



To EI, or Not To EI?

big money *That tax deduction that's sitting on your couch watching The Simpsons? Should he be paying into Canada Pension? By Scott Taylor*

They say trucking gets in your blood, and if you don't believe me just look at the number of family-run carriers. From a tax-planning standpoint, there's a good reason to hire someone in the family: income splitting, where you distribute business profits among family members who helped generate the returns.

But if you're putting your spouse, kids, or some other relative to work, paying a wage or salary, don't forget you're their employer. You may have some type of tax and legal obligations as you would if you'd hired someone off the street. These might include source deductions like Employment Insurance and/or Canada Pension Plan.

Then again, they might not. The Employment Insurance Act states that employees who are related to their employer—be that a sole proprietor or corporation—may not be eligible for EI benefits and should not have EI premiums deducted from their pay. The Income Tax Act deems that related persons do not deal with each other “at arm's length.” People who are connected by blood relationship (relatives of common descent, like a father and son), marriage, common-law partnership, or adoption are considered “related persons.” You also can be related to a corporation if you're related to one or more of the people who control the corporation, or when a corporation employs

someone who controls more than 40 percent of the corporation's voting shares.

On the other hand, some family employees might indeed qualify for EI. For example, a related employee may be insurable if it's reasonable to conclude that you would have hired a non-related person to do the same job at a similar rate of pay. What is reasonable? Some considerations Canada Revenue Agency (CRA) would use:

Remuneration. Is the pay you offer your related employee commensurate with what a non-relative would accept for similar work?

Don't try to arrange a haphazard payment formula or job description after your year-end.

Employment terms and conditions. Are the terms and conditions of employment substantially similar to the ones in an arm's length employment relationship?

Nature and importance of the work performed. Are the services you hired your employee to perform necessary and important to the business operation?

If you're not sure whether to deduct EI premiums for your employee, you can ask Canada Revenue Agency to make a ruling on the case. Rulings are formal CRA decisions that cannot be reversed. They clarify your obligation

as the employer, and your employee can be assured that if he or she is eligible to make an EI claim (due to lay-off, pregnancy, or sickness), coverage would not be denied.

Either you or your employee can make the request by

Hiring family takes serious forethought and solid tax advice from someone who has experience with family businesses. Don't try to arrange a haphazard payment formula or job description after your year-end. Put an employment



sending a letter or a completed Form CPT-1 to the nearest tax services office; you have until June 30 of the year following the year in which the employment occurred to send it in.

Once a ruling has been requested, an authorized CRA officer will contact you or your employee. Sometimes the officer will ask for more information such as payroll records, copies of written contracts, or other related documents; so follow their instructions and be prepared. Once a ruling has been made, the officer sends a letter to the worker and the employer giving the reasons for the ruling. If you've already deducted EI premiums and the officer rules that you shouldn't have, you have up to three years to request a refund of the EI premiums.

agreement in place at the beginning of your fiscal reporting period outlining your decisions behind income splitting, and be ready to defend the value and worth of your family members' contribution to the business and to the bottom line.

If you think the amount you've chosen to pay a family employee seems unreasonable for the job at hand, it probably is.

For information about CRA's rules regarding family employees, visit the Small and Medium-sized Enterprise Zone at www.cra-arc.gc.ca and click on “payroll deductions.” ▲

Scott Taylor is Vice President of TFS Group of Waterloo, Ont. For more information visit www.tfsgroup.com or call 1-800-461-5970