

Canada Emergency Wage Subsidy: Detailed Commentary on New Income Tax Act Section 125.7

On Saturday, April 11, 2020, parliament held a rare weekend debate to pass Bill C-14, a bill containing legislation for the proposed Canada Emergency Wage Subsidy (“CEWS”). The government chose to enact CEWS by adding section 125.7 to the Income Tax Act (“Act”). As we will see in this commentary, this was the right decision. First, many of the existing concepts found in the Act will help administer this subsidy. Second, it will help flow billions of dollars to companies during the COVID-19 crisis without significant interpretive uncertainties.

The explanation of the rules published in the department of finance’s [website](#) is a good starting point to determine whether you qualify or not. Once that is determined, the legislation clarifies how to compute the subsidy with detailed rules, especially for corporate groups. In this post, we have summarized this sophisticated piece of legislation. We hope that our commentary will help remove the veil of uncertainty surrounding these rules for Canadian businesses.

Contents

The CEWS Subsidy Calculation	2
Commentary.....	3
Definitions	4
Baseline Remuneration.....	4
Qualifying Period.....	4
Current Reference Period	4
Prior Reference Period	5
Commentary.....	5
Eligible Employee.....	5
Commentary:.....	6
Eligible Entity.....	6
Public Institution.....	6
Eligible Remuneration	6
Commentary.....	7
Qualifying Entity.....	8
Commentary.....	8
Qualifying Revenue	9
Specified Percentage	9
Other Rules	10
CEWS deemed to be government assistance.....	10
.....	1

Computation of Revenue for Corporate Groups and Management Companies.....	10
Rules to Prevent Multiplying CEWS Between Non-Arm’s Length Entities.....	12
Anti-Avoidance Rules to Avoid Artificial Reduction of Qualifying Revenues	12
Penalty – Artificial Reduction of Qualifying Revenues.....	13
Partnerships Deemed to be a Taxpayer	13
Automatic Meeting of Revenue Test in the Subsequent Period.....	13
False statements or omissions Penalty.....	13
CRA Permitted to Issue CEWS without Tax Return Filed.....	14
Interest on refunds and repayments.....	14
References to Prescribed Rules	14

The CEWS Subsidy Calculation

The wage subsidy is available for a **qualifying entity** for a **qualifying period**. The wage subsidy is treated as an overpayment on account of the qualifying entity’s liability for income tax for the taxation year in which the qualifying period ends. You will find many definitions in the calculation of the CEWS subsidy, we explain each of these in detail below.

The CEWS for the qualifying period is determined by the following formula:

$$A - B - C + D$$

where

A = is the total of all amounts, each of which is for an *eligible employee* in respect of a week in the qualifying period, equal to the greater of:

(a) the least of

- (i) 75% of **eligible remuneration** paid to the **eligible employee** in respect of that week,
- (ii) \$847, and
- (iii) if the **eligible employee** does not deal at arm’s length with the **qualifying entity** in the qualifying period, nil, and

(b) the least of

- (i) the amount of **eligible remuneration** paid to the **eligible employee** in respect of that week,

(ii) 75% of **baseline remuneration** in respect of the **eligible employee** determined for that week, and

(iii) \$847;

B = is the total of all amounts deemed to have been remitted under subsection 153(1.02) by the **qualifying entity** in the **qualifying period**. This refers to benefits received under the 10% wage subsidy.

C = is the total of all amounts received by the **eligible employee** for each week in the **qualifying period** as a work-sharing benefit under the *Employment Insurance Act*; and

D = is the total of all amounts, each of which is for an eligible employee in respect of a week in the qualifying period, if the eligible employee is on leave with pay for that week and the amount is

(a) an amount payable by the **qualifying entity**

(i) as an employer's premium under EI, or

(ii) as an employer's contribution under CPP or QPP, or

(b) an amount payable by the qualifying entity as an employer's premium under the *Act respecting parental insurance*, CQLR, c. A-29.011.

Commentary

The CEWS subsidy is treated as an overpayment of the qualifying entity's income taxes for the taxation year in which the qualifying period ends. In other words, when you get the subsidy, it is on the basis as if you overpaid your taxes (though in reality, this may not be the case). We see the analysis that you must undertake as follows:

1. Make sure you are a qualifying entity for CEWS.
2. Choose a week in the qualifying period.
3. for each eligible employee compute the following two amounts:
 - a. **eligible remuneration** paid to that employee in respect of a given week falling in the qualifying period. Note that the legislation does not say that a person must be paid weekly. All it says is that we need to determine the amount of eligible remuneration paid to the eligible employee in respect of a particular week falling in the qualifying period. Pay attention to the two anti-avoidance provisions we discuss in the commentary below under the definition of *eligible remuneration*.

- b. **baseline remuneration** paid to that employee (this is the average weekly eligible remuneration paid to the eligible employee by the eligible entity from January 1, 2020 to March 15, 2020, excluding any period of seven or more consecutive days where the employee was not remunerated.)
4. Reduce the CEWS benefit by any benefits received under the 10% wage subsidy.
5. For employees on leave with pay, you are entitled to receive back the employer's portion of the CPP and EI in respect of that employee. Note that the legislation does not state that the employee must be on leave due to COVID-19 reasons, so there could be instances where the employee is on leave without pay for non-COVID 19 reasons, whereby the employer receives the CEWS and/or the return of CPP/EI.

Definitions

Baseline Remuneration

Average weekly *eligible remuneration* paid to the *eligible employee* by the *eligible entity* from January 1, 2020 to March 15, 2020, excluding any period of seven or more consecutive days where the employee was not remunerated.

Qualifying Period

This definition is used to figure out the subsidy for three periods between March 15 to June 6, 2020. A Qualifying period is:

- (a) the period from March 15, 2020 to April 11, 2020;
- (b) the period from April 12, 2020 to May 9, 2020; or
- (c) the period from May 10, 2020 to June 6, 2020;

Current Reference Period

The Current Reference Period for a *qualifying period*, means

- (a) for the qualifying period from March 15, 2020 to April 11, 2020, March 2020;
- (b) for the qualifying period from April 12, 2020 to May 9, 2020, April 2020;
- (c) for the qualifying period from May 10, 2020 to June 6, 2020, May 2020; and

(d) for a prescribed period that ends no later than September 30, 2020, a prescribed period.

Prior Reference Period

This definition sets out the baseline comparison period to compare Current Reference Period revenues with. In summary, an eligible entity can choose one of the following two Prior Reference Period.

1. The Year-Over-Year Method

- (a) March 2019 – for the period from March 15, 2020 to April 11, 2020,
- (b) April 2019 – for the period from April 12, 2020 to May 9, 2020, and
- (c) May 2019 – for the period from May 10, 2020 to June 6, 2020.

2. The Alternate Method

- (a) January and February 2020, if the eligible entity meets one of the two conditions:
 - i. on March 1, 2019, the eligible entity was not carrying on business or otherwise carrying on its ordinary activities, or
 - ii. the eligible entity elects for all of the qualifying periods to use the Alternate Method.

Commentary

Normally, you are required to compare current reference period revenues to the revenues in the corresponding month in the preceding year. However, you are allowed to compare current reference period revenues to the average extrapolated January and February 2020 revenues (see computation under “Qualifying Entity”). To do so, you must meet least one of the following two conditions:

1. On March 1, 2019, the business didn’t exist, or if it did, it was not carrying on its ordinary activities. We don’t know what “carrying on ordinary activities” means but the backgrounder does say that this flexibility was put in place to help sectors that faced difficulties in 2019 (probably to an extent they were not able to continue business as usual); or
2. The eligible entity makes an election for ALL of the qualifying periods that they apply for CWES to use January and February 2020 as their reference period instead of the prior year. There doesn’t seem to be any forms you need to fill out to elect. Employers would select the general year-over-year or the alternative approach when first applying for the CEWS and would be required to use the same approach for the entire duration of the program.

Eligible Employee

Only remuneration paid to the eligible employees qualifies for CEWS. An eligible employee must meet the following three conditions:

1. must be employed in Canada by the eligible entity in the qualifying period; and
2. cannot be without remuneration by the eligible entity for 14 or more consecutive days in the qualifying period.

Commentary:

- Suppose an employee was without pay from the eligible entity for 14 consecutive days during April 12, 2020 to May 9, 2020. In this case, you cannot receive the CEWS for this employee. However, if the employee was paid for at least one day in that period, then you can get the CEWS for this employee. Therefore, give thought to how you structure leaves of absences for your employees.
- The individual must be an employee and cannot be an independent contractor.

Eligible Entity

Only Eligible Entities qualify for CEWS. An Eligible Entity is one of the following entities listed below:

- (a) a corporation, other than a tax-exempt corporation or a public institution;
- (b) an individual;
- (c) a registered charity, other than a public institution;
- (d) a person that is exempt from tax under this Part because of paragraph 149(1)(e), (j), (k) or (l), other than a public institution (these include agricultural organization, a board of trade or a chamber of commerce, non-profit corporations for scientific research and experimental development, labour organizations, and non-profit organizations); or
- (e) a partnership, all of the members of which are described in (a) to (d).

Public Institution

Public institutions are not Eligible Entities for the CEWS. These include: crown corporations, corporations owned by the crown, municipalities, wholly-owned municipal corporations, schools, school boards, hospitals, health authorities, public universities, and colleges.

Eligible Remuneration

Only eligible remuneration paid to *eligible employees* of an eligible entity qualifies for CEWS. For this purpose, Eligible Remuneration generally means:

- Amounts described in paragraph 153(1)(a) or (g), which is generally salary, wages or other remuneration, including fees, commissions or other amounts for services.
- The following amounts are deemed NOT to be Eligible Remuneration:
 - i. A retiring allowance;
 - ii. amounts deemed to have been received by eligible employees as stock option benefits under paragraphs 7(1)(a) to (d.1);
 - iii. any amount received that can reasonably be expected to be paid or returned back, directly or indirectly, in any manner whatever, to
 - the eligible entity,
 - a persons not dealing at arm's length with the eligible entity, or
 - other persons at the direction of the eligible entity; and
 - iv. any amount that is paid in respect of a week in the qualifying period, if, as part of an arrangement involving the eligible employee and the eligible entity,
 - the amount is in excess of the eligible employee's baseline remuneration,
 - after the qualifying period, the eligible employee is reasonably expected to be paid a lower weekly amount than their baseline remuneration, and
 - one of the main purposes for the arrangement is to increase CEWS.

Commentary

In this definition, eligible remuneration is any salary, wages or other remuneration, including fees, commissions or other amounts for services. Of things to note, this eligible remuneration **does not** include:

- Amounts that may be returned in the broadest manner, whatever back to the employer.
- Remuneration paid in a qualifying period where the employee and the employer scheme to increase the remuneration compared to the baseline remuneration (i.e., the pre-crisis remuneration) in a qualifying period to maximize the CEWS payment, and after the qualifying period, the employee is expected to be paid a lower weekly amount than their baseline remuneration. Note the words “one of the main purposes.” Therefore, as long as one of the dominating reasons for increasing remuneration during the qualifying period compared to periods after that is to maximize CEWS, then the remuneration may not qualify for CEWS.
- Anti-abuse rules are in place to ensure that the subsidy is not inappropriately obtained and to ensure that employees are paid the amounts they are owed.

Qualifying Entity

An *eligible entity* has to be a *qualifying entity* in order to qualify for CEWS. A qualifying entity must meet the following four conditions:

1. **Application** - files an application with the CRA for the qualifying period before October 2020;
2. **Attestation** - the individual who has principal responsibility for the financial activities has to attest that the application is complete and accurate in all material respects;
3. **Revenue Test** – its *Qualifying Revenues* for the *Current Reference Period* are equal to or less than the *Specified Percentage*, for the Qualifying Period, of
 - i. if the Year-Over-Year *prior reference period* applies – its *Qualifying Revenues* for the Prior Reference Period (i.e., the prior year corresponding month), or
 - ii. If the Alternate (January and February 2020) prior *Reference Period* is used, the amount determined by the formula:

$$0.5 \times A \times (B/C)$$

where

A is its qualifying revenues for the prior reference period,

B is the number of days in the prior reference period, and

C is the number of days in the prior reference period during which the eligible entity was carrying on business; and

4. **Registered for Payroll Account** – it had, on March 15, 2020, a business number in respect of which it is registered with the Minister to make remittances required under section 153.

Commentary

- You have until September 30, 2020 to apply for CEWS.
- You need to have a payroll account (RP Account) with CRA on March 15, 2020, if you create one later, you cannot qualify.
- There is no verification of revenues, an appropriate individual who is responsible for financial activities of the eligible employer must attest that the application is complete and accurate in all material respects.
- If the alternate prior reference period is used, then take the average revenues over January and February 2020, extrapolated over the entire period if the business was only carried on for a portion of the time in January and February 2020.

- For example, suppose a company started its operations on February 1, 2020 and earned revenues of \$100,000 in February 2020. Its qualifying revenues is equal to \$103,448 ($0.5 \times \$100,000 \times (60/29)$).

Qualifying Revenue

Qualifying Revenue is a calculation of revenues used for the revenue test to see if an eligible entity is a qualifying entity for CEWS.

Qualifying Revenue of an eligible entity for a prior reference period or a current reference period means (i) the inflow of cash, (ii) receivables or (iii) other consideration arising in the course of the ordinary activities of the eligible entity — generally from the sale of goods, the rendering of services and the use by others of resources of the eligible entity — in Canada in the particular period, subject to the following rules:

1. It excludes extraordinary items;
2. It excludes amounts derived from persons or partnerships not dealing at arm's length with the eligible entity;
3. It excludes amounts received for CEWS and the 10% wage subsidy.
4. For registered charities,
 - Qualifying revenues include (i) revenue from a *related business* (as defined in subsection 149.1(1)) and (ii) gifts and other amounts received in the course of its ordinary activities. (A related business includes a business that is unrelated to the purposes of the charitable organization if substantially all those employed in the business are unpaid volunteers.)
 - However, the eligible entity may elect to exclude funding received from government sources in calculating its qualifying revenue for all of its prior reference periods *and* current reference periods. It seems like if this election is made for the prior reference period, then you must also exclude government funding from the current reference period revenues.
5. For agricultural organization, a board of trade or a chamber of commerce, and other non-profit corporations:
 - Qualifying revenues include membership fees and other amounts received in the course of its ordinary activities, and
 - the eligible entity may elect to exclude funding received from government sources in calculating qualifying revenue for all of its prior reference periods and current reference periods;

Specified Percentage

The Specified Percentage is used to determine if there is a required reduction in revenue to determine whether there is a drop of at least 15% of their revenue in March 2020 and 30% for the following months.

The Specified Percentage for a qualifying period, means:

- (a) 85% -- for the qualifying period March 15, 2020 to April 11, 2020,
- (b) 70% -- for the qualifying period March 15, 2020 to April 11, 2020 *and* May 10, 2020 to June 6, 2020, and

Other Rules

CEWS deemed to be government assistance

Since the CEWS works as a deemed overpayment of tax, subsection 125.7(3) deems CEWS to be considered government assistance received immediately before the end of the qualifying period to which it relates. Government assistance payments are taxable in the year that it is received under subsection 12(1)(x).

Computation of Revenue for Corporate Groups and Management Companies

Subsection 125.7(4) has special rules for how Qualifying Revenue is to be computed. These are summarized here:

Accounting Method & Consolidated Revenues

- The qualifying revenue of an eligible entity is to be determined following normal accounting practices under paragraph 125.7(4)(a).
- If a group of eligible entities normally prepares consolidated financial statements, each member of the group may determine its qualifying revenue separately, provided every member of the group determines its qualifying revenue on that basis. Under “normal accounting practices,” a parent may be required to prepare consolidated financial statements. Therefore, revenues may be computed on a consolidated basis. This provision allows for parents and subsidiaries to calculate revenues on a legal entity basis as long as every member of the group determines revenues on an entity-by-entity basis.

Cash Method of Accounting

- Paragraph 125.7(4)(e) allows an eligible entity to make an election, which must apply for all qualifying periods, to determine its revenues based on the cash method, within the meaning assigned by subsection 28(1) with any modifications that the circumstances require.
- Business income is generally computed under section 9 on an accrual basis, following ordinary accounting and business practices. However, under section 28, a taxpayer can make an election to compute the income from a farming (or fishing) business under the cash method. The

concession under paragraph 125.7(4)(e) permits all eligible entities (including those that are not farm or fishing businesses) to apply the cash method as prescribed by section 28, with appropriate modifications that circumstances may require.

Option to Consolidate Revenues for Affiliated Groups

- If an eligible entity and each member of an affiliated group jointly elect under paragraph 125.7(4)(c), the qualifying revenue of the group determined on a consolidated basis in accordance with relevant accounting principles is to be used for each member of the group.
- Suppose A and B are affiliated entities. If they both elect under 125.7(4)(b), A and B can consolidate their revenues. The consolidated revenue is now each of A and B's Qualifying Revenue for the Revenue Test mentioned above.

Joint Venture Revenues

A joint venture by itself is not an eligible entity. Under paragraph 125.7(4)(c), If all or substantially all (greater than or equal to 90%) of the qualifying revenue of the eligible entity for a qualifying period is in respect of the joint venture, then the eligible entity may use the qualifying revenues of the joint venture (determined as if the joint venture were an eligible entity) instead of its qualifying revenues for the purposes of Revenue Test in the definition *qualifying entity*.

Joint Election for Inter-Corporate Revenues

It seems like the following rule is there to facilitate situations where eligible employees may be in one entity ("A"), which earns non-arm's length revenues from another member in that same group ("B") where B earns revenues from arm's length Canadian sources.

Paragraph 125.7(4)(d) provides that if all or substantially all (generally, greater than or equal to 90%) of an eligible entity's qualifying revenue (including revenues from non-arm's length persons) for a qualifying period is from one or more non-arm's length persons and each particular person jointly elects with the eligible entity, for the purposes of the Revenue Test, the following rules apply.

- (a) the eligible entity's qualifying revenue for the prior reference period is deemed to be \$100, and
- (b) the eligible entity's qualifying revenue for the current reference period is deemed to be the total of all amounts, each of which is determined by the formula:

$$\mathbf{\$100(A/B)(C/D)}$$

where

A = the eligible entity's qualifying revenue (including non-arm's length revenues) for the current reference period attributable to a particular person or partnership,

B = the total of all amounts, each of which is the eligible entity's qualifying revenue for the current reference period attributable to a particular person or partnership,

C = the particular person's qualifying revenue (including non-Canadian revenues) for the current reference period, and

D = the particular person's qualifying revenue (including non-Canadian revenues) for the prior reference period.

Example of Inter-Corporate Revenue Election under 125.7(4)(d)

Suppose the following situation exists:

- Opco earns revenues from third parties equal to:
 - \$200,000 in the current reference period, and
 - \$500,000 in the prior reference period
- Management Co employs all the staff, and it earns the following management fee revenues from Opco, which is a related party:
 - \$100,000 in the current reference period, and
 - \$250,000 in the prior reference period
- Management Co earns no other revenues.

Applying the Rules under 125.7(4)(d):

- All or substantially all of Management Co's revenues are from Opco, a non-arm's length person;
- Management Co and Opco jointly elect to have this paragraph apply;
- Management Co's prior reference period is deemed to be \$100;
- Management Co's current reference period is deemed to be \$40 ($\$100 \times (100,000/100,000) \times (200,000/500,000)$);
- Therefore, Management Co will compare \$40 to \$100 in determining whether it is a qualifying entity for CEWS.

Rules to Prevent Multiplying CEWS Between Non-Arm's Length Entities

Under paragraph 125.7(5)(b), if an eligible employee is employed in a week by two or more qualifying entities that do not deal with each other at arm's length, the total CEWS in respect of the eligible employee for that week CANNOT exceed the amount that would arise if the eligible employee's eligible remuneration for that week were paid by one qualifying entity. This rule prevents two entities in the group from employing the same employee as a way to multiply the CEWS subsidy.

Anti-Avoidance Rules to Avoid Artificial Reduction of Qualifying Revenues

Subsection 125.7(6) has anti-avoidance rules to prevent employers from artificially reducing revenues in the current reference period. The qualifying revenue of an eligible entity for a *current reference period* for a qualifying period is deemed to be equal to the qualifying revenue of the eligible entity for the *relevant prior reference period*, if all the following two conditions are met:

1. the eligible entity, or a non-arm's length person enters into a transaction (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
2. it is reasonable to conclude that one of the main purposes of the action or failure thereof in (a) is to cause an eligible entity to qualify for CEWS for that qualifying period.

Not only does this anti-avoidance provision looks at overt actions or transactions, but it also includes the failure to take action for the purpose of reducing current reference period revenues.

Penalty – Artificial Reduction of Qualifying Revenues

Subsection 163(2.901) provides that every eligible entity that is deemed by subsection 125.7(6) to engage in artificial transactions to reduce revenue to claim the CEWS, is liable to a penalty equal to 25% of the value of the subsidy claimed.

Partnerships Deemed to be a Taxpayer

As we noted above, since the CEWS is administered through the income tax act, it is deemed to be an overpayment of tax. Since partnerships are not liable for tax (instead its partners are liable), under subsection 125.7(7), a partnership is deemed:

- (a) for the purpose of the CEWS and related provisions to be a taxpayer; and
- (b) to have liability for tax for a taxation year in which a qualifying period ends.

Automatic Meeting of Revenue Test in the Subsequent Period

Subsection 125.7(9) provides that if an eligible entity meets the Revenue Test in a particular qualifying period, then the eligible entity is deemed to meet the Revenue Test for the immediately following qualifying period.

This was put in place to provide certainty for employers. According to Finance Canada, an employer with a revenue drop of more than 15% in March would qualify for the first and second periods of the program, covering remuneration paid between March 15 and May 9. Similarly, an employer with a revenue drop of 30% in April would qualify for the second and third periods of the program, covering remuneration paid between May 10 to June 6.

False statements or omissions Penalty

Paragraph 163(2)(i) provides that every person who makes or acquiesced in the making of a false statement or omission in the CEWS application either knowingly or under circumstances amounting to gross negligence, there is a penalty of the greater of \$100 and 50% of the total of the excess CEWS subsidy received. Partnerships are liable as if they were corporations by virtue of paragraph 169(2.9)(i).

CRA Permitted to Issue CEWS without Tax Return Filed

Subsection 164(2.01) provides that the CRA shall not refund an overpayment of tax unless the taxpayer has filed all of its returns that are required to be filed are actually filed. However, for the purpose of CEWS, subsection 164(1.6) provides that despite what subsection (2.01) says, if at any time after the beginning of a taxation year the taxpayer is entitled to CEWS (which is treated as an overpayment of tax) the CRA may refund to the taxpayer all or any part of the overpayment. This rule permits CRA to issue a “refund” for the CEWS without a taxpayer having to file a tax return for that period.

The legislation did not comment on whether such deemed overpayment will be refunded in instances where the eligible employer owes an amount to the CRA for any outstanding income, HST, or payroll taxes.

Interest on refunds and repayments

Subsection 164(3) provides that CRA does not have to pay interest on the CEWS payments. This is similar to other benefits such as the GST credit or the Canada child tax benefit.

References to Prescribed Rules

There are many references to prescribed legislation. Prescribed amounts and rules are often administered through the Income Tax Regulations, which is easier to pass into law. This gives the government flexibility to make changes to the CEWS without having to go through a rigorous parliamentary process. This could include changing the numbers involved or perhaps even extending the CEWS program beyond June 6, 2020 depending on the COVID-19 situation. However, it appears that the furthest the government can extend the CEWS is September 30, 2020.