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The Canada Emergency Wage Subsidy: A Guide for Businesses

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Introduction

Parliament has enacted legislation adopting the Canada Emergency Wage Subsidy (CEWS) through amendments to the *Income Tax Act* (ITA). Although the CEWS program is not tax legislation, by implementing the CEWS through the ITA, the government sought to leverage existing income tax systems to distribute the subsidy to employers in a timely manner and to utilize the broad investigative powers and penalty provisions of the ITA to verify and encourage compliance with the terms of the program.

The CEWS, which was adopted on April 11, 2020, is intended to support businesses in their efforts to continue to employ their employees during the COVID-19 pandemic by enabling qualifying entities to obtain an emergency wage subsidy from the federal government. **The program is generally intended to provide a subsidy of 75% of eligible remuneration paid to eligible employees, up to \$847 per week, per employee. Special rules exist with respect to remuneration paid to non-arm's length employees.**

An employer must experience a decline of at least 15% in qualifying revenue in March 2020 or 30% in either April or May 2020 to be eligible to receive the CEWS in the qualifying period corresponding to each month. An employer that qualifies for the CEWS in one of these periods automatically qualifies for the CEWS in the following period. To determine whether the requisite decline in revenue has occurred in a particular period, the employer's qualifying revenue in the period is compared with its revenue in a particular pre-pandemic "benchmark" period.

The government has announced that the CEWS will be in place for a 12-week period, from March 15 to June 6, 2020. However, it may extend the CEWS for additional periods up to September 30, 2020.

Qualifying for the CEWS

Eligible Businesses

In order for an employer to qualify for the CEWS, it must first be an "eligible entity." The legislation currently contemplates the following types of eligible entities:

- a corporation that is not exempt from ITA Part I tax;
- an individual;
- a registered charity;
- certain non-profit organizations;
- a partnership comprised exclusively of eligible entities; and
- any other organization prescribed by the government.

Public institutions – including local governments, Crown corporations, schools, school boards, public universities and colleges, hospitals and health authorities – are not eligible entities for purposes of the CEWS.

Although the scope of eligible entities is quite broad, it is notable that the definition looks to the entity that carries on the business, and not to the business itself. **Taxpayers who have structured their businesses as multiple divisions within a single entity may be treated differently under the rules from those that have formed a separate entity for each business.** In particular, where multiple businesses are carried on in a single entity, the financial results for these businesses will automatically be aggregated for purposes of determining whether the entity qualifies for the CEWS, meaning that a business that might qualify for the CEWS if it were carried on in a separate entity may not qualify if it is one of a number of divisions within a single entity.

Qualifying Periods

The CEWS will run for at least 12 weeks, consisting of the following three “qualifying periods” of four weeks each:

- March 15, 2020–April 11, 2020;
- April 12, 2020–May 9, 2020; and
- May 10, 2020–June 6, 2020.

As the economic impact of the COVID-19 pandemic is yet unknown and constantly evolving, the CEWS’ provisions permit the government to extend the program until September 30, 2020, with appropriate adjustments to the amount of the subsidy and revenue reductions necessary to qualify.

Eligibility for the CEWS is determined for each qualifying period, except that an eligible entity that qualifies for the CEWS in a particular qualifying period will automatically qualify for the subsidy in the immediately following qualifying period. For example, an eligible entity that qualifies for the March 15–April 11, 2020 period will automatically qualify for the April 12–May 9, 2020 period. **However, an eligible entity must submit an application for each qualifying period in which it wishes to obtain the CEWS, even if it automatically qualifies for the subsidy in such period.**

Reference Periods and Requisite Reduction in Qualifying Revenue

To determine whether an eligible entity qualifies for the CEWS, its “qualifying revenue” during the applicable “current reference period” is compared with its qualifying revenue during the applicable “prior reference period.” **To qualify, the eligible entity’s qualifying revenue during the current reference period must have decreased by at least 15% in March 2020 for the qualifying period running from March 15 to April 11, 2020, and by at least 30% in either subsequent qualifying period** (subject to automatic qualification, as discussed above).

The Current Reference Period

The current reference period in respect of each qualifying period is the calendar month in which the qualifying period commences. For example, March 2020 is the current reference period for the March 15–April 11, 2020 qualifying period.

The Prior Reference Period

An eligible entity can select one of two methods for determining the prior reference period. Thus, the entity may select whichever method is most favourable in its particular circumstances. However, **once an entity has selected a method for determining the prior reference period, it must use that method for each of the three CEWS qualifying periods.**

Under the first method, the prior reference period is the corresponding 2019 calendar month. Accordingly, an eligible entity using this method would compare its qualifying revenue in March 2020 with its qualifying revenue in March 2019 to determine whether it is eligible for the CEWS during the March 15–April 11, 2020 qualifying period. The entity would then compare its April 2020 qualifying revenue with its April 2019 qualifying revenue for the following qualifying period, and so on. This first method is the default method for determining the

prior reference period, meaning that an eligible entity will automatically be required to use this method unless it elects to use the alternative method described below for all three of the initial qualifying periods.

Under the alternative method, the prior reference period is January and February 2020, using the entity's average monthly qualifying revenue for these two months. This period is prorated to the extent that the entity did not carry on business throughout the whole of January and February 2020. The alternative method is intended to provide relief for new entities that may not have carried on business during March, April or May 2019 or whose operations have scaled up significantly over the past 12 months, though it is not limited to such entities. The proration mechanism also serves to provide a benchmark for startups whose operations commenced during January or February 2020.

While the flexibility presented by these alternative methods provides welcome relief to many Canadian businesses, there may be others for which neither method for determining the prior reference period accurately reflects the impact of the COVID-19 pandemic on their businesses. Businesses that may fall through the cracks could include those with high seasonality or that have contracts that will keep them busy through May 2020 but that may not be renewed.

Requisite Reduction in Qualifying Revenue

To qualify for the CEWS, an eligible entity's qualifying revenue in the current reference period cannot exceed the "specified percentage" of its qualifying revenue in the prior reference period.

The specified percentage in respect of the March 15–April 11, 2020 qualifying period is 85%, and the specified percentage in respect of the two subsequent qualifying periods is 70%. Accordingly, to qualify for the CEWS in respect of the March 15–April 11, 2020 qualifying period, an eligible entity's March 2020 qualifying revenue must have declined by at least 15% relative to the applicable prior reference period. For each of the subsequent qualifying periods, the requisite revenue decline increases to 30%. The lower 15% figure was used for the initial qualifying period because the COVID-19 pandemic was not declared until March 15, 2020, and thus the impact of the pandemic on some Canadian businesses was largely felt during the second half of March 2020.

Revenue Computation Rules

Qualifying Revenue

An entity's qualifying revenue for purposes of determining its eligibility for the CEWS includes the inflows of cash, receivables or other consideration arising in the course of its ordinary activities in Canada in the particular period. However, an entity's qualifying revenue excludes the following receipts:

- extraordinary items;
- amounts received from non-arm's length persons;
- amounts received under the CEWS or the previously announced 10% Temporary Wage Subsidy; and
- for registered charities and non-profit organizations, funding from government sources (if the charity or organization so elects).

In general, an eligible entity's qualifying revenue is determined in accordance with its usual accounting practices. However, as discussed below, some flexibility has been provided for closely held groups and entities that earn all or substantially all of their revenue from non-arm's length sources. In addition, any eligible entity can elect to determine its revenue using the cash method of accounting, though such an election must be made for all qualifying periods.

Accordingly, an eligible entity should take an appropriately long-term view of its business in selecting the appropriate accounting method by which to determine its qualifying revenue. **Entities whose receivables carry high default risk or whose major customers have been particularly hard-hit by the pandemic may wish to consider using the cash method of accounting to ensure that they receive timely recognition of doubtful accounts and/or bad debts for revenue computation purposes.**

Special Rules for Closely Held Groups

The CEWS rules provide eligible entities within a closely held group with additional flexibility in calculating their qualifying revenue for purposes of determining their eligibility for the CEWS.

Consolidation and “De-consolidation”

Eligible entities within a group that normally prepares its financial statements on a consolidated basis may determine their qualifying revenue separately. However, this option is available only if every member of the group determines its qualifying revenue on this basis.

Conversely, an affiliated group of eligible entities (i.e., generally, entities under common control) can jointly elect to determine the qualifying revenue of the group on a consolidated basis in accordance with relevant accounting principles. Consequently, each eligible entity within the group would qualify for the CEWS if the group as a whole qualifies. This option is available only if every member of the affiliated group makes the joint election, though the intended scope is not entirely clear. For example, consider a group of three affiliated corporations. Can two of these corporations (which would also constitute an affiliated group) elect to determine their qualifying revenue on a consolidated basis, or must the election be made by all three? It is hoped that this and other interpretive questions will be answered by the Canada Revenue Agency (CRA) in the coming weeks.

Entities Earning Revenue from Non-Arm’s Length Sources

The CEWS provides a specific relieving rule for entities that earn all or substantially all (generally, 90% or more) of their revenue from non-arm’s length sources. This rule is a corollary to the exclusion of revenue from non-arm’s length sources from the definition of qualifying revenue because eligible entities that earn significant non-arm’s length revenue may fail to show the necessary decline in qualifying revenue regardless of the actual decline suffered by such entities.

To access this relieving rule, an eligible entity must earn all or substantially all of its qualifying revenue (determined without reference to the non-arm’s length revenue exclusion) from non-arm’s length persons and each such person must make a joint election with the eligible entity. Where these requirements are met, the eligible entity’s qualification for the CEWS will be determined by the reduction in qualifying revenue experienced by the particular non-arm’s-length persons from whom it earns revenue. Where the eligible entity earns revenue from more than one non-arm’s length person, its reduction in qualifying revenue is determined by the weighted-average reduction experienced by each such person.

The qualifying revenue of a particular non-arm’s length person for these purposes need not arise from activities in Canada. Thus, an eligible entity that earns all or substantially all of its revenue from non-arm’s length non-residents should be able to access the CEWS if such non-residents experience the requisite revenue reduction in respect of their foreign-based activities.

Amount and Tax Treatment of the Subsidy

Determining the Amount of the Subsidy

The CEWS is generally intended to provide a subsidy of 75% of remuneration (i.e., normal salary, wages and other qualifying remuneration) paid to eligible employees, up to \$847 per week, per employee. In its previous announcements regarding the CEWS, **the government encouraged employers to use the subsidy to top up employees’ wages to pre-crisis levels. However, the CEWS does not require employers to do so.**

Eligible Employees

An eligible employee is an individual employed in Canada by the eligible entity in the qualifying period who was not without remuneration for 14 or more consecutive days during that period. **The eligible entity must employ the individual in order to claim the wage subsidy in respect of that individual.** Thus, for example, if an eligible entity that meets the revenue test pays services fees to another

entity in the larger corporate group for the use of individuals employed by that other entity, the payer entity would not be able to claim the wage subsidy in respect of these employees. "Head office" structures might, therefore, be unable to access the CEWS in respect of the head office employees unless it meets the test described above under "Entities Earning Revenue from Non-Arm's Length Sources."

Computing the Subsidy

Generally speaking, the amount of the subsidy is equal to 75% of the greater of the employee's "eligible remuneration" paid in respect of the week and their "baseline remuneration," up to a maximum of \$847. An employee's eligible remuneration includes normal salary, wages and other qualifying remuneration (such as fees and commissions). However, retiring allowances, stock option benefits and amounts that can be expected to be repaid are excluded. Amounts may also be excluded in certain circumstances in which the employee's remuneration is increased in order to artificially increase the amount of the wage subsidy available to the employer. An employee's baseline remuneration is equal to the average weekly eligible remuneration paid to them from January 1, 2020, to March 15, 2020, excluding any period of seven or more consecutive days for which the employee was not remunerated.

In the case of arm's length employees whose eligible remuneration paid for the week is equal to or greater than their baseline remuneration (e.g., where their salary has stayed the same or increased), the amount of the subsidy will be equal to 75% of the eligible remuneration paid to them that week, up to the \$847 cap per employee. However, where employees' eligible remuneration is less than their baseline remuneration (e.g., where their salary has decreased), the amount of the subsidy will be equal to the lesser of 75% of their baseline remuneration and 100% of the eligible remuneration paid to them in the particular week (again, subject to the \$847 cap per employee).

In effect, the CEWS sets an eligible remuneration "floor" for arm's length employees of 75% of their baseline remuneration, since the subsidy will cover 100% of employees' wages up to this amount. In addition, subject to the cap of \$847 per week and the rules discussed above regarding artificial increases, the subsidy will cover 75% of any increase in arm's length employees' eligible remuneration above their baseline remuneration.

Slightly different rules apply if the employee does not deal at arm's length with the eligible entity, such as where the eligible entity is controlled by the employee or a person related to the employee, as might be the case in a family-owned business. In such a case, the wage subsidy is equal to the lesser of the amount of eligible remuneration paid for the week and 75% of the employee's baseline remuneration, up to the \$847 weekly cap. Thus, the subsidy does not provide for a floor in respect of non-arm's length employees, nor does it cover any increases in non-arm's length employees' eligible remuneration above their baseline remuneration.

Other Amounts That Increase or Reduce the Subsidy

The amount received by an eligible entity under the CEWS is reduced by any benefit it received under the 10% Temporary Wage Subsidy program and any work-sharing benefits received by an eligible employee under the *Employment Insurance Act*.

On the other hand, the amount of the CEWS is increased by amounts payable by the eligible entity as employer premiums or contributions under the *Employment Insurance Act*, the *Canada Pension Plan* (or equivalent provincial plan) and Québec's *Parental Insurance Plan* in respect of eligible employees that are on paid leave.

Distribution of the Subsidy

The CEWS will be distributed by deeming an entity that qualifies for the subsidy to have overpaid income taxes in the amount of the subsidy. The legislation provides that the Minister may refund such deemed overpayments at any time in the taxation year in which an overpayment is deemed to have arisen.

Tax Treatment of the Subsidy

Any subsidy received will be treated as government assistance for purposes of the ITA and thus included in an eligible entity's income for the taxation year. The eligible entity should then be able to offset the inclusion with a corresponding deduction in respect of remuneration paid to its employees. However, the treatment of the subsidy as government assistance may have

unintended consequences for certain taxpayers, such as those who earn investment tax credits in respect of scientific research and experimental development expenditures.

Anti-Abuse Rules

Anti-Avoidance and Penalties

There is a broad anti-avoidance rule that deems an entity not to be eligible for the CEWS where, in general terms, it artificially reduces its revenue in order to qualify for the CEWS.

Where this anti-avoidance rule applies, the entity will be required to repay any subsidy it received and will automatically be liable for a penalty equal to 25% of the subsidy it claimed under the CEWS. In addition, the general gross negligence penalty in the ITA has been extended to apply to amounts received under the CEWS. Thus, an additional penalty equal to 50% of any subsidy received under the CEWS may be imposed on an entity when it can be demonstrated that it knowingly, or under circumstances amounting to gross negligence, applied for the CEWS using false or misleading information.

Public Disclosure of an Applicant's Identity

Although taxpayer information collected by the government is typically considered to be confidential, this is not the case with respect to the identity of taxpayers that apply for the CEWS. The enacting legislation provides that the government is entitled, but not obligated, to publicize, in any manner considered appropriate, the name of any person or partnership that applies for relief under the CEWS. Presumably, the government intended this provision to reduce the risk of fraudulent use of the program. However, it could give rise to privacy concerns, especially with respect to individual applicants, and reputational risk for applicants. The government has not yet provided any directives concerning the possible use of this extraordinary power.

Applying for the CEWS

To apply for the CEWS, an eligible entity must file an application with CRA before October 2020. A separate application must be filed for each qualifying period, even if the entity automatically qualifies for the CEWS in the period in question because it experienced the requisite decline in qualifying revenue in the previous period.

The government has announced that applications can be filed through an entity's CRA My Business Account portal or using an online application form. An individual who has principal responsibility for the financial activities of the entity must attest that the application is complete and accurate in all material respects.

The CRA's website provides a question-and-answer page dedicated to the CEWS.

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