



COMMENT

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INSURABLE EARNINGS FOR FAMILY MEMBERS

The cost of employment insurance premiums can be significant, especially for smaller, family-owned businesses that employ family members. A key issue is whether these family members have “insurable employment.” If the employment is not insurable, then no employment insurance premiums would be payable, and the individual could not claim benefits.

The Employment Insurance Act (“EIA”) defines the conditions under which an individual does not have insurable employment. For example, if an individual owns more than 40 per cent of the voting shares of the corporation, either personally or through a holding company, there is no insurable employment for that individual.

The EIA also provides that employment is generally not insurable if the employee is not at arm’s length with his or her employer. The Income Tax Act definitions of arm’s length and related persons are used for employment insurance purposes. For example, a spouse or common-law partner, a child or a child’s spouse or common-law partner are all at non-arm’s length with an employer who is an individual. Similarly, where the employer is a corporation, such relatives of an individual who controls the corporation would be considered to be at non-arm’s length.

Despite a non-arm’s-length relationship, however, the employee could still be deemed insurable depending upon the specific circumstances of the employment. The EIA deems two parties to deal with each other at arm’s length if the circumstances surrounding the contract of service (including salary, position, duration, type of work and conditions) are substantially similar to what would occur if an unrelated person were to fill the position. There is a subjective assessment associated with the review. This means that if employment conditions are more or less favourable than what an unrelated person might experience, there is the possibility CCRA would rule the employment as un-insurable.

The CCRA might, for example, consider a related employer and employee to be dealing with each other at arm’s length if CCRA could reasonably conclude that:

- an unrelated worker would be employed under similar conditions;
- an unrelated worker would be paid in a similar manner for the same work; and
- an unrelated worker would be hired to do the same type of work.

In this situation, the CCRA would likely conclude that the employment is insurable, thereby requiring deductions and contributions. However, if there is something

unique about the employment circumstances of the related employee, the CCRA may well determine that the employment is not insurable and would not require contributions or deductions for EI.

Once a determination is made, the employer and the employee have 90 days from the date of the decision to question it by sending an objection in writing.

If an employer wants to be clear as to whether an employment situation is truly insurable or not insurable, it is important to request a ruling from the CCRA. Opting out of Employment Insurance premiums is not automatic for related family members.

I/R 3201.05

INCOME TAX INSTALMENTS

Paying taxes is hard enough, but the government wants the money sooner than the filing deadline for the tax return. Canadian residents with income that has insufficient or no tax withheld may have to pay tax by instalments. This can happen particularly to those who receive rental, investment or self-employment income.

Individuals: An individual must make instalment payments if the total tax liability in each of the current year and either of the two preceding years exceeds the amount of tax withheld at source by \$2,000 (\$1,200 for Quebec residents). If instalments are required, the payments are due March 15, June 15, September 15 and December 15.

Required instalments can be calculated in three ways:

1. Current-year option: $\frac{1}{4}$ of the estimated tax payable for the current year
2. Prior-year option: $\frac{1}{4}$ of the tax payable from the immediately preceding year
3. No-calculation option: The Canada Customs and Revenue Agency (“CCRA”) will provide the amounts on instalment reminders it mails in February and August. It calculates these amounts as $\frac{1}{4}$ of the net tax owing for the second preceding year for the March and June instalments, and for September and December, $\frac{1}{2}$ of the excess of the net tax owing for

the immediately preceding year over the sum of the two instalments required at March and June.

The individual taxpayer has the right to choose the most favourable of these options; however, interest is charged on a daily basis at the prescribed rate on late or insufficient payments. Insufficient instalment payments are calculated by comparing the taxpayer’s actual instalments to the lowest amount under the three options listed above.

If the individual taxpayer makes late or insufficient income tax instalments, he or she may choose to overpay the later instalments. By overpaying, the taxpayer may earn “contra-interest” (or interest credits that will partially or fully offset the interest calculated on earlier underpayments for the year) at the prescribed rate, thereby limiting the interest charged on insufficient instalments. Paying subsequent instalments early will produce a similar result.

Self-employed taxpayers are required to increase their instalment payments by the amount of Canada Pension Plan contributions payable. The CCRA’s Guide P110 – *Paying Your Income Tax by Instalments*, provides further details on CPP instalments.

Corporations: A corporation must make instalment payments at the end of each month. Instalments are required if the preceding year’s income tax liability was over

\$1,000 and it is expected that the current year's income tax liability will be over \$1,000. Even though instalments could be based on expected income tax liability, the final actual tax will determine how much the instalments should have been. Similar to individuals, corporations can earn contra-interest to offset insufficient instalment interest. In this fashion, corporations can fine tune their instalment obligations based on the results realized

throughout the year. The CCRA's Guide T7B-CORP – *Corporation Instalment Guide* provides further details.

It should be noted that interest paid on late or insufficient instalments is not tax deductible for individuals or corporations.

I/R 7401.00

INCOME ATTRIBUTION ON SPOUSAL PLANS

Contributing to a spousal RRSP is an effective income-splitting strategy targeted at maximizing after-tax income throughout retirement. To prevent misuse of these types of registered plans, attribution or “anti-avoidance” rules apply. Depositing funds to a spousal RRSP creates the possibility of income attribution when funds are withdrawn.

Note that, while the following material refers to a “spouse” and “spousal plan” for simplicity, these rules apply equally to registered plans for common-law partners.

RRSP attribution: Attribution occurs when funds are withdrawn from a spousal RRSP, to the extent the contributing spouse made deductible contributions to a spousal plan, in the year of the withdrawal or in one of the two immediately preceding taxation years. The fact that there are several spousal plans does not alter the application of the attribution. Attribution takes into consideration the contributions to any spousal plan rather than to a specific spousal plan.

The income attributed back to and taxed in the hands of the contributing spouse is the lesser of the amount withdrawn and the total contributions made by the contributing spouse to all spousal plans in that year and in the two immediately preceding taxation years.

Example:

Situation

- Contributing spouse makes spousal RRSP contributions of \$5,000 in each of February 1997, 1998 and 1999.
- A \$15,000 withdrawal is made from the spousal RRSP in June 2000.

Implications

- Attribution is the lesser of the withdrawal (\$15,000) or the contributions made in the current and preceding two years (\$10,000).

Result

- Therefore, the contributing spouse would include \$10,000 in income for the year of withdrawal. The fact that the 1998 contribution may have been claimed as a deduction for the 1997 taxation year does not change that result. The \$5,000 balance of the withdrawal is taxable to the spouse who is the annuitant under the plan.

RRIF attribution: A spousal RRIF is any RRIF that received funds or property from a spousal RRSP. Thus, once a spousal plan, always a spousal plan, and the rules of attribution follow. If a non-contributing spouse begins to receive payments, as the annuitant, from a spousal RRIF within three years of any deductible contribution having been made to any spousal plan, income attribution may apply.

The income subject to attribution is the amount withdrawn that is above the minimum required withdrawal amount. For example, if the minimum RRIF withdrawal is \$3,000 but the annuitant withdraws \$5,000, the difference between the amount withdrawn and the RRIF minimum for that year (\$5,000 less \$3,000 = \$2,000) is subject to attribution.

The annuitant spouse includes the minimum amount in income for the year. In the year the RRIF is purchased, there is no required minimum amount, and the attribution rules apply to the full amount withdrawn.

After the three-year window has passed (current plus two previous years), no further attribution applies.

Exceptions: The attribution rules for RRSPs and RRIFs do not apply if, at the time of payment or deemed receipt:

- the taxpayer and spouse were living separate and apart because of breakdown in their relationship;
- the taxpayer or spouse was non-resident;
- the funds were transferred directly, in the name of the non-contributing spouse, to another RRSP or RRIF, or to purchase an eligible annuity; or
- the payment was an annuity payment from an eligible annuity.

Attribution does not apply if the contributing spouse dies in the year the RRSP or RRIF payment is received by the non-contributing spouse (annuitant).

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