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Canadian tax alert

Canada Emergency Wage Subsidy update and FAQ

July 23, 2020

The Canada Emergency Wage Subsidy (CEWS) was introduced by the Federal Government on March 27, 2020 with a view to maximize employment in Canada and to encourage growth. As initially enacted, the CEWS was intended to provide qualified employers who have experienced a significant decline in their revenues (i.e., 15% or more in March 2020 and 30% or more in the subsequent months, compared to prior reference periods) with a 75% wage subsidy of up to $847/week per eligible employee.

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Since its introduction, there have been several proposed changes to the legislation to address challenges experienced by employers and to enhance access to the program. The initial legislation received Royal Assent on April 11, 2020 and since then, the Finance Minister has introduced two additional pieces of legislation. On May 15, 2020, several legislative updates were presented, including an extension of the program through to August 29, 2020. Then, on July 17, 2020, a new round of legislative changes were introduced mainly to support businesses during their recovery period. The primary changes announced in the proposed legislation include:

(i) eliminating the revenue threshold effective July 5, 2020, **such that a business with any revenue decline,** irrespective of revenue decline percentage, will be eligible to participate;
(ii) modifying the subsidy such that the amount of subsidy for each employee will **be directly proportional to the revenue decline;**
(iii) increasing the maximum amount of subsidy available for each employee **(from $847 to $960)** for businesses with higher revenue declines (for Period 5 and 6, from July 5, 2020 to August 29, 2020);
(iv) gradually decreasing the maximum subsidy amount available in **Period 7 through 9** (from August 30, 2020 to November 21, 2020) for all businesses; and
(v) **extending the program** by an additional 12 weeks, through to November 21, 2020, with a new submission deadline of January 31, 2021 for all periods.

While the proposed rules will certainly provide additional financial support for employers that have experienced revenue declines, and greatly increase the number of employers eligible for a claim, **these rules will significantly increase the complexity associated with preparing such claims.**

This alert highlights the recent key changes to the CEWS program and the related guidance provided by the Canada Revenue Agency (CRA). This alert also addresses complexities associated with the CEWS program and some common challenges that employers are facing. We will issue a separate alert once the legislative proposals have received Royal Assent.

SUMMARY OF LEGISLATIVE CHANGES PROPOSED ON JULY 17, 2020

A summary of the impact of the proposed changes on the maximum amount of subsidy available per employee per week has been included in the table below. Special attention should be made to this table, **as the actual amount of subsidy available to each entity will vary by each entity's unique combination of revenue declines in the current reference period as well in the preceding three calendar months.** In addition, note that these calculations are based on proposed legislation and may not represent the actual subsidy amounts an employer is entitled to once the legislation is enacted.

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Maximum subsidy per employee per week

Revenue reference	Period 1 March	Period 2 April	Period 3 May	Period 4 June	Period 5 July	Period 6 August	Period 7 September	Period 8 October	Period 9 November
Start of period	15-mars-20	12-avr-20	10-mai-20	07-juin-20	05-juil-20	02-août-20	30-août-20	27-sept-20	25-oct-20
End of period	11-avr-20	09-mai-20	06-juin-20	04-juil-20	01-août-20	29-août-20	26-sept-20	24-oct-20	21-nov-20

% revenue decline

5%	$ -	$ -	$ -	$ -	$ 68	$ 68	$ 56	$ 45	$ 23
10%	$ -	$ -	$ -	$ -	$ 135	$ 135	$ 113	$ 90	$ 45
15%	$ 847	$ -	$ -	$ -	$ 203	$ 203	$ 169	$ 135	$ 68
20%	$ 847	$ -	$ -	$ -	$ 271	$ 271	$ 226	$ 181	$ 90
25%	$ 847	$ -	$ -	$ -	$ 339	$ 339	$ 282	$ 226	$ 113
30%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 339	$ 271	$ 135
35%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 395	$ 316	$ 158
40%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 452	$ 361	$ 181
45%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 508	$ 406	$ 203
50%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 565	$ 452	$ 226
55%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 635	$ 522	$ 296
60%	$ 847	$ 847	$ 847	$ 847	$ 847	$ 847	$ 706	$ 593	$ 367
65%	$ 847	$ 847	$ 847	$ 847	$ 889	$ 889	$ 776	$ 663	$ 437
70% or more	$ 847	$ 847	$ 847	$ 847	$ 960	$ 960	$ 847	$ 734	$ 508

Source: Deloitte.

The above table assumes that current month decline and average preceding 3-month decline are identical.

Where an entity's revenues have recovered in a current period, par. 125.7(9)(b) of the Income Tax Act (ITA) will deem the current period decline to be the more significant decline of the current or immediately preceding period.

Actual subsidy per employee will vary, as the base and top-up percentages scale independently, based on average decline in current month (compared to elected reference period) and average decline for last 3-months (compared to elected reference period), respectively.

The above table may not be accurate for furloughed employees (currently receiving CERB/EI), where the potential subsidy amount is less than their CERB/EI receivable. Additional regulations are expected so as to ensure that the subsidy amount is greater than or equal to the CERB/EI amounts receivable.

FREQUENTLY ASKED QUESTIONS (FAQs)

The following sections relate to some of the most common questions that Deloitte continues to receive from employers in relation to eligibility and qualifying revenue determinations, and eligible remuneration calculations.

Eligibility and qualifying revenue

1) Do I simply take the top-line revenue numbers from the financial statements of the stand-alone Canadian entity to determine qualifying revenue for CEWS?

No. The definition of qualifying revenue, coupled with the various interpretations now publicly available through the CRA's FAQ page, have clearly outlined that there are multiple inflows of cash, receivables, and other

considerations that need to be factored into the computation of qualifying revenue including:

(i) passive income sources such as interest, dividends, and realized/unrealized foreign exchange gains and losses may all be part of qualifying revenue;
(ii) presentation of revenues on a net or gross basis will vary by industry and by claimant; appropriateness of netting certain items (rebates, discounts, returns) against revenue needs to be considered (discussed in more detail in Question 5 below);
(iii) sales made by affiliated entities to third parties may be attributable to the activities of the eligible Canadian entity (discussed in more detail in Question 12 below); and
(iv) mark-to-market adjustments (e.g., hedging, portfolio fair market revaluations) may need to be considered if they are part of the ordinary activities of the entity and if the realized/unrealized gains or losses would otherwise be treated on the account of income.

In short, the definition and interpretation of qualifying revenue is quite broad, and now that the amount of the subsidy available to an entity may be fully driven by the revenue decline for the entity, accuracy in deriving these values (especially for July through November periods) will be critical.

Not only will the qualifying revenue calculations become more complex in these later periods, but the impact of even a small change to revenue decline will be even more significant. Consider that, based on proposed legislation for later qualifying periods, a change from 5% to 10% revenue decline in a particular period would effectively result in doubling the wage subsidy available for that period.

2) If I don't pay income tax in Canada, can I qualify for the program? What is the meaning of "exempt from tax" for purposes of defining an "eligible entity"?

An entity that does not pay income tax in Canada (whether as a result of being a tax-exempt entity, a treaty-exempt entity, or an entity with tax losses or other tax attributes that result in it not having income taxes payable), may still be eligible for the CEWS program.

Bill C-17 (1st reading on June 10, 2020) has not proposed amendments to the definition of "eligible entity"; however, the CRA has elaborated on the meaning of "exempt from tax" and factors in determining a public institution.

For purposes of the CEWS, eligible employers includes a/an:

- individual;
- trust;
- registered charity;
- person that is exempt from tax, which includes agricultural organization, board of trade or chamber of commerce, non-profit corporation for scientific research and development, labour organization, and non-profit organization;
- partnership, where each member of which is a person aforementioned in this list; and
- prescribed organization.

Currently, a trust is considered to be an eligible employer because it is considered to be a person for tax purposes. The government has proposed to amend the legislation to include trusts with employees as eligible employers, with two caveats:

- where a trust is exempt from tax, it should qualify if it is a registered charity or an eligible tax-exempt entity (e.g., not-for-profit organization), and
- where a trust is a public institution, it should qualify only if it is considered to be a prescribed organization.

The proposed exceptions are expected to apply commencing with the start of the third qualifying period (i.e., May 10, 2020 – June 6, 2020).
Public institutions, such as municipalities, public schools, universities and colleges, continue to be ineligible for the CEWS.

Furthermore, the CRA had stated that a non-resident corporation whose Canadian-source income is not included in the computation of its taxable income, due to the income exemptions outlined in the ITA or pursuant to a provision of a tax convention with another state, would not preclude it from being an "eligible entity" for the purposes of the CEWS program. In other words, entities carrying on a business in Canada, albeit covered by treaty exemptions, may still be an eligible entity for purposes of CEWS.

3) What is a public institution?

Generally, public institutions do not qualify for the CEWS program. Public institutions include municipalities and local governments, crown corporations, public universities, colleges, schools, and hospitals.

A corporation with 90% or more of its shares and capital held by one or more entities that are performing a function of government in Canada should not be considered an eligible entity.

The CRA also provides guidance for determining whether an entity is a municipality or public body. Broadly, a municipality is a public body performing a function of government. It is the CRA's position that a municipality or public body performing a function of government in Canada was meant to apply to entities that, while not legally municipalities, possessed attributes of municipalities and provided services similar to those provided by municipalities. In other words, to be performing a function of government, an entity must have the ability and power to govern, tax, pass by-laws, and provide municipal-type services to its members/citizens.[1]

4) Do partnerships with one or more ineligible members qualify for the CEWS program?

Whether such a partnership will qualify will depend on what proportion of ownership is held by ineligible entities. The legislation, as currently enacted, does not allow for a partnership with one or more ineligible entities as members (e.g., public institutions) to qualify for the program; this holds true even in a scenario where the ineligible entity holds a minority interest. However, the

[1] Source: https://www.cpacanada.ca/en/business-and-accounting-resources/taxation/blog/2020/june/covid-19-updates-cews-cra-interpretations

government proposed to the amend the legislation, wherein if the fair market value of the partnership interest held by the ineligible entities does not exceed 50% of the fair market value of all partnership interests, then the partnership may be eligible.

The proposed amendment has yet to be enacted; should it receive Royal Assent, this change will be applicable retroactively to the first qualifying period starting March 15, 2020, and apply to subsequent periods.

5) Does qualifying revenue consider net or gross revenues?

It depends on the facts and circumstances. Qualifying revenue is defined as inflows of cash, receivables, or other consideration arising from the ordinary Canadian activities of the eligible entity, and should not include non-arm's length transactions (subject to the notion of attribution of revenues discussed below). Qualifying revenue should, generally, be computed on a gross basis because the definition does not make any reference to cash outflows.

However, the legislation clearly indicates that an eligible entity should determine qualifying revenue in accordance with the entity's "normal accounting practices". Depending on financial reporting framework an eligible entity's revenue may be net of discounts, rebates, returns, and allowances claims for damaged goods, etc. As such, the nature of the business (e.g., retail businesses) and the entity's normal accounting practices may result in determining qualifying revenues on a net basis.

It should be noted that the CRA's FAQs have stated that an entity should not deduct bad debts or allowance for doubtful accounts, when determining qualifying revenue.

Special attention should also be made in instances where a claimant collects amounts that are not on its own account (i.e., in an agency relationship, sales tax collection) as these amounts would generally be excluded from qualifying revenue under either a cash or accrual basis.

6) Should realized foreign exchange fluctuations be included as qualifying revenue?

It also depends on the facts and circumstances. Realized foreign exchange gains and losses relating to revenues of the entity should be included in qualifying revenue to the extent that the realized foreign exchange gain or loss is treated on the account of income; for greater certainty, the realized foreign exchange fluctuations stemming from payables (such as from the purchase of inventory or supplies) and capital transactions should not be included in the determination of qualifying revenue. Additional attention may be needed where realized gains and losses arise from intercompany transactions, as depending on the application of revenue attribution (see Question 12), they may or may not be included in qualifying revenue.

7) Should unrealized foreign exchange fluctuation be included in as qualifying revenue calculation?

Treatment of unrealized foreign exchange fluctuations would be consistent as those for realized amounts (see Question 6). Note that treatment of unrealized amounts would apply solely to an accrual based claimant, whereas a cash basis

claimant would not include unrealized amounts in its qualifying revenue computations.

8) If an eligible entity has filed a functional currency election, should qualifying revenue be computed in the functional currency?

Yes, where an eligible entity is a corporation that files its income tax returns under a functional currency election, qualifying revenue should be determined in that functional currency.

However, note that there is currently no guidance as to how a functional currency election impacts that calculation of the available subsidy amount. Generally, a functional currency election would impact the remuneration components of a tax credit calculation.

9) If the eligible entity is filing a CEWS claim based on the revenue declines of the non-arm's length party, should the qualifying revenues be translated into Canadian dollars?

Where an eligible entity earns all or substantially all of its revenues from non-arm's length parties, the eligible entity may determine its eligibility for the program based on the revenue declines of the non-arm's length party. If the non-arm's length party derives its revenues in a currency other than Canadian dollars, the CRA's position is that the revenue declines of the non-arm's length party should be determined in the primary currency of the non-arm's length party and in accordance with its normal accounting practices.

10) Should hedging contracts be included in qualifying revenue?

Hedging contracts may be in place with respect to sales, accounts receivables, expenses, accounts payables and/or capital expenditures, in order to minimize exposure to foreign exchange fluctuations. To the extent such hedging contracts are in relation to sales and accounts receivables, the hedging gains/losses should be included in qualifying revenue. For greater certainty, hedging gains and losses in relation to expenses, accounts payables, or capital expenditures should not be included in the computation of qualifying revenue.

11) If the eligible entity has undergone an amalgamation, how should the revenue declines be determined?

Currently, corporations formed as a result of an amalgamation of two or more predecessor corporations may not qualify for the program because they would likely not have benchmark revenues for purposes of demonstrating the necessary revenue percentage decline. The government has proposed an amendment that will allow amalgamated corporations to calculate the benchmark revenues using the combined inflows of cash, accounts receivables and other consideration of the predecessor corporations, to the extent a primary purpose for the amalgamation was not to qualify for the CEWS program.

The proposed amendment should be applicable retroactively to the first claiming period commencing March 15, 2020 and will apply to subsequent filing periods.

12) In the instance that an eligible entity sells its goods or services to a non-arm's length party and that party ultimately re-sells or distributes these goods or services to third parties, how should these intercompany transactions be treated?

Generally, intercompany transactions are not included in qualifying revenue. However, as noted in the CRA's FAQs, where Canadian-sourced goods or services are sold to a non-arm's length party that are then sold to a third party, these revenues could be attributed to the eligible entity. If the non-arm's length party modifies the good or service prior to selling to the third party, the eligible entity may need to determine revenues attributable to its own activities using a reasonable methodology, establishing what portion of the ultimate third party sales revenue would be attributable to Canadian activities.

13) If an eligible entity undergoes significant changes in its business operations (i.e., business structuring, expansion, or discontinued operations), should the revenues be normalized?

No, the CRA's position is that revenues should not be adjusted to reflect business changes when determining qualifying revenue. The CRA further elaborates that there are no provisions that would allow for an eligible entity to adjust its qualifying revenue from prior or current periods. As such, normalized earnings may not be relevant in determining qualifying revenues and therefore, the prior and current period earnings may not align.

Note that the CRA has proposed specific provisions concerning amalgamations as well as the acquisition or disposition of assets that equates to all or substantially all of the value of a business, but these do not extend to partial expansions or discontinuations of businesses (i.e., the proposed rules do not include buying or selling assets that represent a smaller proportion of the business).

Remuneration

14) Would employers who use paymasters qualify for CEWS?

Some organizations establish a centralized payroll function whereby a payroll entity provides services to other members of the corporate group, and the other members earn the third-party revenue. Under the current legislation, an eligible entity that did not have its own payroll account with the CRA, as at March 15, 2020, is not considered a "qualifying entity" and therefore, not eligible for the CEWS. Accordingly, under the current legislation, it appears that where an employer who uses a paymaster or other cost-sharing arrangements where the payroll is administered by a separate entity, the wages of the entities earning third party revenues could not qualify for the CEWS.
Bill C-17 contains proposals to amend the definition of "qualifying entity" to include such an entity that outsources the payroll for its employees to a "payroll service provider". It proposes to extend eligibility to entities who did not have a CRA payroll account but instead use a payroll service provider, who makes the entity's payroll remittances on the provider's CRA payroll account. Note that this change would equally impact entities that engage third party paymasters that make payroll remittances under that paymaster payroll

accounts. In other words, both arm's length and non-arm's length paymaster arrangements may now allow for eligibility.

Again, this proposed change in the draft legislation has not yet received Royal Assent.

15) What are some common errors seen when calculating hourly wages?

The most common errors we have seen with the calculation of eligible remuneration include not calculating hourly wages on a weekly basis using an average of the wages earned by hourly-paid employees. As the CEWS is calculated on a weekly basis, any form of averaging may yield materially inaccurate results with an hourly-paid workforce.

Furthermore, the business' pay periods will sometimes not align with the CEWS claim period. In such a case, the wages will need to be accurately allocated to the claim period based on the days worked during the claim period.

Another common error seen is where businesses base their eligible remuneration on the amounts paid to the employees instead of the amount earned. Eligible remuneration must be calculated based on the particular week a pay relates to, not the week it was paid. The types of remuneration items impacted can include bonuses, commission, retroactive pay, vacation pay, and overtime pay.

16) Are employee commissions included in the calculation of eligible remuneration?

Commissions earned may be included in the employee eligible remuneration calculation; however, very careful attention is required around payment and earning dates. Generally, commissions are paid based on sales generated by employees in a prior period. Often this amount is paid at a later date after the sale has been completed. This may create a difference in timing for when the commission was *earned* and when it was *paid*. Eligible remuneration only considers amounts that were *earned* in respect of the specific claim period week.

As such, if the commission was paid during the claim period, but was actually earned on a date prior to the claim period, the commission should not be included in the eligible remuneration calculation for that period. Instead, the commission may need to be attributed to the appropriate prior claim period. In the worst case, the commission may have been earned prior to March 15, in which case it would not qualify as eligible remuneration for any period.

17) Can an eligible entity claim the wage subsidy for seasonal employees and employees returning from an extended leave?

Currently, the legislation caps the amount of subsidy for seasonal employees (i.e., those that did not receive any pay from January 1 to March 15, 2020) to 75% of current period eligible remuneration, with varying caps for each qualifying period. But, where employees have baseline (pre-crisis) remuneration, the employer may be entitled to a higher subsidy amount, as they would instead be capped at 75% of the baseline remuneration. Where the

employee's current period remuneration is equal to that baseline, they may qualify for a higher subsidy.

To account for this disparity, the government has proposed to amend baseline remuneration to cover additional periods. Baseline remuneration is now proposed to be calculated as the greater of the following:

(i) average of remuneration paid between January 1 – March 15, 2020, and

(ii) if the entity elects:
   a. for Periods 1-3: average of weekly eligible remuneration paid between March 1 and May 31, 2019;
   b. for Period 4: average of weekly eligible remuneration paid between March 1 and June 30, 2019 or elect to still use March 1 – May 31, 2019;
   c. for Periods 5-9: average of weekly eligible remuneration paid between July 1 and December 31, 2019.

It is worth noting that for periods 7, 8, 9, the baseline change will only become relevant for non-arm's length employees, as there will no longer be a component of the subsidy calculation that considers baseline remuneration for any arm's length employees.

It is important to note that these elections would be made on an employee by employee basis.

How can Deloitte help?

If you have questions, please contact your Deloitte representative or any of the individuals noted in this document.

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