



TAX NOTES

April 13, 2020

CEWS LEGISLATION RECEIVES ROYAL ASSENT

1. Introduction

On April 11, 2020, legislation implementing the Canada Emergency Wage Subsidy (CEWS) was tabled as Bill C-14 and received Royal Assent later that day. The concepts underlying CEWS are substantially unchanged from our prior Tax Note, although the legislation provides additional clarity for employers and their advisors. The legislation also confirms that the CEWS rules will form part of the *Income Tax Act*, with any benefit receivable by an employer deemed to be an overpayment of tax that the Canada Revenue Agency (CRA) may refund to the employer at any time. The amount refundable to the employer will bear refund interest at the prescribed rate.

2. CEWS Benefits

The amount that the employer may receive as a refund of overpaid tax in respect of a particular eligible employee for a particular week will depend on whether or not the employer and eligible employee deal at arm's length. If the employer and eligible employee deal at arm's length, the benefit should be equal to the greater of two amounts. The first amount is calculated as the lesser of 75% of the eligible remuneration paid to the eligible employee for that week and \$847. The second amount is calculated as the least of: (i) the eligible employee's eligible remuneration for the week; (ii) 75% of the eligible employee's baseline remuneration (which is discussed below); or (iii) \$847.

If the employer and eligible employee do not deal at arm's length, the benefit should be equal to the second amount calculated above, being the least of: (i) the eligible employee's eligible remuneration for the week; (ii) 75% of the eligible employee's baseline remuneration; or (iii) \$847. In other words, it should not be possible to receive a CEWS benefit in respect of a non-arm's length employee that exceeds 75% of the employee's baseline remuneration.

The amount of the CEWS benefit payable to an employer for an eligible employee is reduced by any amount claimed by the employer under the 10% temporary wage subsidy program in respect of that employee, as well as amounts received by the employee as a work-sharing benefit under the *Employment Insurance Act*. CEWS benefits are increased by the employer's employment insurance premiums and *Canada Pension Plan* contributions paid for the eligible employee.

If the same employee is employed by two or more entities that do not deal at arm's length, a clarifying rule stipulates that the maximum combined CEWS benefit that may be paid to the non-arm's length employers cannot exceed the CEWS benefit that would be received if that employee were employed by a single employer.

CEWS benefits may be paid for three qualifying periods, between March 15, 2020 and April 11, 2020, April 12, 2020 and May 9, 2020, and May 10, 2020 to June 6, 2020. However, the Minister of National Revenue may, by regulation, create additional qualifying periods in respect of which CEWS benefits may be paid, provided that those periods end no later than September 30, 2020.

3. Employees and Remuneration

An employee is an eligible employee for a particular week if they are employed during the qualifying period that includes the week, unless the employee was without remuneration for 14 or more consecutive days during the qualifying period. The effect of this restriction is that an employer cannot claim a CEWS benefit for any employee who would be entitled to claim the Canada Emergency Response Benefit (CERB).

The eligible remuneration paid to an eligible employee is effectively the total of the eligible employee's salary, wages, commissions, fees or other remuneration for services. As expected, eligible remuneration does not include stock option benefits or retiring allowances. The legislation also excludes from eligible remuneration any amount that may reasonably be expected to be returned or repaid by the employee, directly or indirectly, to the employer or a person directed by the employer. An anti-avoidance rule also excludes from eligible remuneration any amount in excess of baseline remuneration if it is reasonably expected that the employee's future remuneration will be less than the baseline remuneration and one of the main purposes of the arrangement is to increase CEWS benefits. This anti-avoidance rule should preclude arrangements whereby an employee's salary is front-loaded into a CEWS qualifying period in order to maximize CEWS benefits.

An employee's baseline remuneration is the employee's average weekly eligible remuneration for the period between January 1, 2020 and March 15, 2020, excluding any period of seven or more consecutive days in which the employee was not remunerated. The effect of the baseline remuneration period is that CEWS benefits for a non-arm's length employee will be nil if the non-arm's length employee was not employed and was not paid remuneration between January 1, 2020 and March 15, 2020.

4. Employer Eligibility

In order to access CEWS benefits, an employer must be both an eligible entity and a qualifying entity. An eligible entity is:

- A corporation that is neither tax-exempt nor a public institution (unless described elsewhere);
- An individual;
- A registered charity that is not a public institution;
- An agricultural organization, a board of trade or chamber of commerce, a scientific research corporation, a labour organization or a not-for-profit organization, other than a public institution;
- A partnership, all of the members of which are eligible entities; or
- Any other entity prescribed by regulation.

Public institutions are excluded from the subsidy and are defined as including employees and the family of employees of foreign countries, municipalities, municipal authorities, First Nations bands, Crown corporations and their subsidiaries, municipal corporations and their subsidiaries, schools, school boards, hospitals, health authorities, public universities or public colleges. Stated simply, if an entity is so closely connected with a municipal, provincial or federal government that it is exempt from Part I income tax, it is likely not eligible for CEWS.

An employer that is an eligible entity is a qualifying entity for a qualifying period if:

- It has applied for CEWS benefits in the qualifying period before October 2020;
- The individual primarily responsible for the entity's finances attests that the application is complete and accurate;
- If the employer does not elect to use January and February 2020 for revenue comparison purposes:
 - Its qualifying revenues for March 2020 are equal to or less than 85% of its qualifying revenues for March 2019 (for the March 15, 2020 to April 11, 2020 period);
 - Its qualifying revenues for April 2020 are equal to or less than 70% of its qualifying revenues for April 2019 (for the April 12, 2020 to May 9, 2020 period); or
 - Its qualifying revenues for May 2020 are equal to or less than 70% of its qualifying revenues for May 2019 (for the May 10, 2020 to June 6, 2020 period);
- If the employer elects to use January and February 2020 for revenue comparison purposes:
 - Its qualifying revenues for March 2020 are equal to or less than 85% of ½ of its qualifying revenues for January and February 2020; or
 - Its qualifying revenues for April 2020 or May 2020 (as the case may be) are equal to or less than 70% of ½ of its qualifying revenues for January and February 2020; and
- The employer had a payroll account on March 15, 2020.

This test will work somewhat differently where an employer elects to use January and February 2020 as its reference period but did not carry on business throughout ALL OF January and February 2020. In that case, there will be a further proration of the qualifying revenues for January and February 2020 in applying the qualifying entity test.

If an employer satisfies the revenue test in a particular qualifying period, the employer is deemed to have satisfied the revenue test in the immediately following qualifying period. So, for example, an employer that satisfies the revenue test for the March 15, 2020 to April 11, 2020 qualifying period is deemed to have satisfied the revenue test for the April 12, 2020 to May 9, 2020 qualifying period. It appears that the purpose of this deeming rule is to permit employers to apply for CEWS for a qualifying period on the basis of the revenue decrease for the preceding qualifying period if they are not yet able to ascertain their revenue decrease for the current qualifying period.

A partnership is deemed to be a taxpayer for the purposes of receiving CEWS benefits, but not for any other purposes. As a result, it appears that an eligible entity that is a member of a partnership and that employs employees separate from the partnership may be entitled to CEWS separately from the partnership if its qualifying revenues from the partnership (or from other sources) have decreased to the extent required to be a qualifying entity; or if the partner and the partnership do not deal at arm's length, if the partnership's income has decreased by a sufficient amount.

5. Qualifying Revenues

As previously indicated by the Department of Finance, an employer may determine its qualifying revenues by reference to either cash inflows or receivables, in either case arising in the course of its ordinary activities in Canada. If an employer elects to compute its qualifying revenues using the cash method, it must use the cash method for all qualifying periods.

Qualifying revenues explicitly exclude extraordinary items – an undefined term that should be determined by reference to accounting standards – amounts derived from non-arm's length persons or partnerships, and CEWS benefits and temporary wage subsidy benefits. Revenues are otherwise determined by reference to normal accounting practices.

Contrary to statements made by the Department of Finance when details of CEWS were initially released, the legislation provides for considerable flexibility for non-arm's length and consolidated groups. In particular:

- The members of a group of entities that prepare consolidated financial statements may, if each member of the group so elects, compute its qualifying revenues separately.
- The members of a group of entities that are affiliated with one another may, if each member of the group so elects, determine their qualifying revenues on a consolidated basis.
- If the eligible entity is the member of a joint venture that employs the employees of the joint venture, the eligible entity may use the qualifying revenues of the joint venture to determine if it is eligible for CEWS.
- If all or substantially all of an eligible entity's qualifying revenue is derived from non-arm's length persons or partnerships, then, provided the eligible entity and the non-arm's length persons or partnerships jointly elect, the eligible entity is deemed to have a decrease in qualifying revenues to the extent of the weighted average arm's length revenue reduction of each entity in the non-arm's length group from which the eligible entity derived revenues.

The consolidation rules should provide considerable flexibility to large employers, including public corporations, to calculate the decrease in their qualifying revenues in a manner that accords with their usual accounting practices. The relieving rule for non-arm's length revenue should be a welcome surprise for corporate groups that employ all of their employees through one or more employer corporations that derive all of their revenues from other members of the corporate group.

The legislation contains a specific anti-avoidance rule that applies where an entity, or the entity and one or more non-arm's length persons, enters into a transaction, series of transactions or arrangement that causes a decrease in current period qualifying revenues and it can reasonably be concluded that one of the main purposes of the arrangement is to cause an entity to be entitled to CEWS. If this anti-avoidance rule applies, then current period qualifying revenue is deemed to be equal to qualifying revenue in the relevant reference period such that no subsidy would be available. This anti-avoidance rule does not apply to a decision to make one or more of the elections permitted in computing qualifying revenues.

6. Administration of CEWS

An employer that is otherwise a qualifying entity must apply for CEWS using the application platform that will be created by the CRA. The employer must apply separately for each qualifying period in respect of which it intends to claim CEWS benefits.

CEWS benefits are taxable, as they are deemed to be assistance received from a government. The assistance is deemed to be received at the end of the qualifying period to which the CEWS benefit relates (and not at the time that the benefit is paid). Employers receiving CEWS benefits that have a taxation year-end in March, April, May or June 2020 should be cognizant of this timing rule to ensure that they do not fail to report the CEWS benefits in their income for that taxation year.

As anticipated, there are two significant administrative penalties that apply where a person or partnership has claimed CEWS benefits to which they were not entitled. First, if the benefits were claimed in circumstances amounting to gross negligence, the person or partnership will be liable for a penalty equal to 50% of the amount by which the CEWS benefits claimed exceed the CEWS benefits to which the person or partnership was actually entitled. Second, if the specific anti-avoidance rule relating to revenue manipulation applies, the person or partnership will be liable for a penalty equal to 25% of the amount by which the CEWS benefits

claimed exceed the CEWS benefits to which the person or partnership was actually entitled. The person or partnership will also have to repay the CEWS benefits that they received but were not entitled to.

The CEWS legislation allows the Minister the discretion to make publicly available, in any manner the Minister considers appropriate, the name of any person or partnership that makes an application for CEWS. Entities should therefore be aware before applying for CEWS benefits that their application, and the implication of a material decrease in revenue, may not be confidential information.

7. Conclusion

The legislation reflects a desire on the part of the Department of Finance to create considerable flexibility for employers in order to ensure that as many employers as possible will qualify for CEWS if their entitlement would be consistent with CEWS' policy objectives. While references in the legislation to accounting practices and other undefined concepts may create uncertainty, we understand that the direction provided to the CRA is that this uncertainty should be resolved in favour of employers where it is reasonable to conclude that the employer should be entitled to CEWS based on the legislative rationale. Thankfully, and in contrast to the legislation enacting CERB, very little relating to CEWS is to be determined by reference to regulations not yet promulgated, so it should be possible for most employers to determine whether they qualify for CEWS based on a review of the legislation and the employers' financial records.

We recognize that ascertaining whether CEWS benefits are available is of critical importance to many of our clients. Any Felesky Flynn LLP lawyer would be pleased to assist you in determining how the CEWS legislation will apply to your organization or to your clients. As always, we remain available to assist you with any other tax-related matters or inquiries that may arise.