

# When Is Employing Family Members “Arm’s Length” for EI Purposes?



Arm's length insurable employment is about transactions, not just relationships.

My brother calls and tells me he just lost his job. I can't lend him money and there are no openings at the company I own. But I have an idea. "I'll hire you for a phony job and fire you in 6 weeks so you can collect employment insurance." What I'm overlooking is that my brother won't qualify for EI benefits. That's because (Section 5(2)(i) of) the *Employment Insurance Act* states that insurable employment doesn't include employment between an employer and an employee that aren't dealing with each other at arm's length. However, an employment relationship between members of the same family **can be** insurable if the CRA thinks that two parties dealing with each other at arm's length would have made a similar agreement. Here are 2 cases illustrating this principle.

## **Family Employment Is Arm's Length**

### **Situation**

Four individuals own 100% of the shares of an Alberta company. Ownership is divided in equal shares—25% apiece. Two of the shareholders are brothers. The other two are unrelated individuals. The company, which pays the brothers a salary, claims that it doesn't have to pay EI premiums for the brothers because their employment isn't insurable. The brothers aren't dealing with the company at arm's length, the company contends.

### **Ruling**

The Tax Court rules that the brothers' employment is insurable.

### **Reasoning**

Yes, the workers are brothers. But arm's length is about transactions, not just relationships. More precisely, the question is whether the transaction is a legitimate business arrangement between two parties, or just a collusion where one side dictates the terms. The key, said the court, is that the company and the brothers weren't acting as one. At 50%, the brothers' combined shares didn't constitute ownership. To get a majority, they needed the agreement of at least one other shareholder. Therefore, the company was more than simply the brothers' alter

ego and the relationship between the brothers and the company really was at arm's length.

[\*Snow White Enterprises Inc. v. M.N.R.\*](#), 2006 TCC 656 (CanLII)

## **Family Employment Is Not Arm's Length**

### **Situation**

The owner and sole shareholder of a health club hires a Chilean contractor to work as a janitor for \$1,500 per month, and later \$1,750 per month. When the contract ends, the owner hires his sister to do the job. She performs the same duties but doesn't sign a contract. She receives \$1,500 per month. She does a good job and takes on additional duties, such as reception work. So, the owner raises her salary to \$2,200 per month. The Minister rules that the sister's employment is not insurable. The owner appeals.

### **Ruling**

The Tax Court rules that the relationship between the owner and sister is not arm's length.

### **Reasoning**

The court acknowledged that the sister's compensation and duties were similar to those of the Chilean contractor. So, on the surface, this looks like an arm's length relationship. But, the court continued, the "manner in which [the sister] was employed was greatly different." The contractor was engaged on a contract basis and had to put in actual hours to get paid. The sister had no contract. And, although she was never absent, if she had been she still would have gotten paid, the court explained. Conversely, she put in longer hours without getting paid for them. This showed just how different this employment relationship was from an arm's length situation, the court concluded.

[\*Hardcore Health & Fitness \(formerly known as Hard Core Gym Ltd.\) v. M.N.R.\*](#), 2006 TCC 659 (CanLII)