Are Lump Sum Termination Payments Subject to EI Withholdings?



Employers must deduct termination payments that lead to overpayments of EI benefits.

Employees who get terminated often settle with their former employers after they've already received EI benefits compensating them for their loss of employment. The termination payments they receive as part of these subsequent settlements could result in an overpayment of EI benefits. This scenario, which is purely hypothetical, illustrates the rules governing EI withholdings in these situations.

SITUATION

A paralegal sues the law firm that fired her for wrongful dismissal. With the lawsuit pending, she applies for EI benefits. Service Canada approves the claim and notifies the firm. After receiving 6 months of EI, the paralegal reaches an out of court settlement with the firm under which she's to receive a lump-sum payment of $100,000 as damages from the loss of her employment to be paid by Dec. 31, 2023. When she was originally let go on March 31, she received minimum employment standards notice; no other EI insurable earnings were paid or payable at termination. The paralegal had yet to reach her maximum EI insurable earnings for the year at the time of termination.

QUESTION

Is the $100,000 payment subject to EI withholdings?

1. No because the payment is a retiring allowance and thus isn't considered insurable earnings subject to EI.
2. No because Service Canada will deal directly with the firm to recover any overpayment of benefits.
3. Yes because the paralegal hasn't yet reached her EI maximum for the year.
4. Yes because employers must deduct any overpayment of benefits that result from subsequent payments.

ANSWER

1. **The $100,000 would likely result in an overpayment of benefits, which the firm must recover at source since it was aware that the paralegal was receiving EI benefits.**

EXPLANATION

Employees must declare any earnings they receive while they're on EI. Service Canada will reduce a former employee's benefits, dollar for dollar, for any earnings greater than 25% of the person's weekly benefit rate, or, if that benefit rate is less than $200 per week, greater than $50. Subsequent payments by employers are treated as earnings for this purpose and are allocated by Service Canada back to the start of each EI claim. This allocation is based on the former employee's normal weekly earnings.

Assuming the paralegal's normal weekly earnings before she was terminated were $2,000, the $100,000 settlement package would be allocated as $2,000 per week, over each of 50 weeks, starting at the beginning of her claim. Since $2,000 is greater than what the paralegal received as weekly EI benefits, the full amount of EI she received becomes an overpayment when the $100,000 is paid. And since the firm was aware that she had been receiving EI, under sub-section 46(1) of the *Employment Insurance Act*, it must contact Service Canada to determine the amount to deduct at source for this overpayment. Any overpayment must be deducted at source from the $100,000 and remitted separately to the CRA.

WHY WRONG ANSWERS ARE WRONG

A is wrong because the requirement for the employer to recover an overpayment of EI benefits is on top of the normal source deductions on EI insurable earnings. It's true that a retiring allowance isn't insurable for the purpose of deducting EI premiums. But normal EI premiums aren't the same as recovering an overpayment of EI benefits. Amounts subsequently paid by the employer that create an overpayment of EI benefits are subject to withholding at source by the employer to recover the overpayment.

B is wrong, even though the employee is also obligated to report any subsequent payments and any resulting overpayment of benefits directly to Service Canada. This employee obligation doesn't relieve the employer of its own obligation to recover any overpayment of EI benefits stemming from subsequent payments to former employees. The employer's liability to recover such an overpayment arises first when the employer becomes legally committed to the subsequent payment, before payment is actually made.

C is wrong because the annual maximums on EI insurable earnings and premiums don't apply to the employer recovery of an overpayment of EI benefits. It doesn't matter whether the paralegal had already paid all of the EI premiums on her insurable earnings for 2023. This has no bearing on the requirement to repay Service Canada for the overpayment of benefits.