is missing, then the tests discussed earlier must be taken into consideration.

Personal Services-Corporation

The term personal services corporation refers to the situation where an individual, who would normally be considered an employee, forms a corporation and provides the services through the corporation. The purpose of this rule is to restrict the deductions of the corporation to those allowed by employees. If you think you may have this situation, you must ensure the corporation is calculating net income correctly.

Note: If ever in doubt as to the status of an individual, Request a Ruling from CRA (see Requesting a Ruling Later in this Guide)



Excluded Earnings and Occupations

The following **types of earnings** are specifically EXCLUDED for calculating insurable earnings as well as EI premiums:

- Supplementary Unemployment Benefits
- Non Cash Benefits including payments to an individuals locked in RRSP
 - (excluding the value of room and board provided to the individual)
- Any amounts excluded from income under the Income Tax Act
- Retiring Allowances
- Amounts paid to an individual to cover the waiting period of maternity or parental benefits providing:
 - The total amount paid plus EI benefits does not exceed the individual's normal weekly earnings
 - The payment does not reduce any other accumulated employment benefits (vacation pay etc.)
- Advances or Loans paid to an employee awaiting a Workers Compensation claim decision
- A top up amount paid to an individual collecting Workers Compensation Benefits
- Top ups to wage loss replacement plans

The following **types of employment** are specifically excluded for calculating insurable earnings as well as EI premiums, even when an employee / employer relationship appears to exist:

- Casual employment, when the employment is not for the usual trade or business of the employer
- Employment where the employee and employer do not deal at Arms Length ([see related parties section of this guide](#))
- The employee owns more than 40% of the voting shares of the Corporation
- Employment that is an exchange of work or services
- Employment in an agricultural or horticultural operation when the individual:
 - Receives no cash remuneration
 - Works for less than 7 days with the same employer during the year
- Employment of a person or persons connected with a Circus, Fair, Parade, Carnival or similar except for Entertainers, if the individuals:
 - Are not a regular employee (casual labour)
 - Work for less than 7 days with the same employer during the year
- The individual is employed in a rescue operation and they are not normally employed for that purpose

- The individual is employed by the government in an election if the individual:
 - Is not a regular employee of the government
 - Works for less than 35 hours in the calendar year
- The individual is employed in Canada under an exchange program and the individual is not a resident of Canada
- The individual is employed as a member of a religious order and has taken a vow of poverty
- Any employment where the individual must pay premiums according to the unemployment laws of the United States or according to the Railroad Unemployment Act of the United States
- The individual is employed in Canada is a non resident of Canada and must pay premiums under the Unemployment Insurance Act of a foreign country
- The individual is employed in Canada by a foreign government or other international organization, unless the foreign government or organization agrees to cover the individual under Canada's EI Act and HRSDC agrees.
- The individual is employed under the Self Employment assistance program or Job Creation programs of HRSDC or any similar government program.



EI for Related Parties

Another area of concern for a business owner is employing relatives. Although it is usually quite beneficial to employ relatives, it may cause issues when it comes to filing a claim for EI benefits. As noted above, if an individual owns more than 40% of the voting shares of a Corporation, they are ineligible for EI benefits and therefore should not pay EI premiums. Using this assumption, when a business is owned by a Husband/Wife collectively, neither party would pay EI premiums, nor would they be able to file for EI Benefits if the business was sold or discontinued. There are however a number of other circumstances that could effect the eligibility of other relatives.

To be eligible for EI benefits, an individual must be in insurable employment. This means that they must be employed in a truly employee / employer relationship and must be deemed to be dealing at arm's length.

Arm's length, in simple terms means they are not related by blood, marriage (or common law relationship), or adoption, AND they are treated the same or very similar to any other individual that would be employed in the same capacity. Factors to determine similar capacity include rate of pay, benefits, hours of work, conditions of employment and the importance of the work they are performing. Following is an example of a ruling:

Harry owns a business, ABC Manufacturing Inc., and hires his daughter for the summer to perform general administrative duties such as answering the telephones, opening mail, and filing documents. His daughter attends University, and needing the money for school, Harry pays her \$750.00 per week for the summer. Is this employment insurable?

Answer: No, for two reasons.

1. CRA reviews the situation and finds that Harry pays another employee working in the same capacity \$500.00 per week.
2. They are related (father and daughter) and are not dealing at arm's length.

Change the above situation to the following:

Harry employs his daughter for the summer in the same position, but due to her lack of experience, pays her only \$400 per week. Is this employment insurable?

Answer: Probably

CRA would determine, although related (not dealing at arm's length) she is employed in a similar capacity and at a comparable wage to the other person. Therefore if all of the other terms and conditions of her employment are equal to the other person, the employment would be insurable.

In either case above, it is ALWAYS advisable to Request a Ruling from CRA to determine whether or not the employment is insurable.

If a business fails to deduct and remit EI premiums for insurable employment, CRA may impose significant fines and penalties.

Terms and Conditions of employment are ruled on by HRSDC on a case-by-case basis, and no two situations are equal for EI Benefits.



Requesting a Ruling from CRA

Whenever you are in doubt, or even if the situation appears to be clear, it is advisable to request a ruling from CRA on the status of the individual. There are 2 methods available to obtain a ruling:

1. Complete form [CPT1, "Request for Ruling as to the Status of a Worker Under the Canada Pension Plan and/or the Employment Insurance Act"](#). This form may be completed by the worker, the payor, or a representative of the business making the payments.
2. If the business is owned by a number of shareholders, it is advisable to complete and attach form [CPT59, "Corporate Share Arrangement"](#)
3. CRA will accept written requests for rulings providing the request gives complete details of the conditions of employment, the relationship between the employee and employer as well as any other information that may be deemed relevant in making a decision.

In either case, the applicant should include copies of any employment contracts, agreements, comparisons and job descriptions / functions of the individual that the ruling pertains to.

Completing form CPT1

CPT1 is a very brief form and does not provide much room for information that may be relevant. As noted above, attaching copies of other pertinent information will assist CRA in determining the status of the individual. One form may be filed for multiple individuals if the terms and conditions of employment are the same for all. If such is the case, you must attach a separate list of names, address, home telephone, business telephone and SIN's of the individuals related to the ruling. Requests for rulings may be made up to June 30th of the year following the period for which you are requesting a ruling.

Upon review of the Request for Ruling, CRA will contact the individual and the payer either by telephone, in person or both to discuss the circumstances surrounding the request. Once CRA has ruled, they will notify both parties in writing.

The form is comprised of 3 sections:

Section 1 – Who is completing the application?

If the application is being completed by a representative (third party) and not the worker or payer, the representative must attach form [T1013, Authorizing or Cancelling a Representative](#). This form allows the representative to act on behalf of the other parties for the tax year concerned or for other/all years. Without this form CRA will not talk directly to the representative. In absence of the form, CRA will accept a letter signed by all parties, consenting to the release of information.

Section 2 – The Payer

This section relates to information about the employer (business) and must include the Name, business number, address, phone number, officer and province of employment for which the ruling relates to.

Section 3 – The Worker

This section relates to information about the individual that is, was, or will be receiving the payments from the business.



As you can see by the above, there is no area for any descriptions or comments relating to the type of employment, relationship to the employer, or other relevant information. It is therefore necessary to attach a letter or other information to properly describe the circumstances.

In the past, the CPT1 form have 5 questions that assisted CRA to determine the status of the individual. Although these questions do not appear on the form any longer, they are the types of questions that CRA will ask during a telephone conversation or meeting with the persons involved.

Question 1.

Describe the circumstances and conditions under which the person works and the nature of their work.

Items to consider:

- Relationship to employer – Brother, Sister, Spouse, Child etc.
- Position in the company
- Are they treated differently than other employees? If so, explain how and why. (This will assist CRA in determining if they are dealing at Arm's length or Non-Arm's length.
- If this individual did not work for the business, would another person be hired for the same position with the same or similar responsibilities?

Question 2.

How and when is the worker paid and what is the basis on which the worker is paid?

Items to consider:

- Are they paid hourly or salary
- Are they paid overtime if applicable
- Are they entitled to Bonuses or a reduction in pay depending on the performance of the business?
- Are they paid in similar fashion as another person would be in the same position?

Question 3.

Is the worker responsible for any losses, expenses or damages that the worker may cause? If so, explain the level of responsibility.

Items to consider:

- If the individual's pay could be negatively affected by loss or damage they caused, it should be mentioned.

Question 4.

Do you exercise any control over the worker and if so, describe it.

Items to consider:

- Exercising control over an individual may demonstrate an Arm's length relationship, however in many businesses employees are allowed to determine their own hours.
- Does the business determine when the individual is entitled to vacations



Question 5.

State the reasons why you believe the worker is an employee or Self-employed.

Items to consider:

- Does the individual perform services for other businesses as well as yours?
- Does the individual have the ability to control their earnings / expenses?
- Can the individual be terminated in the same or similar fashion of another individual?
- Is there a contract of service for a specified project or time period?

Other items to consider:

- CRA will review all of the information provided and will verify as much of the information as possible by interviewing all concerned parties.
- Ensure that all parties related to the ruling have a copy of the Request for Ruling for reference purposes.
- Be as clear as possible in the information you provide. Being vague or misleading may adversely affect the ruling or further delay the process.
- Requests for Rulings can take up to 3 months to process.
- Retain the ruling letter for your records. Should the business be the subject of a payroll or trust compliance audit, the employer will have to produce a copy of the ruling.
- If the circumstances of employment change for an individual, request another ruling.
- EVERY request is handled independently and is unique. CRA does not have set profiles for determining the status of an employee and will review all of the information provided in exercising their judgment.
- If you are not thorough and truthful in the application, the ruling may not be rendered as you desired.
- Seek advice from an Accounting Professional when completing the application to ensure that you have completed the request properly.
- A Request for Ruling may be appealed. If the decision is not rendered according to what you desired, you may appeal by providing further information or offering clarification on the situation.



Appealing a CRA Ruling

As mentioned above, if a decision is rendered that is not favourable, you may file an appeal by completing form [CPT100, Appeal Under the Canada Pension Plan and/or Employment Insurance Act](#). An appeal may also be filed by writing a letter of appeal and addressing it to the Chief of appeals of the nearest CRA office. In either case, you must attach a copy of the ruling letter, notice of assessment and other relevant documents.

Who can file an appeal?

- The employer who requested the initial ruling
- The worker that the ruling affected
- A representative of either party, providing they have consent ([see consent form above](#))

When must an appeal be filed?

- An appeal must be postmarked within 90 days of notification of the ruling. As this is not clear, it is best to appeal within 90 days of the Date on the Letter of Ruling.
- An appeal relating to a Notice of Assessment must be postmarked within 90 days of the date indicated on the Notice of Assessment.

Other Considerations:

- If you applied for a ruling before June 30th, the appeal will be based upon a ruling for both the current and previous calendar year.
- If you applied for a ruling after June 30th, the appeal will be based solely upon a ruling for the current year.
- You must file a separate appeal for each ruling letter received, unless the rulings involve the same employee/employer for more than one period.
- You must file a separate appeal for each Notice of Assessment being appealed.
- If the address or contact information of any of the appellants changes during the appeal process, you must notify the Chief of Appeals at the nearest CRA tax office of the change.
- Further information is available from CRA in the Brochure [P133 "Your Appeal Rights: Employment Insurance and Canada Pension Coverage"](#)
- If an appeal to the Chief of Appeals is not satisfactory, further appeals may be filed with:
 - The Federal Court of Appeal
 - The Tax Court of Canada



Refunds of Overpayments

If the Request for Ruling results in a CRA decision rendering the individual not insurable, and the business has been deducting and remitting EI premiums, a Request for refund of overpayments may be filed. To request the refund, the business or an authorized representative must complete form [PD24, Application for a Refund of Overdeducted CPP Contributions or EI Premiums](#).

Who can apply for a refund?

An employer or their representative that overpaid EI premiums for any of the following reasons:

- Premiums were paid in excess of the annual maximum for the year concerned
- Premiums were paid on behalf of a person owning more than 40% of the voting shares of a corporation
- Premiums were calculated erroneously resulting in an overpayment
- Premiums were paid for an individual that was not engaged in insurable employment (Ruling Decision)

When must the application be filed?

An application can be filed within any of the following time constraints:

- With the T4 Information Return (prior to the last day of February of the following year)
- No later than three years from the end of the year in which the overpayment occurred
- If the overpayment has resulted from CRA or a decision of the courts, within 30 days of the communication of the decision.

Other Considerations:

- EI premiums paid should not be adjusted on Employee's T4's, CRA will refund any overpayment directly to the employee when the individual files their personal income tax return.
- If an overcontribution is made in the current year for only one individual, the business does not have to file an application for refund; CRA will adjust the remittances accordingly (based upon T4 information) and notify the employer of any credit balances.
- If overcontributions are made for more than one individual, Part B of the application for refund must be completed and submitted.
- If the overdeduction occurs within the current calendar year, reduce the next remittance to CRA by the amount of the over contribution.
- If the overpayment is related to an employee of a corporation controlling more than 40% of the shares, you must attach a copy of the [Share Register](#) or complete the appropriate section of the form.



Reducing EI Premiums

If a decision or ruling of CRA requires you to deduct and remit EI premiums on behalf of an employee, it is still possible to reduce the amount of the employer's matching contribution. The matching contribution is the amount of tax the business must pay in addition to the premiums deducted from the employee. Currently, the business by default must pay \$1.40 for each \$1.00 of employee premiums.

The Premium Reduction Program ([more information](#)) allows employers with a Short Term Disability Plan to pay matching contributions at a reduced rate, providing the employees are covered by a plan that meets certain requirements established by HRSDC.

The program is designed to reduce the premiums of both the employee and the employer, however, for administrative purposes the rate is only reduced for the employer, as such, the employer must return a portion of the savings directly to the employee. The amount to be returned to the employee is generally ^{5/12} of the savings. This information must be conveyed to the employee in a formal agreement, for details see the more information link noted above.

Basic Requirements of the Plan

To qualify for the Premium Reduction Program, the plan must meet or exceed the following:

- Provide a minimum of 15 weeks of benefits for short-term illness or disability
- The plan must meet or exceed the coverage available for illness or injury under the EI program
- The plan must pay benefits within 14 days of the employee becoming ill or disabled
- The plan must allow employees to join within 3 months of their employment
- The plan must cover employees 24 hours per day.

The following types of plans typically qualify for the premium reduction program:

Weekly Indemnity Plan – Provides coverage through an arrangement with the employees (self-insured) or through an underwriter (insurance company), and pays weekly benefits when an employee is ill or injured.

Cumulative Paid Sick Leave Plan – Allows for an employee to accumulate sick leave credits based upon their duration of employment. Paid sick leave plans must provide a minimum of one paid sick leave day per month of continuous employment and allow for a minimum accumulation of 75 days.

What are the Savings?

The amount of savings for the employer depends upon:

- The type of plan
- The employees insurable earnings
- The date the employer applies for the reduction
- The date the plan meets or exceeds the requirements

The rates are valid for only one year at a time; HRSDC sets the premium rates each year.



Other Information:

- The plan may be enacted Retroactively for up to 36 months.
- If the terms or conditions of the Short Term Disability Plan change, HRSDC must be notified within 30 days of the change.
- A renewal application must be completed each year by the company
- A decision on premium reduction eligibility may be appealed.

Savings Example:

A company has 10 employees, all earning \$35,000 and is awarded a reduced rate by HRSDC.

The reduced rate awarded to the business is \$1.24 (the regular rate is \$1.40) for each \$1.00 in employee premiums.

The 2004 employee rate is 1.98%

Description	Regular Rate	Reduced	Savings
Premiums payable per employee	\$693.00		
Employer match	\$970.20	\$859.32	\$110.88
Employer Refunds to Employee (5/12)			(\$46.20)
Net Savings to Employer per employee			\$64.68
Annual Savings to Employer			\$646.80

The following table illustrates the applicable reduction rates available for 2004

Category	Rate (employer match)
1	1.289
2	1.238
3	1.248
4	1.228

Category 1 – Cumulative Sick Leave Plan with minimum 1 day accrual

Category 2 – Cumulative Sick Leave Plan with minimum 1 2/3 day accrual

Category 3 – Weekly indemnity plan with maximum of 15 weeks of benefits

Category 4 – Weekly indemnity plan with maximum benefit duration of 52 weeks (this is only available to public employers of a province)



EI and Income Splitting

Income Splitting

Taxation in Canada is graduated, therefore, the more you make, the more you pay. One means of reducing your family tax burden is to 'split income' amongst family members. CRA states that any payments made to family members must be reasonable and reflect what the business would pay to a third party for the same services. Be sure to well document the duties and services performed by each family member as well as any hours worked. For CRA to allow the claims, you must treat the family members as you would any other employee.

Some items that family members can be compensated for include:

- Answering Telephones/taking messages
- Banking, including making deposits and obtaining petty cash
- Making deliveries and pick ups
- Purchasing office supplies
- Doing computer work, typing
- Filing and mailing invoices, payments etc.
- Office Cleaning

Some other items that can be considered include:

- Directors Fees
- Loan Guarantee Fees

These 2 items however come with risks and should be well investigated before committing to the payments.

A problem may arise however if you are paying a spouse for the purpose of income splitting and you apply to HRSDC for EI Exemption status.

When you file for EI exemption for a spouse, if you indicate or the answers you provide to HRSDC illustrate that they are being paid in excess of the Fair Market Value for the services they are providing to the business, HRSDC can and likely will forward the information to CRA, resulting in an Audit from CRA. Should the results of the CRA audit determine that the payments were solely for the purposes of income splitting, they can and will allocate the earnings of the spouse to the business owner for tax purposes and re-assess the personal tax returns of the business owner and add interest and penalties for the taxes under paid.

The following examples illustrate the way CRA would likely interpret 2 different situations:



Situation 1

Harry owns ABC Company and his wife Sarah performs various office duties full-time for the business. She is paid \$40,000 per year for her services. Jennifer, who is no relation to Sarah and Harry is employed by ABC Company in the same capacity of Sarah and is paid \$42,000 per year. As Sarah is the spouse of the business owner, she would likely not be able to claim EI benefits and as such applies for the EI exemption. HRSDC grants the exemption and CRA audits ABC Company.

CRA finds: Sarah is paid fairly in comparison to Jennifer for performing essentially the same duties. Therefore the payments are not solely for the purpose of income splitting and Harry owes no additional taxes.

Situation 2

Change the above circumstances slightly and CRA will change their ruling. Sarah is paid the same \$40,000 per year but works only 2 days per month performing bookkeeping duties.

CRA finds: Sarah is overcompensated and the payments are strictly for the purpose of avoiding tax. CRA rules the services performed by Sarah are worth only \$4,000 per year and transfers the extra \$36,000 in income to Harry. Harry is reassessed and pays the tax owing, interest and penalties.

Tax Avoidance:

Using the above situations and assuming Harry earns \$50,000 per year:

	Harry's Tax	Sarah's Tax	Total Tax
Situation 1, Harry and Sarah are taxed on their individual earnings as assessed by CRA	\$10,500	\$7,400	\$17,900
Situation 2, CRA reassesses and adds Sarah's income to Harry for personal income tax calculations	\$23,475	\$0	\$23,475
Assessment from CRA, plus interest and penalties etc.			\$5,575

** This is a very basic example and is intended for illustration purposes only. There are too many other factors affecting personal income tax to provide an accurate depiction. You can however see why CRA treats Income splitting very seriously.



Other Guides and Information available from Ledgers:

- Income Tax for Students
- Income Tax for Senior Citizens
- Income Tax for Persons with Disabilities
- Income Tax for Persons with Chronic Health Problems

- Guide to Incorporations
- Employment Insurance – Who is Exempt?
- Buying and Selling a Business
- Employee or Self-Employed? How do you know?



This guide was prepared by Ledgers Canada,
to find the Ledgers Representative in your area
and to have your tax return professionally prepared, visit <http://www.ledgers.com/>
or call, toll free 1-888-470-0772

For assistance in dealing with HRSDC or CRA, The Canadian Federation of Independent Business provides services of this nature to its members as part of the services available with membership.

