

HOW CORPORATE SHAREHOLDINGS CAN AFFECT EI BENEFITS

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Most Canadian employees have at least a general understanding of employment insurance (EI) benefits. Employees pay into employment insurance with each paycheque and can claim EI benefits if they lose their jobs. Most are aware also that any employment or self-employment income earned while collecting EI benefits can reduce or even eliminate the benefits.

For purposes of EI benefits, self-employment refers not only to income earned through a sole proprietorship, but also to earnings from a partnership, a co-adventure, and, depending on the circumstances, a corporation. It is the latter that might come as a surprise to some. Benefits may be reduced or eliminated where the recipient operates a corporation in which he or she owns shares.

It is important to look at the facts of each situation. It is the actual nature of an individual's involvement in a business, and not the legal structure, that determines whether self-employment exists.

If an individual shareholder earns income from the corporation purely through his or her investment, the income received is considered a return on investment rather than earnings from self-employment. However, a shareholder who is also involved in running the business is considered self-employed for EI purposes, and any income attributable to self-employment will affect the EI benefits. This can be problematic for individuals who are employed while also being involved in the operations of a corporation in which they own shares. If the individual loses his or her job and collects EI benefits, the benefits may be reduced or eliminated due to the corporation earning income.

Once it is determined that self-employment exists, the net income of the corporation is attributed to the shareholder based on the level of ownership. The fact that funds are not taken out of the corporation, or that funds are received in the form of dividends,

does not mean the shareholder can report zero earnings for EI benefit purposes. Whether or not the individual actually receives funds during the period is irrelevant; the individual's right to share in the net income is considered income for these purposes. Moreover, once self-employment is deemed to exist, according to section 5.16.2.4 of Service Canada's *Digest of Benefit Entitlement Principles*, an individual cannot attribute one portion of earnings to investment income and another portion to self-employment income.

Consider this example, with alternative facts:

A husband and wife jointly own a corporation, ABC Inc. Each owns 50% of the shares. The husband also worked for XYZ Inc. for many years, but was laid off recently. The husband applies for EI benefits.

1. *Both are actively involved in running the business.*

Both the husband and wife are considered self-employed since they are both actively involved in running the business. While collecting EI benefits, any income of ABC Inc. during the claim period will be considered self-employed earnings and will affect the husband's EI benefit entitlement.

2. *The husband does not participate in running the business.*

The husband is strictly a shareholder of ABC Inc. Any income received by the husband will be considered a return on investment and thus will not affect his entitlement to EI benefits.

The net income of the corporation is irrelevant.

Contact your Collins Barrow advisor for more information on the impact of corporate income on EI benefits.

Collins Barrow periodically publishes a *Tax Alert* for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada. While *Tax Alert* suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.

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