



COVID-19 Tax Update: A Detailed Review of the Recent Changes to the Canada Emergency Wage Subsidy (CEWS)

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I. OVERVIEW

On Saturday, April 11, 2020, Parliament – in a special sitting – enacted Bill C-14 to implement the Canada Emergency Wage Subsidy (the “CEWS”). Unlike Bill C-13, which implemented a broad variety of pandemic initiatives, including the Canada Emergency Response Benefit (the “CERB”), Bill C-14’s near-exclusive focus is on amending the *Income Tax Act* (Canada) (the “ITA”) to implement the CEWS.

The CEWS is by far the most significant economic relief measure enacted by the federal government in response COVID-19, both in terms of its expected cost and the scope of its application. The Department of Finance estimates the cost of the CEWS to be \$73 billion, or roughly 68% of its announced direct support measures and almost three times more costly than the CERB. For context, that amount equates to just under \$2,000 for every Canadian and roughly \$5,200 per household.¹

The objective of the CEWS is to prevent further private sector job losses resulting from COVID-19 by temporarily and partially subsidizing wages paid to employees. In general, the legislation implementing the CEWS is drafted in a manner consistent with this objective: it is available to a wide range of private sector employers (a *qualifying entity*) who have lost revenue (*qualifying revenue*) as a result of the pandemic compared to a prior period (*prior reference period*) and who continue to pay employees (*eligible employees*) remuneration (*eligible remuneration*).

For a considerable number of employers, the CEWS should apply as intended. However, despite its broad ambit, a number of interpretive issues exist for other employers, particularly those with more complex structures, atypical employment relationships and intra-group service or marketing entities.

This blog summarizes: (i) the structural mechanism underlying the CEWS; (ii) certain key statutory terms and tests that dictate who is eligible, including how the decline in the employer’s revenue is computed; (iii) how the amount of the CEWS is calculated; (iv) certain key administrative provisions; and (v) how employers can apply for the CEWS.

II. HOW THE CEWS WORKS

The CEWS operates in a similar fashion to a refundable tax credit. Specifically, the employer is deemed to have made an overpayment of tax under Part I of the ITA in an amount equal to a specified portion of remuneration paid to an *eligible employee*. In this regard, the language parallels the language of other refundable tax credits in the ITA, including the GST/HST Credit, the Canada Child Benefit and the Canadian Film or Video Production Tax Credit.

¹ Based on the most recent Statistics Canada population estimate of 37.9 million people and 14.0 million households. See https://www.statcan.gc.ca/eng/subjects-start/population_and_demography.

As the credit is considered government assistance, it is included in the employer's income under paragraph 12(1)(x) of the ITA. However, the employer's deduction of remuneration paid to the employee should offset the inclusion, resulting in no new taxable income for the employer. Government assistance received can also be relevant for other purposes in the ITA, such as claims under the scientific research and experimental development (SR&ED) program.

Normally, a deemed overpayment is only refundable upon the taxpayer filing all requisite returns. However, new subsection 164(1.6) ensures that the Minister may immediately refund the CEWS.

III. WHO IS ELIGIBLE – *ELIGIBLE ENTITY* AND *QUALIFYING ENTITY*

In order to qualify for the CEWS, the applicant must be both an *eligible entity* and a *qualifying entity*.

An *eligible entity* is defined to mean one of:

- a corporation, other than a tax-exempt corporation or a *public institution*;
- an individual;
- a registered charity, other than a *public institution*;
- certain tax-exempt entities, other than a *public institution*;
- a partnership, all of the members of which are an entity referred to above.

A notable exception to *eligible entities* are *public institutions*, which are defined to include: municipal authorities and other public bodies; crown corporations and subsidiaries of crown corporations; municipal corporations; subsidiaries of municipal corporations; schools; school boards; hospitals; health authorities; and public universities or colleges.

Assuming an employer is an *eligible entity*, in order to be a *qualifying entity* it must also have:

- filed an application for the CEWS before October 2020;
- had a registered payroll account with the CRA on March 15, 2020; and
- for a particular *qualifying period*, suffered a decline in *qualifying revenue* by a *specified percentage* as compared between a *current reference period* and a *prior reference period* (the "Revenue Decline Test").

The first two requirements are relatively unambiguous, though the second requirement may pose issues for new employers. The Revenue Decline Test, however, is subject to numerous different rules and will likely be the focus of analysis for many employers seeking to claim the CEWS.

IV. *QUALIFYING REVENUE* COMPUTATION RULES AND SPECIAL CIRCUMSTANCES

Key Terminology

In order to apply the Revenue Decline Test, there are several key terms which are summarized in the chart that follows.

- ***Qualifying Period:*** The legislation contemplates four separate periods with respect to which a *qualifying entity* can claim the CEWS. Specifically, only remuneration paid by an employer during a *qualifying period* is relevant in determining the amount of the employer's claim to the CEWS. However, an employer may qualify for the CEWS in one *qualifying period* without qualifying in a different *qualifying period*.

Notably, there is a special rule that deems an *eligible entity* to meet the Revenue Decline Test in a *qualifying period* if they met that test in the immediately preceding *qualifying period*. Thus, an employer who fails to meet the Revenue Decline Test in a given *qualifying period* may still qualify for the CEWS if that entity met the Revenue Decline Test in the prior *qualifying period*. For example, if a corporation met the Revenue Decline Test in the first *qualifying period* but only suffered a 10% comparative revenue decline in the second *qualifying period*, then it would still qualify for the CEWS in that second *qualifying period*.

- ***Current Reference Period and Prior Reference Period:*** For each *qualifying period*, the CEWS specifies a *current reference period* to benchmark the employer's decline in *qualified revenues* as against a *prior reference period*. The chart below summarizes the relevant periods to compare.
- ***Specified Percentage:*** In order to qualify for the CEWS in a given *qualifying period*, the decline in revenue between the relevant reference periods must equal or exceed a *specified percentage*.

The relevant *qualifying periods*, reference periods and *specified percentages* are summarized below.

Qualifying Period	Current Reference Period	Prior Reference Period	Specified Percentage
March 15 – April 11, 2020	March 2020	March 2019 OR Average of Jan-Feb 2020	85% (15% decline)
April 12 – May 9, 2020	April 2020	April 2019 OR Average of Jan-Feb 2020	70% (30% decline)
May 10 – June 6, 2020	May 2020	May 2019 OR Average of Jan-Feb 2020	70% (30% decline)

Additionally, the legislation contemplates the ability to add by regulation new *qualifying periods* subsequent to June 6, 2020 but prior to September 30, 2020.

Determination of Qualifying Revenues (Ignoring Elective and Special Rules)

As noted above, the decline in an employer's *qualifying revenues* for a given period must meet a certain threshold in order for the employer to qualify for the CEWS.

Ignoring certain special rules that are discussed in further detail below, for most employers *qualifying revenues* are defined in a manner that is consistent with the ordinary meaning of that term. That is, it

means “cash, receivables or other consideration arising in the course of the ordinary activities of the eligible entity”, but excludes:

- extraordinary items;
- amounts derived from persons or partnerships not dealing at arm’s length with the employer; and
- amounts received under the CEWS or amounts for which the employer is eligible under the Temporary Wage Subsidy in subsection 153(1.02).

Notably, for the purposes of this definition, *qualifying revenue* only consists of amounts derived from ordinary activities performed by the *eligible entity in Canada* for the particular period. This can pose particular issues for companies engaged in income-earning activities outside Canada or with non-resident entities. Registered charities and tax-exempt entities are also subject to special inclusions and exclusions regarding their revenue-generating activities.

No definition or guidance is provided in the legislation for what constitutes an “extraordinary item”, and the term is not used elsewhere in the ITA. Thus, its ordinary meaning should prevail. An example of an “extraordinary item” might be the proceeds from a sale of capital property, or some other receipt which arose outside the ordinary course of business.

Finally, as noted above, an employer’s CEWS claim is reduced by any amounts which they could receive under the Temporary Wage Subsidy program. The employer need not actually receive those amounts for their CEWS claim to be reduced; they are deemed to receive them regardless of actual receipt. As a result, CEWS applicants must first compute their Temporary Wage Subsidy entitlement before being able to calculate their CEWS claim amount.

Determination of Qualifying Revenues – Elective and Special Rules

The definition of *qualifying revenues* described above sets out the “base case” calculation for the Revenue Decline Test. However, several special rules can affect the employer’s eligibility for the CEWS.

- ***Prior Reference Period Election.*** As noted above, an employer ordinarily needs to undertake a year-over-year comparison for the purposes of the Revenue Decline Test. However, it may file a special election to compare its revenues for the *current reference period* against an average of its *qualifying revenues* for January and February of 2020. That election can have a significant impact on the Revenue Decline Test, particularly where the underlying business is seasonal or newer.

As summarized below, this election is one of two elections that binds the electing employer for all *qualifying periods*.

- ***Consolidated Financials.*** Groups of *eligible entities* that normally prepare their financial statements on a consolidated basis are permitted to determine their *qualifying revenues* on an unconsolidated basis, provided that every member of the group does so. Since taxpayers in Canada, unlike some other jurisdictions, are required to file income tax returns on an unconsolidated basis, electing to use this method should be relatively straightforward for large groups.

- ***Affiliated Groups.*** Groups of *eligible entities* that are members of an affiliated group can jointly elect to determine their *qualifying revenues* on a consolidated basis in accordance with relevant accounting principles. Each member of that electing group must then use the consolidated revenue figure to determine its *qualifying revenues*.
- ***Joint Ventures.*** *Eligible entities* that are owned by participants in a joint venture who derive “all or substantially all” of their *qualifying revenues* from the joint venture are permitted to use the *qualifying revenues* of the joint venture. The joint venture is deemed to be a separate entity for this purpose.
- ***Intra-group Service or Marketing Entities.*** The definition of *qualifying revenue* excludes amounts derived from persons or partnerships not dealing at arm’s length with the *eligible entity*. This is particularly relevant for entities that derive all of their revenue from non-arm’s length sources (e.g., management services companies). However, *eligible entities* that derive “all or substantially all” (generally 90% or greater) of their *qualifying revenues* from non-arm’s length persons are permitted to compute their *qualifying revenues* using a pro-rated formula. In general, that formula compares the revenue decline of each non-arm’s length payee for the relevant period and then pro-rates that decline based on the non-arm’s length payee’s contribution to the *eligible entity’s qualifying revenues*.

The intra-group service or marketing entity and each non-arm’s length payee must jointly elect for this rule to apply.

- ***Cash Method.*** Provided an election is made, an *eligible entity* can compute their *qualifying revenues* using the cash method available to farming and fishing businesses under subsection 28(1) of the ITA.

As discussed below, these special computational rules give rise to a number of important interpretative issues. Additionally, many of these rules can have consequential impacts on the employer’s claim to the CEWS in subsequent *qualifying periods*, as well as the CEWS claims of related entities. Employers and their advisors should carefully consider any such potential impacts prior to claiming the CEWS. A summary of some of these considerations is as follows:

Revenue Rule	Binding on Subsequent Periods	Election Required	Binding on Other Entities ²
Prior Reference Period Election	Yes	Yes	Possibly
Consolidated Financials	No	No	Yes
Affiliated Groups	No	Yes	Yes
Joint Ventures	No	No	Possibly
Intra-Group Service Providers	No	Yes	Possibly
Cash Method	Yes	Yes	Possibly

² The term “possibly”, refers to the possible interaction of multiple revenue rules among themselves, as discussed below.

Particular Interpretive Issues

As time progresses, we expect a number of interpretative issues relating to the revenue computation rules to arise. Further clarification on how these rules apply will undoubtedly be sought. Our review indicates that certain discussion points may be particularly relevant to CEWS claimants, both with respect to the Revenue Decline Test and more broadly:

- Affiliated Groups. The rule for an “affiliated group of eligible entities” could have a potentially broad application. Notably, the term “affiliated group of eligible entities” is not defined in the ITA. Therefore, a number of key interpretative issues arise as to which entities are members of such a group and would be required to make the joint election.
- Intra-Group Service Entities. The pro-ration formula for intra-group service entities is unexpectedly complex. In particular, the formula pro-rates each non-arm’s length payee’s revenue decline based on its *current reference period qualifying revenues*. This may effectively diminish the weight accorded to those non-arm’s length payees’ that have the most significant revenue declines. That result is arguably directly contrary to the intention of the Revenue Decline Test.
- Payroll Agents and Secondment. A payroll account number is required for an *eligible entity* to be a *qualifying entity*; however, not all employers may have a payroll account. For example, one member or a nominee corporation can hold the payroll account and be reimbursed by a group that shares costs (other than in partnership). The various elective and special rules for determining *qualifying revenues* may not appropriately connect the revenue of other entities in the non-affiliated group to the entity that holds the payroll account, such that no one entity meets all of the qualifications for the CEWS.

In secondment situations, the legal employer may be someone other than the entity that bears the cost of an employee’s remuneration. These scenarios raise the issue of whether there must be a direct legal employment relationship between the CEWS claimant and the employee remuneration borne by that claimant.

- Interaction Between Various Rules. There seems to be no reason to suggest that the various rules should be mutually exclusive. To take a simple example, if an operating entity within a group that has a central services corporation elects to use the cash method, presumably their cash method determination of their *qualifying revenues* would impact the calculation of the central services corporation’s *qualifying revenues*, based on the pro-rated formula set out above.

Further, the operating entity may have no employees and, therefore, no reason to apply for the CEWS, other than for the potential impact of its election on the central service corporation’s CEWS claim.

These are only a few of the interpretative issues which claimants may encounter in navigating the CEWS legislation. Undoubtedly, further issues will become apparent as time goes on.

V. HOW THE CEWS IS CALCULATED

Key Terminology

In order to calculate the amounts of the CEWS, there are several key terms that are relevant.

- Eligible Employee: Only amounts paid to an *eligible employee* are included in computing the CEWS.

An *eligible employee* means an individual employed in Canada by the *eligible entity* in the relevant *qualifying period* but excludes individuals who are without remuneration by the *eligible entity* in respect of 14 or more consecutive days in the *qualifying period*. This latter exclusion may exist to prevent “double-dipping” of both the CEWS and the CERB.

- Eligible Remuneration: Only *eligible remuneration* paid to an *eligible employee* is included in computing the CEWS.

Eligible remuneration is defined to mean the most common forms of remuneration that are subject to payroll withholding, being salary, wages and fees for services. It excludes retiring allowances, employee stock option benefits, amounts which will be repaid by the employee or excess remuneration paid to an employee which is designed to increase the *qualifying entity's* CEWS claims.

Calculation of the CEWS

A *qualifying entity's* CEWS entitlement is calculated on a weekly basis. The formula examines the total *eligible remuneration* paid by the claimant to *eligible employees* each week during the relevant *qualifying period*.

The governing formula is complex. However, for most employees the CEWS is equal to the lesser of:

- \$847 per week (approximately \$44,000 annualized); and
- 75% of the *eligible remuneration* paid (meaning that the subsidy will be capped at \$58,725 on an annualized basis).

Once computed, the total of those amounts is:

- reduced by any amounts which the employer is entitled to claim under the Temporary Wage Subsidy in subsection 153(1.02);
- reduced by the total of all amounts received by an *eligible employee* in respect of a work-sharing benefit under the *Employment Insurance Act*; and
- increased by the amount of employer premiums for employment insurance and certain employer pension plan contributions for employees who are on paid leave throughout a particular week, effectively meaning that employers can be refunded 100% of these amounts.

Special Computation Rules

The calculation set out above applies for most typical employees. However, each employee must be analyzed on a case-by-case basis having regard to the following additional rules.

- Non-Arm's Length Employees. Amounts paid to employees who do not deal at arm's length with their employer (for example, owner-managers) do not qualify for the CEWS unless those employees were being paid *eligible remuneration* during the period between January 1 and March 15, 2020, excluding any period of seven or more consecutive days for which the employee was not remunerated ("**baseline remuneration**").
- Employees Whose Pay is Reduced. The concept of *baseline remuneration* is also relevant for computing the CEWS in respect of employees who have taken a limited pay cut in the *qualifying period* relative to their pre-pandemic earnings. In effect, the formula computes the CEWS with reference to the *baseline remuneration*, rather than the *eligible remuneration* actually paid, provided the employee's remuneration reduction did not exceed 25%.
- Employees With Multiple Employers. If an *eligible employee* receives *eligible remuneration* from two or more *qualifying entities* that do not deal with each other at arm's length, the total CEWS attributable to that employee cannot exceed the amount of the CEWS that would arise if that employee's remuneration was only paid by one employer.

VI. PENALTIES, ANTI-AVOIDANCE RULE AND ADMINISTRATIVE AMENDMENTS

Given the significant fiscal impact of the CEWS, unsurprisingly Bill C-14 included a number of new administrative provisions. The context of the CEWS also no doubt influenced certain of those provisions since vast sums are proposed to be released in a very short period of time. In particular, several measures have been added to deter claimants from applying for the CEWS in inappropriate circumstances. The most significant of those provisions are summarized below.

- Anti-Avoidance Rule and Associated Penalty. A new specific anti-avoidance rule applies where:
 - an *eligible entity*, or a person who does not deal at arm's length with the *eligible entity*, enters into a transaction or series of transactions, or takes any other action (or fails to take an action), that has the effect of reducing the *qualifying revenues* of the *eligible entity* for the *current reference period*; and
 - it is reasonable to conclude that one of the main purposes of that transaction, series or (in)action was to cause the *eligible entity* to qualify for the CEWS.

If the anti-avoidance rule applies, the *eligible entity* is deemed to have suffered no revenue decline for the purposes of the Revenue Decline Test. Thus, it is ineligible for the CEWS.

Additionally, where the anti-avoidance rule applies the *eligible entity* is liable to a new penalty equal to 25% of the amount of CEWS overpayment. Such a serious penalty for merely contravening a specific anti-avoidance rule is relatively unique in the ITA.

Simply put, this anti-avoidance rule and the associated penalty are both broad in scope and, given the amounts expected to be paid out under the CEWS, potentially confiscatory. For example, the rule can be engaged where the *eligible entity* fails to take action. Furthermore, the penalty is applied against the *eligible entity*, notwithstanding that the *eligible entity* has, by definition, paid out the amount of the CEWS to its *eligible employees* and no longer has access to those funds.

- *Gross Negligence Penalty*. In addition to the specific penalty noted above, the CEWS application has been added to the list of “statements or omissions” that can trigger the assessment of a gross negligence penalty under subsection 163(2).

In brief, if a person makes (or participates in, assents to, or acquiesces to) a false statement or omission in their CEWS application that is made knowingly or under circumstances amounting to gross negligence, then that person may be liable to a penalty equal to up to 50% of the excessive CEWS. That penalty applies regardless of whether the CEWS was received.

This penalty may be particularly relevant to the individual required to sign the attestation on the application, as well as anyone who participates in the preparation of that application.

- *Disclosure of Applicant Identities and Information*. New provisions explicitly provide the Minister (i.e. the CRA) with the power to disclose to the public the identity of any applicant, without qualification or specific justification, and in whatever format it deems appropriate. To be clear, any applicant may have its name – and, implicitly, the fact that its business suffered dramatically as a result of COVID-19 – disclosed to the public, regardless of whether it qualified for the CEWS or not. The CRA has indicated that it intends to publish a list of all employers who apply for the CEWS.

VII. HOW TO APPLY

As noted above, to claim the CEWS an *eligible entity* must file a prescribed application with the Minister, beginning on April 27, 2020 and before October 1, 2020. Practically, employers who are entitled to the CEWS for the first *qualifying period* (March 15 to April 11, 2020) will presumably apply as soon as possible. CEWS payments to employers are expected to begin on May 7, 2020 and should generally be sent within 10 days of applying to the program. In certain circumstances, employers may consider claiming the Temporary Wage Subsidy until they are able to finalize their CEWS applications (as noted above, eligibility for the Temporary Wage Subsidy will reduce the amount of CEWS that an employer may claim).

CEWS applications will be made online through the *My Business Account* portal or an equivalent web-based application form. Representatives who are authorized with the CRA can also apply on behalf of their clients. A separate application will need to be made for each payroll account (RP) of the employer. The CRA has also provided a calculator to help employers determine the amount of CEWS to claim.

Employers who expect to receive CEWS payments in excess of \$25,000,000 also need to be registered on the Large Value Transfer System.

Given the significant penalties referred to above, CEWS applicants should make maintaining records that support their CEWS claims a priority.

Finally, certain provisions specify that a claimant is not entitled to any CEWS in excess of the amount claimed. Therefore, an applicant may wish to wait until they are certain of their maximum claim before applying. Otherwise, the employer may be prevented from claiming the full amount of the CEWS that they are entitled to.

VIII. CONCLUSION

The CEWS is without doubt an ambitious policy initiative to respond to extraordinary events. The technical mechanism through which it is implemented is direct: an immediately refundable income tax credit to employers who continue to pay wages and other remuneration to their employees in spite of significant revenue declines.

Notwithstanding this relatively simple and direct approach, many employers will need to carefully consider a CEWS claim, both in terms of their eligibility and the amount of the claim. Decisions made, or not made, by employers and other parties will impact their eligibility for current and subsequent CEWS claims. Careful consideration is also warranted due to the significant new penalties that may apply if the claim is subsequently challenged.

UPDATE: This post has been updated to reflect the further details announced by the federal government on April 21 and 27, 2020.

The authors would like to thank Julia Ji, Kyle B. Lamothe and Alexander Demner for their assistance in editing this blog.

indicated: <https://www.canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-frequently-asked-questions.html>