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COVID-19 Tax Update: A Detailed Review of the New Canada Emergency Rent Subsidy (CERS) and Lockdown Support Programs

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I. OVERVIEW

On November 19, 2020, Parliament enacted the Canada Emergency Rent Subsidy ("**CERS**"). Ostensibly designed to replace the underutilized Canada Emergency Commercial Rent Assistance ("**CECRA**"), the CERS subsidizes commercial real estate expenses incurred by businesses negatively affected by COVID-19. For businesses subject to a public health order, the CERS includes a separate, but intertwined, "lockdown support" top-up component.

The CERS is available as of September 27, 2020. Consequently, as of that date businesses qualifying for both the basic CERS and "lockdown support" top-up may receive up to $67,500 per property per month from the federal government. Similar to the Canada Emergency Wage Subsidy (the "**CEWS**"), CERS payments come in the form of a refundable tax credit under the federal *Income Tax Act* (Canada) (the "**ITA**").

Also similar to the CEWS, the rules and technical nuances underlying the CERS are startingly complex. This article aims to assist businesses, and practitioners advising them, with the tools and guidance necessary to safely navigate the new rules – and, ultimately, maximize the monetary amount of any CERS claim.

The CERS is available for expenses paid from September 27, 2020 onwards, and applications can already be made online. To maximize readability, concepts and definitions used below which are derived from CEWS – of which there are many – will not be separately reproduced; readers are advised to refer to our earlier blog posts on the CEWS (here and here) as key reference points.

II. KEY TAKEAWAYS

Broader Application than "Rent"

Despite the title, CERS applies to far more than mere rent. Several types of fixed commercial real estate expenses are eligible for the subsidy. As detailed below, the definition of *qualifying rent expense* includes mortgage interest, insurance, and property taxes. All such expenses are typically borne by the real estate owners, not renters.

Considerable Overlap with CEWS

The CERS adopts and relies upon many of the same definitions and concepts as the CEWS. Indeed, the CERS was placed into the same section of the ITA implementing the CEWS (section 125.7).

For example, CERS eligibility is segregated into the same *qualifying periods*, is based on an entity's *qualifying revenue* decline (calculated using the existing CEWS methodologies), and fits within the same overall framework – including elections, deeming rules, and administrative provisions – as the CEWS.

The two programs are also similar in design and concept. In essence, the CERS is to commercial real estate expenses what the CEWS is to employee wages. Both programs entitle qualifying businesses to a proportional reimbursement of fixed business expenses (each as determined, generally, on a sliding scale proportionate to the entity's revenue decline).

Ironically, although such overlap may increase overall efficiency it may also be detrimental in many cases. Employers seeking to maximize their CEWS claims may take steps – including filing certain elections (or not) – which negatively impact their CERS entitlement, or *vice versa*. For example, a corporate group may consider filing the "affiliated group" election (in s.125.7(4)(b)) to maximize their aggregate CEWS claim, even though it may result in less CERS overall. Entities with few employees but high real estate expenses (or *vice versa*) should be especially mindful of this issue.

Practically, claimants may need to consider both their CEWS and CERS entitlements simultaneously. Before filing a claim for either subsidy, care should be taken to ensure that one does not negatively impact the other.

As an aside, Bill C-9 (which enacted the CERS) contained several key revisions to the CEWS program. See our Tax Alert summarizing those changes here.

Widespread Eligibility and Benefit

Countless businesses will be entitled to the CERS. As noted above, both owners and tenants of real property may qualify, and – as discussed below – only a modicum of revenue decline is required to receive at least some benefit.

The CERS may provide up to up to $67,500 per *qualifying property* per *qualifying period*, and is not restricted to only "small businesses". Therefore, virtually every business regardless of size should consider its CERS entitlement. Realistically, many groups could receive hundreds of thousands of dollars per month under the CERS.

CERS Broader than CECRA

A key point of contention under the CERS' conceptual forebearer – CECRA – was that landlord buy-in was required. Absent a landlord agreeing to forego collecting 25% of rent otherwise payable, CECRA was unavailable to a tenant. In many cases this proved to be a bridge too far for many small business owners.

CERS eliminates that requirement. A tenant may thus qualify and apply on its own accord without reliance on a third party. Any CERS received is paid directly to the affected business. That said, landlords indirectly benefit in that they retain tenants whose rent liability is partly (or largely) financed by the federal government.

"Lockdown Support" Highly Beneficial

Parliament enacted a key "lockdown support" measure alongside the CERS. In essence, businesses subject to a *public health restriction* are entitled to a "top-up" of 25% of *qualifying rent expenses* throughout any *qualifying period* in which such restrictions are in place.

Conceptually, the "lockdown support" program is an add-on to the CERS – much like how the CEWS contains a top-up mechanism for businesses with the most severe revenue decline. Unlike the CEWS, however, the lockdown support is available to all businesses negatively affected by a *public health restriction*, regardless of overall revenue loss (similar to the "cliff" effect in place for the first three *qualifying periods* of the CEWS).

III. CERS – ELIGIBILITY

Qualifying Property

The CERS applies to expenses paid in connection with a *qualifying property*. That term generally includes any commercial real estate in Canada. The only exceptions are "self-contained domestic establishments" – that is, personal dwellings used by the owner (or a non-arm's length person) as a residence. That would seemingly disqualify expenses paid on home offices or in respect of other businesses run from the claimant's home.

Qualifying Periods

As with the CEWS, entitlement to the CERS is segregated into periods (i.e., *qualifying periods*). The same *qualifying periods* used for the CEWS applies to the CERS, with the first *qualifying period* for which the CERS is available being September 27, 2020 to October 24, 2020.

An entity's entitlement to the CERS may vary by *qualifying period*. That is, an entity may qualify for the CERS in one *qualifying period* but not another, depending on (among other things) their applicable revenue decline. However, the deeming rules in s.125.7(9) of the ITA – which permit an entity to rely on its revenue reduction in the immediately-preceding *qualifying period*, if advantageous – also apply to the CERS.

Since the CERS is only effective as of September 27, 2020, it only applies to the eighth *qualifying period* any beyond. No CERS claim may be made in respect of expenses incurred during any of the first seven *qualifying periods*.

Qualifying Renter

To qualify for the CERS in any given *qualifying period*, an applicant must be a *qualifying renter*. As noted elsewhere in this blog, this definition is not restricted to entities that only "rent" real estate. Rather, a *qualifying renter* is any *eligible entity* that:

I. files an application for the CERS no later than 180 days after the end of the relevant *qualifying period*;

II. obtains an attestation, by the individual with principal responsibility for the financial activities of the *eligible entity*, that the application is complete and accurate in all material respects; and

III. meets one of the following conditions:

- on March 15, 2020, the *eligible entity* had a payroll account registered with the Canada Revenue Agency (the "**CRA**");
- on March 15, 2020, the *eligible entity* had a payroll service provider in place to make remittances on its behalf regarding one or more of its employees (and the payroll service provider continues to make such remittances); or
- on September 27, 2020, the *eligible entity* had a CRA business number.

An *eligible entity* means:

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

Public institutions do not qualify for the CERS (or CEWS). Those generally include municipal authorities, crown corporations, schools, school boards, hospitals, and public universities or colleges.

IV. CERS – SUBSIDY AMOUNT

Rent Subsidy Percentage

A *qualifying renter's* subsidy for a given *qualifying period* is based on their *rent subsidy percentage*. That percentage is calculated by reference to the entity's *revenue reduction percentage* ("**RRP**"). Generally, an entity's RRP is their revenue decline as compared between a *current reference period* and the applicable *prior reference period*. The CERS largely adopts the existing CEWS framework – including reference months, elections, and deeming rules – in determining revenue decline.

Conceptually, an entity's *rent subsidy percentage* represents the percentage of *qualifying rent expenses* which the federal government will subsidize (subject to top-up under the "lockdown support" mechanism, analyzed below). There are three general rules for calculating an entity's *rent subsidy percentage*, based on its applicable revenue decline:

1) If an entity's RRP is 70% or more, their *rent subsidy percentage* is 65%.

2) If an entity's RRP is at least 50% but less than 70%, their *rent subsidy percentage* is the amount calculated under the following formula:

   40% + (*revenue reduction percentage* – 50%) x 1.25

3) If an entity's RRP is less than 50%, their *rent subsidy percentage* is 80% of their RRP.

The following table summarizes (in 5% increments) a *qualifying renter's rent subsidy percentage* based on their RRP:

Revenue Reduction Percentage (%)	Rent Subsidy Percentage (%)
70%	65.00%
65%	58.75%
60%	52.50%
55%	46.25%
50%	40.00%
45%	36.00%
40%	32.00%
35%	28.00%
30%	24.00%
25%	20.00%
20%	16.00%
15%	12.00%
10%	8.00%
5%	4.00%
0%	0%

Those amounts are in addition to any top-up available under the "lockdown support" mechanism. As such, each subsidy rate could increase by up to 25% (to a maximum of 90% total).

Qualifying Rent Expenses

At its core, the CERS subsidizes a portion of an entity's *qualifying rent expenses*. There are generally two types of eligible expenses – rent and specified realty costs. Each are described in further detail below.

The *qualifying rent expense* definition contains a few notable aspects of broad application:

- Expenses are aggregated on a property-by-property basis. Each *qualifying property* is subject to its own calculation of *qualifying rent expenses*. A single entity may thus need to make multiple calculations depending on how many commercial real estate properties it uses.

- The maximum monthly expense pool for each *qualifying property* is $75,000. The CERS thus provides for a maximum base subsidy of $48,750 (being 65% of $75,000) per *qualifying property* per *qualifying period* (subject to an aggregate $300,000 expense limit, discussed below).

- Expenses must be paid pursuant to a written agreement entered into before October 9, 2020 (or pursuant to the renewal, on substantially similar terms, or assignment of such agreement). Thus, parties cannot enter in a new agreement now in order to access the CERS.

- Expenses paid to a non-arm's length entity do not qualify. That includes intercompany rent and interest charges. Only amounts paid to arm's length parties may constitute *qualifying rent expenses*.

- Any rent received or receivable from an arm's length party reduces the eligible entity's expense pool. For example, an entity that has $75,000 of *qualifying rent expenses*, but receives $10,000 of rental income during the relevant *qualifying period*, will only be able to claim the CERS on $65,000 of expenses. Note that rent received from a non-arm's length entity does not contribute to that reduction.

The first category of *qualifying rent expenses* is, naturally, rent. The legislation specifically contemplates different types of rental arrangements – including fixed rent arrangements, rent paid as a percentage of sales or profits, or "net lease" arrangements whereby the tenant pays additional property-related expenses (such as insurance, property taxes, and utilities). Sales taxes, payments for damages, interest and penalties, and "fees payable for discrete items or special services" are expressly excluded from the rent calculation.

The current legislation provides that only rent actually "paid" qualifies for the CERS. This would present significant cashflow issues since tenants would need to first pay rent before receiving the CERS. To alleviate that issue, on the same day that the CERS was enacted into law the Department of Finance ("**Finance**") tabled legislative proposals stipulating that rent payable (not just paid) is a *qualifying rent expense* if:

1) the entity attests that it will pay the subject rent within 60 days after receiving the CERS; and

2) the entity does, in fact, pay such rent within 60 days.

Small businesses with limited liquidity could greatly benefit from that change. Finance has already stated that applicants may calculate their CERS claims on the assumption that those amendments will become law with full retroactive effect.

The second category of *qualifying rent expenses* includes interest on mortgage-backed debt (subject to an upper limit, discussed below), insurance, and property (or similar) taxes. For that category, however, properties used primarily to generate rental income do not qualify, unless rented to a non-arm's length person who uses it primarily for purposes other than to generate rental income (e.g., for use in its own active business).

As noted, interest on mortgage-backed debts is subject to a maximum amount. Such interest is only included "to the extent that" the underlying debt obligation does not exceed the lesser of:

- the lowest aggregate principal amount of mortgage-backed debts on the *qualifying property* at any time after its acquisition (excluding any temporary refinancing period); and

- the *cost amount* (i.e., tax cost) of the property to the entity.

The first restriction seemingly excludes any refinancing which results in a higher mortgage principal (whether undertaken to increase a CERS claim or otherwise). The policy rationale for such a broad limitation is unclear.

Similarly, unclear is the result which arises if the debt obligation exceeds the lesser of those two amounts. The phrase "to the extent that" suggests a proportionate reduction to the amount of expense included, such that a portion of the interest (notionally computed on a debt obligation that is the lesser of those two amounts) remains a *qualifying rent expense*. The converse view is that no interest is so included if the debt obligation is excessive. Clarity from Parliament (or the CRA) on that point would be welcome.

Maximum Expense Limit and Affiliated Groups

The CERS formula contains an upper limit of $300,000 for all *qualifying rent expenses* incurred by a *qualifying entity* in a given *qualifying period*. Thus, an entity using more than four commercial properties (for example) may have a restricted CERS claim, even if it expends $75,000 or more per *qualifying period* on each property.

Further, that $300,000 limit must be shared between all affiliated entities. Specifically, if a *qualifying renter* is affiliated with any other *eligible entity* claiming the CERS, each affiliated entity must enter into an agreement (in prescribed form) allocating a percentage of that aggregate $300,000 limit amongst themselves – similar to the rules allocating the $500,000 "small business deduction" business limit among associated entities.

As a consequence, the maximum basic CERS payment per *qualifying period* is $195,000 (being 65% of $300,000). The $75,000 limit per *qualifying property* still applies, however, and thus it is not possible (for example) to simply aggregate all real estate expenses paid across an affiliated group.

Notably, the "affiliated group" language for the CERS is broader, and arguably more precise, than under the CEWS. It more closely matches the language used in the small business deduction context for associated companies. In addition, there is a "transitivity" rule in s.125.7(11) of the ITA which provides that if two *eligible entities* are affiliated with the same third *eligible entity*, they are deemed to be affiliated with each other. This mirrors the rule in s.256(2) of the ITA for determining association, albeit without an election equivalent to s.256(2)(b)(ii) if such transitivity causes inequitable results.

Finally, this transitivity rule only applies to determining the aggregate CERS entitlement of an affiliated group, not their *qualifying revenues*. Consequently, an organization may have one affiliated group for purposes of calculating their aggregate CERS entitlement and a different affiliated group for purposes of calculating their *qualifying revenues*.

Anti-Avoidance Rule

The existing anti-avoidance rule in s.125.7(6) of the ITA has been expanded to cover the CERS. Previously, that rule only applied if a transaction, or series of transactions, resulted in a reduction to an entity's *qualifying revenues* and was undertaken for the purpose of enabling the entity to claim the CEWS or increase its CEWS entitlement.

The anti-avoidance rule now applies if a transaction, or series of transactions, has the effect of increasing the *qualifying rent expenses* of the relevant entity. The purpose test has also been expanded to cover transactions undertaken to increase the amount of a CERS claim.

Interestingly, falling afoul of that rule effectively results in the entity losing its revenue decline, not decreasing (or eliminating) its *qualifying rent expenses* pool. That can lead to a draconian result. For example, if a transaction was intended to only marginally increase an entity's *qualifying rent expenses*, the anti-avoidance rule would seemingly result in a total loss of the CERS (not just negating the marginal benefit sought).

If this anti-avoidance rule applies, the claimant is also subject to a special penalty equal to 25% of the subsidy amount claimed. That penalty has been expressly expanded to CERS claims.

V. LOCKDOWN SUPPORT

Like the CEWS, the CERS contains a "top-up" concept which provides an additional subsidy to certain businesses. Unlike the CEWS, however, the CERS top-up is not limited to businesses suffering the most severe revenue declines. Instead, the focus is on whether the entity it subject to a *public health restriction*. Finance aptly described the mechanism as "lockdown support".

Public Health Restriction

A *public health restriction* is essentially a public health order issued in response to COVID-19 which requires the complete cessation of certain business activities within a defined area. Specifically, a *public health restriction* is defined as an "order or decision" which:

- is made under the laws of Canada or a Province;
- is made in response to COVID-19;
- is limited in scope (based on, e.g., defined geographical boundaries, business type / activities, or location-specific risks);
- provides that non-compliance can result in fines or other legal sanctions;
- does not result from an entity's violation of a previous public health order;
- requires the specific *eligible entity* to wholly cease – for at least one week – some or all of the activities which it would have otherwise carried out at, or in connection with, the specific *qualifying property* (so-called "restricted activities"); and
- prevents restricted activities which generated "at least approximately" 25% of the specific entity's *qualifying revenues* for the *prior reference period* that it earned from, or in connection with, the *qualifying property*.

Notably, an entity may claim the CERS top-up subsidy even if their overall revenues only minimally declined. Take a restaurant prevented from in-room dining which shifted its business model to take-out, for example. Or a fitness center providing online classes. Their overall revenues may not have suffered greatly, though their business model has been greatly disrupted. In that way, the CERS top-up subsidy could arguably be viewed as "business disruption" assistance.

Not all public health orders will trigger access to the CERS top-up. Orders which only limit the hours within which a business may operate, or mandate that physical distance measures be implemented, for example, would not qualify. Businesses subject to those orders would be limited to claiming the basic CERS (and/or CEWS) subsidy.

Top-Up Subsidy Calculation

An entity's top-up entitlement is based on its *rent top-up percentage*. That percentage is 25% if the *eligible entity* is subject to a *public health restriction* throughout the entirety of the applicable *qualifying period*. If a *public health restriction* is only in effect for a portion of the relevant *qualifying period*, the percentage is prorated accordingly; for example, the *rent top-up percentage* is 12.5% if the restrictions are in place for only two out of four weeks in a given *qualifying period*.

An entity's *rent top-up percentage* is then multiplied by its *qualifying rent expenses* to determine its CERS top-up subsidy. As with the basic CERS calculation, eligible expenses for a given *qualifying period* are capped at $75,000 in calculating the top-up subsidy.

Unlike the basic CERS, however, there is no overall limit to an entity's top-up subsidy claim. Further, for affiliated groups each entity is entitled to its own top-up subsidy without regard to claims made by other entities within the group. Larger corporate groups could benefit significantly from that lack of aggregation.

As a result of the lockdown support mechanism, a *qualifying entity* with a revenue decline of at least 70% will be entitled to an aggregate CERS subsidy per *qualifying period* of 90%. Practically, on the first $75,000 of eligible expenses an entity could thus claim $67,500 from the federal government.

VI. APPLICATIONS

The CRA has already opened applications for the CERS. The CRA's main webpage regarding the CERS, with general information and links to the application process, can be found here.

As noted above, *eligible entities* have until 180 days after the end of the relevant *qualifying period* to apply for the CERS and/or lockdown support. For the first *qualifying period* in which those subsidies are available – that is, September 27, 2020 to October 24, 2020 – the application deadline is thus April 22, 2021.