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## Be Prepared: Audits of Canada Emergency Wage Subsidy Claims Underway

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A key part of the Canadian government's response to the COVID-19 pandemic has been the Canada Emergency Wage Subsidy (CEWS). Although the CEWS has undergone a number of changes over the past year, its basic framework has remained the same: a wage subsidy of up to 75% of eligible remuneration (subject to a cap) paid by employers that have suffered a decline in revenue during the pandemic in comparison with a corresponding pre-pandemic period. In its most recent costing estimate, the [Parliamentary Budget Officer](#) estimated that the CEWS will cost \$85.6 billion in 2020-21 and \$13.9 billion in 2021-22 (with about \$11.5 billion and \$1.9 billion, respectively, recovered in corporate income taxes), making it the costliest element of Canada's COVID-19 Economic Response Plan.

With a historic deficit, the Canadian government will need to find solutions to offset its unprecedented spending. The Canada Revenue Agency (CRA) has already informed taxpayers that it intends to closely scrutinize CEWS claims. And it has issued warnings that employers that do not meet the CEWS eligibility criteria or that abuse the program will face severe penalties, even fines, in addition to having to reimburse, with interest, amounts previously received.

According to the CRA, as of April 11, 2021, it had approved 3,141,900 claims for the CEWS out of a total of 3,171,960 claims received – an initial acceptance rate of nearly 99%.

In its report released on [March 25, 2021](#) (OAG Report), the Office of the Auditor General (OAG) applauded Finance Canada and the CRA for its rapid design and implementation of the CEWS. However, the OAG cautioned that the CRA did not have the appropriate information to validate the reasonableness of CEWS applications before issuing payments and chose to forgo certain controls in order to expedite payments.

Even though the CEWS is an ongoing program and Budget 2021 proposes to extend it until September 25, 2021, post-payment audits began in August 2020. The CRA has announced that a sampling of employers of all sizes across Canada will be used to identify risks and compliance issues related to CEWS claims. An inaccurate or unfounded CEWS claim could result in significant financial hardship to the employer in question, especially since the scope of an audit initiated by the CRA would not necessarily be limited to the CEWS claim. A CEWS audit could therefore precipitate a review of other tax matters disclosed in connection with the claim. The same can be said for the Canada Emergency Rent Subsidy as well as the new Canada Recovery Hiring Program announced in Budget 2021, which raise similar audit questions and could involve substantial claims.

In this context, what best practices should be adopted to minimize the impact of such audits and protect the rights of the taxpayers that submitted such claims?

### The CRA's Audit Powers

The CRA has very powerful tools at its disposal and broad audit powers to ensure compliance with Canadian tax legislation.<sup>1</sup> However, these powers must still be used fairly and reasonably.

The CRA expects employers to maintain proper accounting records when submitting a CEWS claim. The CRA also requires employers to ensure that their claims are complete and accurate. For this purpose, any CEWS application must be accompanied by an attestation signed by the person in charge of the employer's finances. This attestation states that the "employer has and will maintain records for CRA review that demonstrate the revenue reduction, eligible remuneration paid to employees and any other information required to verify

the amount of the CEWS claim.” By signing the attestation, the person in charge of the employer’s finances acknowledges that making a false attestation is a criminal offence. Subject to solicitor-client privilege, these records will need to be disclosed to the CRA during an audit – if requested.

The CRA therefore expects that ledgers, journals, financial statements, contracts, elections, calculations or other working papers, payroll records, sales invoices and any other relevant document will be readily available in the event of an audit of a CEWS claim. Remember that in the course of an audit, the CRA cannot require the creation of documents that do not exist at the time of the claim under audit; nor can it (for the moment<sup>2</sup>) ask a taxpayer to provide documents that reveal uncertain tax positions such as tax accrual working papers.

CRA requests for information that have already been sent to claimants have required the following documents and information, and they also outline additional documents that may be requested in connection with a CRA audit.

- a. partnership agreements, banking resolutions and directors’ resolutions that demonstrate the decision-making process and approvals that authorize the officers of the relevant entity to submit a CEWS claim;
- b. contracts and agreements relating to intercompany advances and loans;
- c. internal policies regarding the use of funds for all items included in revenues, including deferred revenues, deductions or unearned revenues;
- d. internal policies relating to products for all items included in revenues, including deferred revenues, deductions or unearned revenues;
- e. summary of revenue sources based on geographic source (i.e., in Canada as opposed to foreign jurisdictions);
- f. employment contracts of eligible employees and proof of payment to such employees;
- g. data supporting manual calculations seeking to align irregular pay periods with weekly periods for CEWS purposes; and
- h. detailed payroll journal and proof of payment to employees.

The CRA has stated that some information requests sent out were in fact “templates” and in the future that auditors would limit the scope of the documents requested in connection with a CEWS audit.

Furthermore, according to the OAG Report, it would appear that, as of June 2020, the CRA had troubling data about figures used by some employers as part of their applications. The OAG questioned the CRA’s decision not to promptly initiate targeted audits after obtaining this data. In this regard, the CRA stated that more comprehensive audits of CEWS recipients will begin in spring 2021 and will take place over several years.

It will therefore be important to promptly discuss with the auditor assigned to the audit the scope of such requests and the relevance of some items sought in order to possibly narrow the focus and avoid overflow. The information requested must, in fact, be narrowed down to avoid imposing an excessive burden on taxpayers. A taxpayer is entitled to ask why a document is required, and the CRA auditor should explain the reasons for the request. The CRA should be transparent and quickly disclose the scope of an audit.

The following are practical tips to minimize the impact of a potential audit for employers that have received the CEWS.

## 1. Document everything from the start!

*Be proactive* from the moment you start preparing your CEWS claim.

The CEWS was adopted in a hurry and amended multiple times, with more modifications likely on the way. The administrative positions on which a claim for a given qualifying period is based may change in a few months; it is therefore important to properly support and document your claim.

For example, archiving copies of various published government documents and online resources would be useful – for instance, the CRA's Frequently Asked Questions webpage (which makes notable administrative concessions but has been gone through several iterations since its inception). The OAG Report recommended the use of business intelligence data to further identify ineligible recipients – a recommendation that the Minister of National Revenue (the Minister) adopted. Accordingly, the consistency of information provided to the CRA should also be kept in mind.

A well-prepared employer will have immediate answers for an auditor at the start of an audit and will thereby demonstrate, both subjectively and objectively, that its claim was prepared diligently and with care. This may help reduce the scope of an audit and increase the claim's credibility.

## 2. Separate documents protected by solicitor-client privilege

Tax authorities are not entitled to access documents that are protected by solicitor-client privilege. Broadly, solicitor-client privilege applies to confidential communications between a lawyer and client relating to the research, development or provision of legal advice. A taxpayer must not accidentally waive privilege by delivering privileged documents to tax authorities.

To avoid any mistakes, employers should store documents protected by solicitor-client privilege *separately* from other documents prepared to support the CEWS (or any other COVID-19 support) claim – for example, legal opinions discussing an employer's eligibility for the subsidy, the computation of qualifying revenue, the characterization of eligible remuneration or, even, whether it was reasonable to conclude that one of the main purposes for entering into a transaction was to increase the amount of CEWS.

## 3. Designate a contact person

Limiting the number of persons in contact with the CRA will allow questions to be answered in a consistent manner and reduce the risk of conveying inaccurate, incomplete or even contradictory information.<sup>3</sup>

It is therefore important to quickly identify a *single person* to be the employer's contact person in its communications with the CRA and, whenever possible, all exchanges with the CRA should be in writing. This could be important if the primary contact person or any other person involved in the claim leaves the company in the future. Furthermore, since an audit could take place several years from now, these writings will help refresh the memory of these individuals at a later stage. It would also be wise to confirm telephone conversations with an auditor in writing.

Likewise, be on the lookout for any potential contact of eligible employees by the CRA. Such employees, and any other person not identified as the primary contact person, should refrain from communicating with the CRA, either formally or informally.

## Challenging a CRA Determination

Under the ITA, the CEWS is distributed by deeming an eligible employer that qualifies for a subsidy to have overpaid income taxes equal to the amount of the subsidy it is entitled to under the program. This mechanism was put in place to allow the government to rely on an established system in order to quickly make payments to eligible employers.

For claims submitted after September 21, 2020,<sup>4</sup> a notice of determination or notice of assessment will be issued if the CEWS claim is denied, in whole or in part. An employer that disagrees with the CRA's determination may challenge the determination in accordance with the usual recourse in tax matters. A taxpayer has 90 days from the date of a notice of assessment, reassessment or determination to file a notice of objection, and 90 days from the CRA's decision regarding the objection to file a notice of appeal to the Tax Court of Canada. A notice of determination may be issued "at any time" by the CRA. Thus, CEWS audits could very well continue over time without constraint. This is consistent with the Minister's statement issued in March 2021 with respect to ongoing CEWS audits and compliance activities continuing over the next several years. Not many provisions within the ITA are not subject to a limitation period as is the case here. Moreover, for the time being, a taxpayer appears unable to request that a notice of determination be issued or that an audit of its CEWS claim be initiated – unlike, for example, a request for a notice of loss determination, which can be made by a taxpayer under the ITA.

## Amending a CEWS Claim

A CEWS claim may be amended by the due date for filing the wage subsidy application for that claim period. In its FAQs, the CRA indicated that it will accept a late-filed amended wage subsidy application at any time if the application seeks to reduce the amount of wage subsidy claimed. The CRA has discretion to accept an application that seeks to increase the amount of wage subsidy claimed for the claim period (an upwards adjustment). Requests for a late-filed amended wage subsidy application seeking an upwards adjustment must be made within 30 calendar days following the later of (i) April 21, 2021, and (ii) the applicable filing deadline.

<sup>1</sup> See sections 231.1, 231.2, 231.6, 231.7 and 232 of the *Income Tax Act* (ITA), and *Redeemer Foundation v Canada (National Revenue)*, 2008 SCC 46.

<sup>2</sup> Budget 2021 provides for new requirements for specified corporations to report uncertain tax treatments. However, no draft legislation had been released at the time of publication of this bulletin.

<sup>3</sup> Note that the CRA recently stated that CEWS audits will be similar to other audits conducted under the ITA, and they will likely begin with a call or a letter. The CRA's procedures in this respect have changed somewhat due to the current COVID-19 situation.

<sup>4</sup> The CRA had announced that the administrative review process would apply to CEWS claims denied, in whole or in part, prior to September 21, 2020, and for which a request for review was made within 30 days of the date of the letter setting out the CRA's original decision. The decision following the second review will be communicated to the eligible employer in writing, and subsequently a notice of determination or notice of assessment will be issued for the claim period.

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