



FRASER MILNER CASGRAIN LLP

MEMORANDUM

TO: CACE
FROM: JOEL NITIKMAN
DATE: SEPTEMBER 25, 2004
SUBJECT: WITHHOLDING ON LUMP SUM PAYMENTS

At the inaugural CACE conference on September 24, 2004 I was asked this question from the floor: suppose an employee is dismissed on January 1, 2005. He or she collects employment insurance under the Employment Insurance Act (Canada) (the “EIA”) of \$20,000 between January 1-June 30, 2005. Human Resources and Skills Development Canada (“HR”) withholds \$5,000 as income tax from the \$20,000 and pays the employee a net amount of \$15,000. On July 1, 2005 the employer agrees to pay the employee \$50,000 as a wrongful dismissal settlement. How is the withholding calculated?

Subparagraph 56(1)(a)(iv) of the Income Tax Act (Canada) (the “ITA”) requires the employee to include the \$20,000¹ in computing his or her income for the year. It states:

56(1) Amounts to be included in income for year
Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year,

(a) Pension benefits, unemployment insurance benefits, etc.
any amount received by the taxpayer in the year as, on account or in lieu of payment of, or in satisfaction of,

(iv) a benefit under the Unemployment Insurance Act, other than a payment relating to a course or program designed to facilitate the re-entry into the labour force of a claimant under that Act, or a benefit under Part I, VIII or VIII.1 of the Employment Insurance Act.

HR is required to withhold on the EI payments under paragraph 153(1)(d.1) of the ITA:

¹ Note that the entire \$20,000 must be included, even though \$5,000 has been withheld as tax.

(1) Withholding

Every person paying at any time in a taxation year

(d.1) an amount described in subparagraph 56(1)(a)(iv)

shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee's tax for the year under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution.

When the \$50,000 is paid, the employee is required to repay the entire \$20,000 to HR. This is pursuant to section 45 of the EIA, which states:

EI Act Return of benefits by claimant

45. If a claimant receives benefits for a period and, under a labour arbitration award or court judgment, or for any other reason, an employer, a trustee in bankruptcy or any other person subsequently becomes liable to pay earnings, including damages for wrongful dismissal or proceeds realized from the property of a bankrupt to the claimant for the same period and pays the earnings, the claimant shall pay to the Receiver General as repayment of an overpayment of benefits an amount equal to the benefits that would not have been paid if the earnings had been paid or payable at the time the benefits were paid.

Although it is the employee's responsibility to repay the \$20,000, the employer will be required to withhold \$20,000 from the \$50,000 and pay the \$20,000 to HR, pursuant to subsection 46(1) of the EIA²:

Return of benefits by employer or other person

46(1) If under a labour arbitration award or court judgment, or for any other reason, an employer, a trustee in bankruptcy or any other person becomes liable to pay earnings, including damages for wrongful dismissal or proceeds realized from the property of a bankrupt, to a claimant for a period and has reason to believe that benefits have been paid to the claimant for that period, the employer or other person shall ascertain whether an amount would be repayable under section 45 if the earnings were paid to the claimant and if so shall deduct the amount from the earnings payable to the claimant and remit it to the Receiver General as repayment of an overpayment of benefits.

Return of benefits by employer

(2) If a claimant receives benefits for a period and under a labour arbitration award or court judgment, or for any other reason, the liability of an employer to pay the claimant earnings, including damages for wrongful dismissal, for the same period is or was reduced by the amount of the benefits or by a portion of

² If the employer cannot determine how much to withhold, he may have to pay the amount he believes is the correct amount into court and notify HR: see Scharf v. Freure Homes Limited, 1994 CarswellOnt 1193, [1996] 1 C.T.C. 70D.

them, the employer shall remit the amount or portion to the Receiver General as repayment of an overpayment of benefits.

Because the employee was required to include the \$20,000 in income under 56(1)(a)(iv), it stands to reason that he or she would be entitled to a deduction for the same amount when that amount is repaid by the employee under section 45 or by his or her employer under section 46, and indeed such a deduction is provided for by subparagraph 60(n)(iv) of the ITA:

60. Other deductions

There may be deducted in computing a taxpayer's income for a taxation year such of the following amounts as are applicable:

(n) Repayment of pension or benefits

any amount paid by the taxpayer in the year as a repayment (otherwise than because of Part VII of the Unemployment Insurance Act, chapter U-1 of the Revised Statutes of Canada, 1985, or of Part VII of the Employment Insurance Act) of any of the following amounts to the extent that the amount was included in computing the taxpayer's income, and not deducted in computing the taxpayer's taxable income, for the year or for a preceding taxation year, namely,

(iv) a benefit described in subparagraph 56(1)(a)(iv).

Pursuant to paragraph 153(1)(c) and income tax reg. 103(4), all or a portion of the \$50,000 payment will be subject to withholding:

103(4)

Subject to subsection (5), where a lump sum payment is made by an employer to an employee who is a resident of Canada,

(a) if the payment does not exceed \$5,000, the employer shall deduct or withhold therefrom, in the case of an employee who reports for work at an establishment of the employer

(i) in Quebec, 5 percent,

(ii) in any other province, 7 percent, or

(iii) in Canada beyond the limits of any province or outside Canada, 10 percent, of such payment in lieu of the amount determined under section 102;

(b) if the payment exceeds \$5,000 but does not exceed \$15,000, the employer shall deduct or withhold therefrom, in the case of an employee who reports for work at an establishment of the employer

(i) in Quebec, 10 percent,

(ii) in any other province, 13 percent, or

(iii) in Canada beyond the limits of any province or outside Canada, 20 percent, of such payment in lieu of the amount determined under section 102; and

(c) if the payment exceeds \$15,000, the employer shall deduct or withhold therefrom, in the case of an employee who reports for work at an establishment of the employer

(i) in Quebec, 15 percent,

(ii) in any other province, 20 percent, or

(iii) in Canada beyond the limits of any province or outside Canada, 30 percent, of such payment in lieu of the amount determined under section 102.

Normally, the total amount of a retiring allowance is included in the calculation of the amount of the “lump sum” which is subject to withholding under reg. 103(4), pursuant to reg. 103(6)(e):

103(6)

For the purposes of subsection (4), a “lump sum payment” means a payment that is

(e) a retiring allowance.

For purposes of the above withholding rules, the net amount of the retiring allowance is determined by reg. 100(3)(c). It states:

For the purposes of this Part, where an employer deducts or withholds from a payment of remuneration to an employee one or more amounts each of which is

(c) a premium under a registered retirement savings plan, to the extent that the employer believes on reasonable grounds that the premium is deductible under paragraph subsection 60(j.1) or 146(5) or (5.1) of the Act in computing the employee's income for the taxation year in which the payment of remuneration is made,

the balance remaining after deducting or withholding this amount, as the case may be, shall be deemed to be the amount of that payment of remuneration.

Accordingly, in my opinion the entire \$50,000 (less any amount contributed to the employee’s RRSP) is the “lump sum” for purposes of reg. 103(4), notwithstanding that \$20,000 has been repaid to HR and notwithstanding that of that \$20,000, \$5,000 represented tax withheld by HR. This makes sense because when the employee files his or her return, he or she will claim a deduction for the \$20,000 under 60(n)(iv) and hence will be entitled to a refund of the \$5,000, plus interest. Thus, there is no element of double tax.