CURRENT ISSUES

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Current Issues: CRA Audit Issues Relating to CEWS and CEBA, the Time Limits and Other Periods Act, and Recent CRA Technical Interpretations and Administrative Announcements.

Introduction

2020 is an extraordinary year. It is not every year federal and provincial budgets are delayed or significantly out of date within days or weeks of announcement. Every week, sometimes everyday, new programs were announced to support Canadians during the COVID-19 pandemic. Both the federal and provincial governments launched unprecedented fiscal programs to support Canadians, businesses and jobs. The majority of the federal support was to support employment. The Department of Finance drafted legislation with unprecedented speed and the Canada Revenue Agency (CRA) announced administrative positions to support Canadians. This year's current issues topic will discuss the audit issues associated with the Canada Emergency Wage Subsidy (CEWS) and the Canadian Emergency Business Account (CEBA), select CRA technical interpretations and administrative announcements, new legislation which will affect time limits in the administration of the *Income Tax Act* (Canada) during 2020 and select budget announcements. The paper primarily focused on CEWS as this appears to be the federal program likely to attract the most audit issues.

Canada Emergency Wage Subsidy

The Canada Emergency Wage Subsidy (CEWS) regime was first introduced and passed into law by the government on April 11, 2020. The rules were subsequently amended through a bill introduced on July 20, 2020. These amendments were enacted on July 27, 2020. The CEWS program is administered through the income tax system as a deemed overpayment of Part I income tax, and most of the CEWS provisions were added to the Act as new section 125.7. As of September 13, 2020, there has been more than 312,000 unique applicants with approved CEWS claims and $35.3 billion of CEWS subsidies handed out.[1] It is beyond a doubt that the government will provide sizable resources to the CRA in the coming years on comprehensive post-claim audits.

At the time of the preparation of this paper, most employers entitled to CEWS had already applied for several months of CEWS, and most advisors are generally familiar with the mechanics of the program. The CRA has provided a number of resources on the program, including an excel calculator[2] and a very useful frequently asked question webpage[3] (referred to throughout this paper as the "CEWS FAQ"). There are also already many excellent publications and tools that comprehensively covers how the CEWS program works.[4] Rather than rehash the basic mechanics of the program, this section of the paper focuses on issues that may arise on future CRA audits relating to the CEWS program and how CEWS claimants may be able to prepare for them.

Documentation supporting CEWS calculations, monthly revenues and elections

The first and best defence when facing a CEWS audit is having documentation on the basics. A file should be set up to retain all CEWS related documentation.

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[1] The Government of Canada publishes CEWS claims statistics and update them continuously on this webpage: https://www.canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-statistics.html

[2] https://www.canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-calculate-subsidy-amount.html

[3] https://www.canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-frequently-asked-questions.html

[4] For example, see *Ryan Keey, "Covid-19 – Canada Emergency Wage Subsidy (CEWS)", Thomson Reuters, July 28, 2020.* Third-party CEWS calculators are also available, such as the tool from Tax Templates Inc. Also, for a flowchart depiction of the CEWS rules, please refer to the CEWS Entitlement flowchart prepared by Moodys Tax: https://www.moodystax.com/flowcharts/cews-entitlement/

All computation of CEWS amounts for each qualifying period should be retained. The calculation should be clearly laid out using either the CEWS calculator spreadsheet offered on the CRA website, a CEWS calculator product from a reputable provider, or a manually prepared calculation that correctly follows the CEWS mechanics contained in section 125.7. Detailed employee payroll record for each week should be kept. It is expected that total CEWS amount received for each employee will have to be disclosed on their T4 slips. The aggregate CEWS disclosed on the T4's should agree with the total CEWS claims per the employer's CRA 'My Account' portal.

Since the CEWS calculation is based on monthly revenue declines, it is vital to retain detailed accounting record of monthly revenues for all relevant current and prior reference periods in 2019 and 2020. Detailed supporting documentation of all revenue items for these months should be kept.

Also, a Form RC661 "Attestation for owner/managers and/or senior employees (comptroller/VP Finance/CFO) of an eligible employer applying for the Canada Emergency Wage Subsidy" should be prepared, signed and retained for each qualifying period. Since there is no prescribed form for the various CEWS elections, this form will effectively serve as evidence of the CEWS elections made for each qualifying period.

When preparing this paper, a redacted letter from the CRA has been shared with the authors informing of a certain taxpayer of a "limited scope audit" on its CEWS application. The letter requested the taxpayer provide to the CRA a tremendous amount of information to facilitate the audit, such as:

- Minute book documents including information on all entities within the corporate group, all inter-company loans and advances, and directors' resolutions demonstrating decision-making process and approvals for making the CEWS claims;

- 2019 and 2020 revenue details such as general ledgers, monthly and yearly trial balances, monthly sales report breaking down revenue type and source, sales journal, and cash receipts journals;

- Detailed computation and description of qualifying revenues;

- Break down of revenues from non-arm's length sources;

- Revenue recognition policy for all revenue items;

- Detailed payroll information by pay period and by employee for all claim periods, including hours or days worked in a week for any irregular pay periods;

- Employment contracts for all employees, and a list of employees who were independent contractors with respect to any qualifying periods;

As reported by the National Post on August 25, 2020,[5] the CRA's goal of these limited scope audits is to gather data to help CRA refine the size and scope of "large-scale audits" that are scheduled for fall of 2020. Our advice: start gathering documents and preparing for a potential audit while memories are fresh.

Qualifying Revenue Audit Issues

Revenue calculated under "normal accounting practices"

Subsection 125.7(4) requires qualifying revenue be calculated in accordance with normal accounting practices of the eligible entity. For some businesses (such as those with significant work-in-progress), timing of revenue recognition can dramatically impact revenue from month to month and thus materially change

[5] Christopher Nardi, "CRA to launch audit pilot project to see if fraud is prevalent in federal wage subsidy program", National Post, Aug 25, 2020

the various revenue decline calculations. These businesses should prepare documentation to describe the monthly revenue recognition methodology used in determining qualifying revenue, and explain how that methodology is consistent with their normal accounting practices.

Normal accounting practices do not have to be accounting practices that follow any recognized accounting principles, as it is simply the accounting practices that the entity normally use. In reality, most business' revenue recognition methodology, even if they do not report under a recognized accounting principle such as the Accounting Standards for Private Enterprises ("ASPE") or the International Financial Reporting Standards ("IFRS"), does not differ too far from these generally accepted accounting methods. Where we often see variations, especially for those that do not follow ASPE or IFRS, are in terms of what items are classified as part of revenue. While this never used to matter for tax, these presentation practices suddenly become important with CEWS because they determine what gets included in, or subtracted from, qualifying revenue.

The definition of qualifying revenue in subsection 125.7(1) does not specifically refer to "revenue". Instead it defines qualifying revenue as "*the inflow of cash, receivables or 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*". This wording however is almost word-for-word lifted from ASPE's definition of revenue.

Per paragraph 3400.03(a) of the ASPE handbook: "Revenue is the inflow of cash, receivables or other considerations arising in the course of the ordinary activities of an enterprise, normally from the sale of goods, the rendering of services and the use by others of enterprise resources yielding interest, royalties and dividends."

This similarity to ASPE together with subsection 125.7(4) instructing claimant to determine qualifying revenue in accordance with its normal accounting practices leave little doubt that qualifying revenue starts with the eligible entity's accounting revenue. Therefore, what is included as part of revenue under the entity's normal accounting practices is included in qualifying revenue. Vice-versa for amounts excluded from accounting revenue.

For instance, an entity that uses the accrual method may have always calculated its revenue net of bad debt. While this presentation is not in accordance with either ASPE or IFRS, it would be this entity's normal accounting practice and it must continue to use this methodology for calculating its qualifying revenue.[6] Upon a CRA audit, the entity should be prepared to explain why its qualifying revenue of its prior and current reference period were reduced by bad debt, and be able to demonstrate how this was consistent with its normal accounting practice pre- and post- Covid.

Another instance where inclusion or exclusion from revenue matters is investment revenues. As stated by the CRA in its response to Q.6-1 of the CEWS FAQ, investment income should be included in qualifying revenue to the extent it "*arises in the course of an eligible employer's ordinary activities in Canada in the particular period, is not an extraordinary item or on account of capital, and is included in revenue under its normal accounting practices*". Therefore, if an eligible entity includes investment revenues in its qualifying revenue determination, it should be prepared to demonstrate how such investment revenues had always been reported as part of revenues under its normal accounting practices.

Exclusion of extraordinary items

Per paragraph (c) of its definition, qualifying revenue excludes any "extraordinary items". This exclusion appears redundant since the preamble of the definition already limited qualifying revenue to amounts "*arising in the course of the ordinary activities of the eligible entity*". Something arising in the course of

[6] In its verbal response to a question at the 2020 International Fiscal Association (Canadian Branch) Young Members Event webinar on 6 August 2020 (Question 15), the CRA appears to confirm this approach.

ordinary activities must already exclude any "extraordinary items". Indeed, paragraph (c) says that this exclusion for extraordinary item is there only "*for greater certainty*".

Why did the legislator feel it is necessary to add this for greater certainty clause? As discussed above, the "ordinary activities" component of the qualifying revenue definition is part of a reference to accounting revenue, which is to be determined in accordance with an entity's normal accounting practice. It is not inconceivable that an entity' normal accounting practice could entail including extraordinary items into revenue. Paragraph (c) then says that such extraordinary items must be excluded, irrespective of normal accounting practice.

So what is an "extraordinary item"?[7] Despite the requirement under subsection 125.7(4) to determine qualifying revenue using normal accounting practices, extraordinary item is actually an outdated concept under both ASPE and IFRS. Neither accounting standards adopted the concept of extraordinary item.[8] In fact, IFRS specifically prohibits amounts from being presented as extraordinary items (IAS 1, para. 87). This is similar in the U.S., where U.S. generally accepted accounting principle ("US GAAP") removed the concept of extraordinary item in 2015 (ASU 2015-01).

Since the Act contains no definition for extraordinary item, and given the requirement to interpret qualifying revenue in accordance to accounting practices, the best authority for what extraordinary item means is likely the obsolete definition found under old Canadian generally accepted accounting principles ("Old GAAP"), section 3480. There, extraordinary items are defined as items that were not expected to occur frequently over several years, that did not typify the normal business activities of the entity, and that did not depend primarily on decisions or determinations by management or owners. As such, extraordinary items are meant to capture truly rare events. This view is aligned with the CRA's.

The CRA's guide for completing the GIFI, RC4088, contains a discussion of what constitutes extraordinary item. In RC4088, the CRA repeated almost word-for-word the definition found in section 3480 of Old GAAP. The CRA also gave examples of what it considers extraordinary item: "*the expropriation of a corporation's or partnership's land and buildings for a highway, the destruction of a large portion of a wheat crop by a tornado, and an explosion in a nuclear reactor resulting in high-level radioactive emission*."

In its response to Q.6-2 of the CEWS FAQ, the CRA gave further commentary on these same criteria, and also explained why the CRA considers emergency government assistance directly related to Covid to be an extraordinary item:

"Generally, the CRA would expect extraordinary items to meet all three of the following characteristics:

> *A. Not be expected to occur regularly or frequently within several years*
>
> *Grants or other government assistance that an entity is eligible to receive on a regular or reoccurring basis would not meet this criteria.*
>
> *B. Not typical of the normal activities or risks inherent in the normal operations of the entity*
>
> *Consideration should be given to the nature of the services or products offered by an entity and the normal environment in which it operates.*

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[7] Discussion of what extraordinary items meant under the various accounting principles are largely taken from *Ryan Keey*, "*Covid-19 – Canada Emergency Wage Subsidy (CEWS)", Thomson Reuters, July 28, 2020.*

[8] The Accounting Standards Board explains its decision to exclude extraordinary item from ASPE in paragraph 175 of the *Accounting Standards for Private Enterprises – Background Information and Basis for Conclusions*.

C. Primarily out of the control of owners or management

Consideration should be given to the extent that inflows are influenced by the decision of owners or management.

The determination of whether an entity has an extraordinary item is a question of fact. However, due to the highly unusual economic impact and response resulting from the COVID-19 crisis, the CRA would generally consider emergency government assistance, including assistance from provinces and municipalities, directly related to COVID-19 to be an extraordinary item. However, the CRA would not consider COVID-19 related government assistance to be extraordinary to the extent that it replaces or is meant to replace normal or recurring government assistance."

It is tempting to try to apply the extraordinary item exclusion to exclude revenue derived from various business activities during Covid to show a lower qualifying revenue in a current reference period. Covid has certainly forced many to adopt different modes of business activities. For example, restaurants switched to take-out and delivery, and spirit producers switched to producing hand sanitizers. While such radical changes in how business is done are due to the extraordinary circumstances of Covid (which is not expected to recur on a regular basis), do they really meet the other two criteria contained in section 3480 of Old GAAP: is it typical of the normal activities of the entity; and does it depend on decisions or determinations by owners or management? The authors believe that these changes in product line or mode of delivery are not really so outside of the normal activities of these restaurants and spirit producers to justify extraordinary item treatment. Furthermore, these adaptations are certainly within the decisions or determinations by the owners or management. Also, the CRA's response to Q.6-2 of the CEWS FAQ appears to have added an additional criterion: that the item in question is not meant to replace normal or recurring amounts. These changes in mode of business are all meant to replace normal or recurring revenues otherwise lost due to Covid, and would therefore fail this apparent new test from the CRA.

In most cases, arguing for exclusion under the extraordinary item category will be an uphill battle. Any business that makes this claim needs to be fully prepared to justify how they meet *all* three criteria of an extraordinary item in Old GAAP section 3480, and maybe even how the amount is not meant to replace normal or recurring revenues. Perhaps an argument can be made that the meaning of extraordinary item is not limited to its restrictive accounting definition under Old GAAP, due to extraordinary item having been made obsolete in accounting standards and therefore cannot be "normal accounting practices". Should this unlikely argument succeed, a claimant may be able to define extraordinary item more broadly.

"In Canada" requirement

The preamble of the qualifying revenue definition requires that the amounts must arise in the course of the ordinary activities of the eligible entity *in Canada*. For some businesses, this may not be a clear cut matter. At one end of the spectrum, a business may carry on all of its activities within Canada but ships products to customers outside Canada. Even though the customer is outside Canada, the revenue arose from activities within Canada and thus the revenue should be included in qualifying revenue. On the other end of the spectrum, an entity may have a branch outside Canada, and derives revenues from activities carried on wholly in that foreign branch. In that case, those revenues would be excluded from qualifying revenue. However, some businesses may have vertical integration across countries within the same entity, so that it is not possible to trace a particular revenue to activities carry on solely within Canada or outside Canada. There is little legislative guidance for that.

Things get messier when foreign entities are consolidated with Canadian entities for purpose of determining qualifying revenue. This may occur because consolidation is the normal accounting practice and the Canadian entity does not make an election under 125.7(4)(a), or because the consolidation election under 125.7(4)(b) is made. On its face, the legislation presents an enigma because the foreign entity's activities generally are not carried on within Canada (if it does, it could be considered to be carrying on business in Canada and be required to file Canadian tax returns). Yet, that foreign entity may be selling to arm's length customers products it acquired from a Canadian entity of the consolidated group that manufactured those

products within Canada. The revenue of the Canadian entities from their sales to that foreign entity must be excluded due to the non-arm's length exclusion in paragraph (d) of the qualifying revenue definition. If the foreign entity then cannot include its third-party sales of those products in qualifying revenue, all revenues associated with those products disappear from the consolidated group's qualifying revenue even though those products originated from Canadian activities.

The CRA attempts to provide guidance on this issue through Q.9-1 of the CEWS FAQ: "*an amount representing a portion of the revenue from a sale to a third party by a non-resident member of the group may be included in computing the qualifying revenue of the eligible employer if it can be demonstrated that it arose in the course of the ordinary activities of the group in Canada. In determining whether a portion of the amount of a sale to a third party arose in Canada, each transaction or series of transactions will need to be considered in light of the facts and circumstances of that particular situation.*" Some interpret this to mean that a foreign entity's revenue may be included in consolidated qualifying revenue so long as such revenue arose from Canadian activities of the group. Under this interpretation, since the product arose from Canadian activities of the group before it was sold to the foreign entity, the foreign entity's sales arose in the course of Canadian activities of the group and therefore should be included in consolidated qualifying revenue.

This may be a reasonable interpretation because "arising in the course of" is a fairly broad term. For example, in *MNR v Yonge-Eglinton Building Ltd.*, the FCA said the following in the context of former paragraph 11(1)(cb), which is a predecessor to paragraph 20(1)(e): "*the words "in the course of" in paragraph 11(1)(cb) are not a reference to the time when the expenses are incurred but are used in the sense of "in connection with" or "incidental to" or "arising from" and refer to the process of carrying out or the things which must be undertaken…*".[9] A part of a business process may be considered as being arising in the course of the process as a whole. Whether this can extend to cover business process undertaken across different entities remain to be seen.

To prepare for CRA scrutiny, claimants should document how each of the items included in qualifying revenue arose in the course of activities in Canada. When facts are uncertain, arguments similar to the above may have to be made to rely on the broad meaning of "arising in the course of" (or making the opposite argument, if a claimant wishes to exclude certain amounts).

Note that paragraph 125.7(4)(d) also provides for a consolidation election if certain conditions are met, but that election removes the "in Canada" requirement so that this is no longer an issue. It is difficult to see the policy justification of this differential treatment between paragraph 125.7(4)(d) and other situations requiring consolidation of qualifying revenues.

Personal income as qualifying revenue

Although CEWS entitlement is always discussed in the context of employees of a business, the CEWS legislation does not necessarily restrict claimants to businesses only. Eligible entity is defined in subsection 125.7(1) to include an individual. The definition of qualifying revenue makes no reference to what types of revenue can be included. In fact, the CRA made it clear that investment income may be included in qualifying revenue in Q.6-1 of the CEWS FAQ, provided that the income arose in ordinary activities and is included in revenue under the entity's normal accounting practice.

Many individuals who do not carry on businesses hire employees. The most common examples are individuals hiring child-care, health-care, and home-care employees for personal needs. To qualify for CEWS, the individual must have suffered the necessary decline in qualifying revenue. The question then is what should be included in the individual's qualifying revenue?

One of the requirements for qualifying revenue is that it needs to be determined in accordance with the entity's normal accounting practice. Does an individual without a business have a normal accounting practice? Probably yes. According to the Webster dictionary, accounting is the system of recording and

[9] 74 D.T.C. 6180, para. 13.

summarizing business *and* financial transactions. It may be said that every individual who files a personal income tax return performs an accounting of their income each year, according to the rules of the Act. And that, is their "normal accounting practice".

Another requirement for qualifying revenue is that the amount must be in the course of the ordinary activities of the entity in Canada. Employment and investment activities can certainly fall within ordinary activities. In fact, the definition of qualifying revenue explicitly mentions "*the rendering of services and the use by others of resources of the eligible entity*" – these aptly describe employment and investment.

Based on the foregoing, there is at least a reasonable filing position for an individual to use a decline in employment and investment income to qualify for the claiming of CEWS for wages they pay to personal employees. This does not appear to be incongruent with the spirit and purpose of the CEWS program. An employee hired to fulfill a personal need is still an employee, the individual employer has suffered a decline in personal income (which in many cases the individual was able to earn due to having the help of those employees, but whether that is true is not a relevant test for the CEWS rules), and the CEWS claimed help that employee retained their job.

To date, the CRA has not commented on this, and the government never explicitly indicated that CEWS may be claimed outside of a business context (although one may be able to point to CRA's comments regarding inclusion of investment revenue in qualifying revenue in Q.6-1 of the CEWS FAQ to be an endorsement of this). Individuals who are making claims on personal care workers should be prepared for CRA scrutiny.

A related issue to this is whether personal income needs to be included in qualifying revenue when the affiliated consolidation election is made under paragraph 125.7(4)(b). Once that election is made, all affiliated entities must determine qualifying revenue on a consolidated basis. Affiliated entities include the controlling individual and their spouse. If it is correct that an individual should include all ordinary activities revenues as qualifying revenue, these personal revenues should be included in the consolidated qualifying revenue whenever the paragraph 125.7(4)(b) election is made.

"Not dealing at arm's length" exclusion

Paragraph (d) of the qualifying revenue definition requires any amounts derived from persons or partnerships not dealing at arm's length with the eligible entity be excluded from qualifying revenue. A CEWS claimant should carefully review its revenues in both current and prior reference periods for amounts derived from non-arm's length sources.

An arm's length relationship is defined in subsection 251(1). Persons not dealing at arm's length with a taxpayer includes the following three categories:

(a) Related persons;

(b) A trust in which the taxpayer (or another person not dealing at arm's length with the taxpayer) is a beneficiary; or

(c) Persons who are factually not dealing at arm's length with the taxpayer.

Revenues earned from family members (spouse, common-law partner, parents, grand-parents, siblings, children, grandchildren, in-laws) or corporations controlled by these family members fall under (a) above and such revenues must be excluded from qualifying revenue.

Category (c), factual non-arm's length, is much harder to determine. It is a question of fact and the criteria generally been used by the courts to find parties to not be dealing at arm's length are:

- A common mind which directs the bargaining for both parties to a transaction;

- Parties act in concert without separate interests; or
- One party having de facto control over the other.

A full discussion of factual non-arm's length is outside the scope of this paper, but much has been written about this topic.[10]

Eligible Remuneration Audit Issues

Remuneration "in respect of" weeks within a qualifying period

Although the calculation of CEWS differs between the first four qualifying periods (March 15, 2020 to July 4, 2020) and the subsequent qualifying periods, CEWS is always calculated based on the amount of eligible remuneration "*in respect of*" weeks within a qualifying period. Furthermore, it is not sufficient to simply determine aggregate eligible remuneration in respect of all the weeks within a qualifying period because there is maximum threshold on a weekly basis to take into account. For qualifying periods (a) to (c.1), it is a maximum of $847 of CEWS per week. For qualifying periods (c.2) to (d), it is a base of $1,129 per week on which the base percentage and top-up percentage is applied.[11]

To illustrate, for the qualifying period (c.4), i.e. August 30, 2020 to September 26, 2020, an employee was paid the following in respect of each week inside that period:

- $800 for the week of August 30;
- $1,500 for the week of September 6;
- $1,500 for the week of September 13; and
- $800 for the week of September 20.

When calculating the CEWS for this qualifying period, it will be necessary to cap the second and third week remuneration to $1,129 per week.

Therefore, to properly calculate CEWS, employers must ascertain eligible remuneration in respect of each week of each qualifying period, on an employee-by-employee basis. Since the beginning and end of each qualifying period do not line up with actual pay periods for most employers, making this necessary determination is sometimes difficult and employers need to have documentation to defend their determination. Below is a discussion of some of these difficult scenarios.

For employees paid on an hourly basis, the employer should identify the hours worked each week by an employee to determine the eligible remuneration in respect of that week. Similar concept should apply for employee paid on a piece-work basis or on commission basis – the employer likely has to determine the employee's production each week and determine how much of the piece-work pay or commission was in respect of that week. This is going to be particularly problematic for employers with employees compensated with 'lumpy' commissions. To illustrate with an extreme example, a sales employee made only one sale in a qualifying period earning a $4,000 commission on that sale, and received no other remuneration during the qualifying period. It may be open for the CRA to argue that the $4,000 relate only to the week of the sale and thus is capped by the weekly maximum, with no eligible remuneration paid in respect of other weeks of the qualifying period. A reasonable counterargument against this may be that

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[10] See for example: Sandra Mah and Mark Meredith, "Factual Non-Arm's-Length Relationships," in Report of Proceedings of the Sixty-Sixth Tax Conference, 2014 Conference Report (Toronto: Canadian Tax Foundation, 2015), 16:1-24, and CRA Folio Income Tax Folio S1-F5-C1, Related Persons and Dealing at Arm's Length

[11] See the CEWS calculation mechanics contained in 125.7(2).

despite of the compensation structure, the commission is in substance remuneration in respect of all working days of the employee even though it is computed based on sales for incentive purpose. The likelihood of success for such counterargument will likely be based on the facts and circumstances of each case.

Sick pay, vacation pay and statutory holiday pay would all be considered eligible remuneration, but it is necessary to determine if they were paid in respect of a certain week for which CEWS was being claimed. In Q.17-3 of the CEWS FAQ, the CRA expressed its views that payment for sick, vacation or statutory holiday time are generally in respect of the days the employee is absent from work for these respective events. Where vacation pay entitlement is paid out in addition to base wages on every paycheque, the vacation pay would be considered in respect of the same week as the wages paid. However, according to the CRA in that same FAQ, lump-sum sick or vacation pay that accrued in a prior period is not considered to be in respect of the week of the payment and do not qualify for CEWS. To make things even more complicated, the CRA said that where an eligible employee receives a lump-sum amount of vacation pay for a week when the employee is taking what would otherwise be unpaid vacation time, a reasonable amount of the lump-sum may be considered to have been paid in respect of the week. See CRA example 9-3 in the CEWS FAQ for an illustration of that last scenario.

While the authors agree that lump-sum vacation or sick pay accrued from a prior period should not be considered to be in respect of the week in which it is paid, the authors do not agree with the CRA's statement that they were simply ineligible for CEWS. According to the CEWS calculation in subsection 125.7(2), CEWS is calculated on eligible remuneration "paid … in respect of [a week in the qualifying period]". This wording does not require the payment of the remuneration to be in the same week (or even within the qualifying period) that the remuneration was in respect of. Therefore, to the extent a pro-rata portion of the lump-sum vacation or sick pay related to a week in a prior qualifying period, the employer should be able to amend the CEWS claim for that prior qualifying period to include that pro-rata portion (assuming those prior weeks were not already capped by the maximum weekly threshold).

How about bonuses? Again, this will be dependent on facts. If the employer can justify the bonus as payment for performance by the eligible employee during weeks throughout the year, the authors believe that the employer should be entitled to include pro-rata portion of that bonus for qualifying periods throughout the year. This may require amending CEWS claims previously filed. Where the employee has already been paid base wages throughout the year, this may be a moot or immaterial issue because eligible remuneration per week is capped by a maximum anyways.

A signing bonus may be more difficult to argue to be in respect of weeks worked during employment. In general, the CRA views signing bonus to be merely an incentive to enter into an employment contract.[12]

Exclusion of retiring allowance, stock option benefits and taxable benefits not actually "paid"

Per paragraphs (a) and (b) of its definition, eligible remuneration cannot include retiring allowance and employee stock option benefits.[13] [14] Care should be taken to ensure these exclusions are considered when computing CEWS (e.g. on a final paycheque to a terminated employee, the severance portion cannot be included in eligible remuneration because it would be considered an retiring allowance, while the regular wages portion of that paycheque would be eligible remuneration). Both retiring allowance and stock option benefits have distinct coding on T4 slips so they will be very apparent to the CRA on an audit.

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[12] See CRA documents #9819311 and #2009-0350531I7.

[13] "Retiring allowance" is defined in subsection 248(1), and the stock option benefit excluded are those described in paragraphs 7(1)(a) to (d.1).

[14] The exclusion of retiring allowance in paragraph (a) of the definition of eligible remuneration is just a "for greater certainty" provision. This is because retiring allowance is actually excluded by the preamble of the definition where it refers to amounts described in paragraph 153(1)(a) or (g). Paragraph 153(1)(a) refers to "salary, wages or other remuneration". The definition of "salary or wages" contained in subsection 248(1) excludes retiring allowance.

Although the definition of eligible remuneration makes no explicit mention of taxable employment benefit, eligible remuneration certainly includes employment benefits. The pre-amble of the eligible remuneration refers to amounts described in paragraph 153(1)(a) or (g). Paragraph 153(1)(a) refers to "salary, wages or other remuneration". The CRA has said that "*when interpreting "salary, wages or other remuneration" used in paragraph 153(1)(a) of the Act, the definition of "salary or wages" in subsection 248(1) of the Act applies*".[15] In subsection 248(1), "salary or wages" is defined to mean income of a taxpayer from an office or employment as computed under subdivision a of Division B of the Act, which includes all of the taxable employment benefit provisions such as section 6.

The CRA however has stated that eligible remuneration cannot include taxable benefits if they are not paid – see CRA's response to Q.17 of the CEWS FAQ. As shown above, eligible remuneration certainly includes taxable employment benefit irrespective of whether they were paid. Therefore, the CRA is likely not saying that unpaid taxable benefits are not eligible remuneration, but is making reference to the requirement in subsection 125.7(2) that CEWS be calculated on eligible remuneration that were "paid … in respect of" a week. If an eligible remuneration was never "paid", it cannot be included in computing CEWS even if it is in respect of a week within a qualifying period.

In Q.17-01 of the CEWS FAQ, the CRA gave the example of automobile standby charge and explained that it is not part of the CEWS calculation because "*the value of such benefit is not eligible remuneration paid to an eligible employee*". The authors believe it is possible to challenge the CRA's position on this.

Payment does not necessarily have to be by the delivery of money. Delivery of other things or services of value, when agreed upon by the parties, also constitutes payment. *In Gibson v. R., the Tax Court examined an order that transferred the husband's equity in the matrimonial home to the wife to satisfy support arrears. The court held that the transfer was a form of payment and that "payment in kind provided there has been an agreement or a binding determination of the value in money of the object given, will suffice"*.[16]

In Johnson v. R., the Tax Court found that redeemed frequent flyer points was an "amount paid", stating that the phrase includes payments made by means of a transfer of a right or thing where the value of the right or thing can be expressed in terms of an amount owing, and is not limited to a transfer or delivery of money alone.[17]

Finally, the CRA maintaining that employment benefits that are not paid in the traditional sense is not considered "paid" for purpose of the Act is contradictory to the CRA's own source withholding policy. Subsection 153(1) requires every person "paying" salary, wages or other remuneration to deduct or withhold from the "payment" source withholding. If non-cash employment taxable benefits are not "paid", then payroll source withholding should not apply to them. However, according to Chapter 1 of the CRA's Guide T4130 *Employers' Guide – Taxable Benefits and Allowances,* non-cash benefit (described as good, service, or property given to employees) are subject to payroll income tax withholding in the pay period. The only exception provided by the Guide to this was if the non-cash taxable benefit was the only remuneration provided to the employee so that there was no remuneration from which to withhold.

So why does the legislation in subsection 125.7(2) uses the phrase "eligible remuneration *paid*"? We think it is simply there to avoid employers from claiming CEWS on accrued wages payable, and for which an actual paycheque was *never* issued to the eligible employee.

Would wages that qualify for government grants be excluded from eligible remuneration?

Because of paragraph (c) of its definition, eligible remuneration excludes any amount received by an employee that can reasonably be expected to be paid or returned, directly or indirectly, in any manner whatever, to the employer, a person or partnership not dealing at arm's length with the employer or at the

[15] CRA document #2017-0735481E5.
[16] 95 D.T.C. 749, para. 11.
[17] 2010 TCC 321 (Informal Procedure), para. 15. This case is later cited in *Air v R.,* 2011 TCC 248.

direction of the employer. While paragraph (c) appears aimed at artificial arrangements where an employer attempts to increase CEWS entitlement by paying wages that will eventually be recovered directly or indirectly from the employees, some has questioned whether it is possible this provision may apply to exclude wages reimbursable under various governmental assistance program. For example, the federal Canada Summer Jobs program provides qualifying employers up to 50% of the provincial or territorial minimum hourly wage paid to Canadian youths.[18] Some provinces have their own wage subsidy programs as well, such as the Back To Work Manitoba program.[19]

While it seems overly lucrative to an employer to have the same wage subsidized by more than one government program, the authors believe there is a reasonable argument that wages reimbursable by governments should not be excluded from eligible remuneration due to paragraph (c). The definition of eligible remuneration begins with the perspective of the employee receiving the remuneration: "*eligible remuneration, of an eligible employee of an eligible entity, means …*". The exclusion in paragraph (c) then refers to any amount received [by the employee] that can reasonably be expected to be paid or returned, directly or indirectly, in any manner whatever, to the employer. In the context of the whole definition, the action of the paying or returning the amount described in paragraph (c) is arguably referring to an action of the employee, not by an independent third party (here, the government). This also aligns with the purpose of paragraph (c) which we presume is limited to dealing with artificial arrangements where wages paid to an employee are cycled back to the employer. The words "in any manner whatever" is likely used to encompass creative ways of cycling money back, and not to stretch the paragraph to include governmental programs. Also, if wages entitled to government assistance were to be excluded from eligible remuneration, arguably paragraph (c) must also exclude the amount of wages covered by CEWS. That certainly is not the way the government has described the CEWS program thus far.

Eligible Employee Status Audit Issues

Employee was not without remuneration for 14 or more consecutive days (Qualifying Periods 1 to 4 only)

For qualifying periods (a) to (c.1), the definition of "eligible employee" in subsection 125.7(1) excludes "an individual who is without remuneration by the eligible entity in respect of 14 or more consecutive days in the qualifying period". Qualifying periods (a) to (c.1) are the first four qualifying periods, beginning March 15, 2020 and ending July 4, 2020.

This exclusion is an easy to trap to miss for employers. The following are broad categories which this exclusion could apply to employees during March 15, 2020 to July 4, 2020:

1. New or rehired employee – if an employee starts with an employer more than 14 days into a qualifying period (e.g. starting on March 29, 2020 which is the 15th day of the first qualifying period), the employee would be without remuneration by the employer for 14 or more consecutive days within that qualifying period. CEWS cannot be claimed in respect of that employee until the subsequent qualifying period.

2. Employee termination – if an employment relationship ends with 14 days or more remaining in the qualifying period (e.g. termination of March 28, 2020 which means there are 14 days remaining in the first qualifying period), the employee would be without remuneration by the employer for 14 or more consecutive days within that qualifying period. CEWS cannot be claimed in respect of that employee since the start of that qualifying period.

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[18] Applicant Guide – Canada Summer Jobs 2020, https://www.canada.ca/content/dam/canada/employment-social-development/services/funding/CSJ2020_applicant_guide.pdf

[19] Under the Back To Work Manitoba program, employers are eligible to receive a reimbursement of 50% of total wages paid between July 16 and October 31, 2020, up to $5,000 per worker.

3. Part time employee – if the work arrangement is such that there is a period of 14 or more consecutive days during which an employee is not remunerated, CEWS cannot be claimed for that employee for the whole qualifying period.

4. Switch of employee between employer entities – if an employee is transferred from one payroll entity to another during a qualifying period, there may be a period of 14 or more consecutive days within the qualifying period in which the employee is not remunerated by one of the payroll entity. If so, that payroll entity cannot claim CEWS in respect of the employee for that qualifying period. This will be the case even if the entities calculate qualifying revenue on consolidated basis.

Employers should review CEWS claims for qualifying periods between March 15, 2020 and July 4, 2020 for any employees who may be in above categories, and make amendments to their CEWS claims where appropriate. Deficiencies in this area should be easy for the CRA to detect as the employee may have claimed Canada Emergency Response Benefit (“CERB”) for the 14-or-more-day unpaid period.

Are the “wages” paid to an employee or someone who is factually a contractor?

Per its definition, an eligible employee has to be an individual employed by the eligible entity. Someone declared as an employee may not necessarily be an employee. The distinction between an employee versus an independent contractor is a question of fact and has been the subject of many court cases and CRA publications.

In 2001, the Supreme Court of Canada reviewed this distinction in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, and summed up the test as follows:

> “The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account. In making this determination, the level of control the employer has over the worker’s activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker’s opportunity for profit in the performance of his or her tasks. It bears repeating that the above factors constitute a non-exhaustive list, and there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of the case.”[20]

If a service provider is found under this test to be acting as a person in business on their own account, that person is not an employee and CEWS cannot be claimed on amounts to that person. This may very well turn out to be a prevalent issue on CEWS audits, as many businesses have converted independent contractors into full or part time employees to maximize CEWS entitlement. Employers should be aware of this and be prepared to defend borderline cases, or to amend incorrect CEWS claims.

Proving employees to be “on leave with pay”

The CEWS program is particularly generous with employers paying employees who are “on leave with pay”. Provided the employer’s revenue reduction percentage or top-up percentage for a qualifying period exceeds 0%, its CEWS is increased by its contribution to the on-leave-with-pay employee’s EI and CPP, and the CEWS formula would usually yield a higher CEWS than for a regular employee (e.g. for qualifying periods (c.2) and (c.3) – CEWS is calculated at 75% of eligible remuneration without needing to meet a 30% revenue decline threshold).

[20] 2001 SCC 59, para. 47 and 48.

Employers who are including on-leave-with-pay eligible employees in their CEWS claims need to ensure those employees are:

- "On leave", meaning that employee does not perform any work throughout the week, and
- "With pay", meaning that employee must be paid throughout the week.

It may be difficult to prove after the fact that an employee is not performing any work during a specific period of time. The best practice here would be for the employer to obtain a signed document from each on-leave-with-pay employee that they had not performed any work for the employer throughout a specified week (consider making this a condition for the employee to get paid for those weeks). Such documentation will be invaluable upon a CRA audit.

Note also that the CRA has stated in its response to Q.20-03 of the CEWS FAQ that the CRA does not consider an employee to be "on leave with pay" if the employee is on a period of paid absence, such as vacation leave, sick leave or a sabbatical, or where the employment relationship has been severed and the terminated employee is paid wages in lieu of termination notice. Whether the CRA's view is correct is likely a matter of what is considered "on leave" under employment law, which is a matter outside of the scope of this paper.

Non-Arm's Length Employees Audit Issues

Baseline remuneration – average weekly eligible remuneration "paid" during a testing period

For remuneration paid to an eligible employee who does not deal at arm's length with the employer, the CEWS calculation is restricted by the "baseline remuneration" for that employee. Baseline remuneration is defined in subsection 125.7(1) to mean the average weekly eligible remuneration paid to an employee (excluding any period of seven or more consecutive days for which the employee was not remunerated) during a default January 1, 2020 to March 15, 2020 testing period, or a different elective testing period during 2019 depending on the qualifying period. Below summarizes the options available:

- Default testing period for all qualifying periods: January 1, 2020 to March 15, 2020
- Elective testing period for qualifying periods (a) to (c): March 1, 2019 to May 31, 2019
- Elective testing period for qualifying period (c.1): either March 1, 2019 to May 31, 2019, or March 1, 2019 to June 30, 2019
- Elective testing period for qualifying periods (c.2) to (d): July 1, 2019 to December 31, 2019

Baseline remuneration is computed on what was "paid" during the testing period. When the original CEWS rules were introduced on April 11, 2020, it was already too late to pay salary or wages to non-arm's length employees during January 1, 2020 to March 15, 2020. The CRA confirms this in its response to Q.18-1 of the CEWS FAQ: "*For a payment of eligible remuneration to be included in baseline remuneration, such an amount must be paid during the relevant baseline remuneration period…*".

By restricting baseline remuneration to amounts paid, it prevented family businesses from inflating CEWS by adding non-arm's length persons to payroll or by increasing non-arm's length employees' remuneration post-Covid. There is little wiggle room on this issue. Earlier we discussed the broad meaning of the word "paid", but "paid" clearly has a different meaning in the Act than just "payable" or "credit". For example, paragraph 20(1)(c) describes an amount "paid in the year *or* payable in respect of the year", and subsection 212(1) describes an amount that a Canadian resident person "pays *or* credits". To have baseline remuneration, the employer must have actually "paid" eligible remuneration during the testing period, and

that could be a transfer of cash or property, a set off against shareholder loan, or some other in-kind payment. A mere journal entry will not be sufficient.[21]

Also, for an amount paid during a testing period to be considered in baseline remuneration, it must be in the nature of an eligible remuneration. The best evidence that payments during the baseline remuneration testing period were eligible remuneration is timely filed payroll source deduction that identified the payroll amount, the period for which the payroll was for and the payroll deductions withheld. Without this, it may be difficult for the employer to prove that the amount was paid during the testing period, and that the amount was not just a loan or dividend to the non-arm's length person.

Baseline remuneration – what is "average weekly eligible remuneration"?

Once it is determined how much eligible remuneration was paid during a testing period, the next issue is how that translates to an employee's "average weekly eligible remuneration" during the testing period. While simple in concept, difficulties can arise.

First, is average weekly eligible remuneration the average weekly amount or the testing period aggregated amount averaged into 7-day increments? In other words, is the exercise to determine the "weekly eligible remuneration" paid for each week of the testing period first then calculates the "average" of all those weekly eligible remuneration during the testing period? Or is the claimant supposed to calculate "average weekly eligible remuneration" based on the mathematical 7-day average of all amounts paid during the testing period?

For example, let's assume a baseline remuneration testing period of January 1, 2020 to March 15, 2020 and an employee is paid a consistent $800 per week throughout that period. Assume payroll was done bi-weekly every second Friday, and the first payroll date of the testing period was January 10, 2020. In this example, the employee would have received five paycheques of $1,600 each (being January 10, January 24, February 7, February 21, and March 6), for a total of $8,000.

Here is what average weekly eligible remuneration would be under the two methods:

- Method #1 – $800 per week. This is because the employee has received five bi-weekly paycheques, meaning ten weeks of pay. The employee was paid $800 for all those ten weeks. Therefore, the average of these weekly payment amount is also $800, being $800 multiplied by 10/10.

- Method #2 – $757 per week, because there were 74 days within the January 1 to March 15 testing period and $8,000 divided by 74 days multiplied by 7 days is $757.

Method #2 results in a lower baseline remuneration in this case because remuneration in respect of March 7 to March 15 cannot be considered, since that was part of the March 20 pay cycle thus paid outside the testing period. But what about a scenario where the eligible remuneration paid during a testing period relates more to work performed outside that period than within it? Assume an owner-manager of a business who worked for the business consistently throughout the year was paid wages only once during 2019 - on December 31, 2019 - in the amount of $30,000. The business is now calculating CEWS for qualifying period (c.2), which is period starting July 5 and ending August 1, 2020. The business makes the election to compute baseline remuneration for this owner-manager based on the testing period July 1, 2019 to December 31, 2019.

Although the owner manager was paid $30,000 of wages on the last day of the year, that $30,000 related to work performed consistently throughout the whole year. Under Method #1, the "weekly eligible remuneration" paid for each week during the six months of July 1, 2019 to December 31, 2019 would be

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[21] It is CRA's longstanding position that journal entries do not, by themselves, constitute payment of remuneration. See CRA document "July 1991 – 48 — Unpaid Remuneration".

$30,000 / 52 weeks, i.e. $576 per week. $576 per week would also be the average weekly eligible remuneration and thus the amount of baseline remuneration. Contrast this with Method #2, under which the baseline remuneration jumps to $1,141 per week, being $30,000 divided by the 184 days in the July 1 to December 31 2019 testing period, then multiplied by 7 days.

In this second scenario, Method #2 yields a significantly better result than Method #1: $1,141 of baseline remuneration instead of $576. Based on the text of the legislation, both methods appear valid. On its face, Method #1 appears to be the more reasonable approach since it results in a baseline remuneration in line with the actual remuneration per week based on work performed throughout the year, and Method #2 seems inflated due to it taking the entire December 31, 2019 payment into account despite only half was in respect of work performed during the testing period.

However, is really Method #1 really more in line with the legislative scheme of the baseline remuneration definition? Given baseline remuneration completely disregards eligible remuneration paid outside of a testing period despite such remuneration pertaining to work performed during the testing period (case in point: Method #2 yields a worse result in the first example above), it is logically consistent to calculate an average amount based on whatever eligible remuneration payment(s) fall within the testing period irrespective of when the work may be performed. The legislator made a conscious choice to use the “paid” test for the baseline remuneration definition rather than the “paid … in respect of” test used elsewhere in section 125.7, so they will have to let the chips fall where they may.

While we feel Method #2 is more persuasive than Method #1, our view is that both methods could prevail. CEWS claimant choosing one method over the other may consider the arguments above should the CRA disputes their claim. Irrespective of the method chosen, claimant should make sure to apply it consistently for baseline remuneration computation across qualifying periods.

Baseline Remuneration – exclusion of “any period of seven or more consecutive days for which the employee was not remunerated”

Per the baseline remuneration definition, the average weekly eligible remuneration ought to exclude any period of seven or more consecutive days for which the employee was not remunerated. The presumed intent is to take into account business cycles and absences such as parental leave. For vacation and regular sick leave, the CRA is likely to take the view that these absences cannot trigger the exclusion period because the employee would have been remunerated with vacation pay and sick pay during those absences. This view is probably correct and would be consistent with their views on including sick and vacation pay in the CEWS calculation as eligible remuneration in respect of the week of absence (see earlier discussion).

This exclusion period can be very beneficial for certain fact patterns. For example, a child of a business owner may only have worked during the Christmas holiday week, say December 22 to December 28, 2019 for $800 of wages paid. For computing CEWS for qualifying periods paragraphs (c.2) to (d), the business may elect to use the July 1 to December 31, 2019 test period for determining baseline remuneration for the child. Since the child only worked and was remunerated for the week of December 22 to 28, 2019 during the test period, the calculation excludes all the other weeks in the test period for which the child was not remunerated so that the baseline remuneration turns out to be based solely on the average weekly eligible remuneration of that one week. The child ends up with a $800 baseline remuneration for all the weeks of qualifying periods (c.2) to (d). This is a very generous result but is unambiguously the effect of the baseline remuneration definition.

For matters regarding this exclusion period, the CRA will likely focus on asking the business to prove that an employee was not performing any work during the exclusion period and that the employee was not remunerated by sick pay or vacation pay during that period.

Retroactive pay for work performed by family members during qualifying periods (a) to (c.1)

When the CEWS rules were first introduced, only the default January 1, 2020 to March 15, 2020 testing period was available, which meant many family-owned business had family employees with baseline remuneration of nil because no wages were paid during that testing period. Knowing CEWS were not going to be available anyways, many of those businesses continued to not pay their working family employees wages.

Then, on July 17, 2020, the government released amendments which allowed for the various elective baseline remuneration testing periods during 2019. The ability to make those elections meant many working family employees had positive baseline remuneration for certain or all qualifying periods. Since those family employees were indeed performing work during qualifying periods prior to July 17, 2020, the business should be able to pay wages in respect of those historical weeks. Provided there is sufficient baseline remuneration, the business should be entitled to claim CEWS for those retroactive pay because the pay would have been eligible remuneration "paid … in respect of" the weeks in those historical qualifying periods. As discussed earlier, there should be no requirement for the remuneration to be paid within a qualifying period, provided it is actually paid. Claimants may also amend CEWS claims to effect this if the claims for the earlier periods have already been filed.

The CRA should not take issue with this approach, as they even allow for retroactive hiring of employees. In Q.14 of the CEWS FAQ, the CRA stated that "*It is possible for an eligible employer to hire back eligible employees and pay them retroactively in respect of a claim period, to be able to qualify for the wage subsidy*." However, businesses making these retroactive payments should be mindful that, on a CRA audit, they may be asked to justify how those payments were "in respect of" the weeks in the historical qualifying periods. This may sometimes be difficult for family businesses as many do not keep documentation of hours or days worked by family member employees. At the very least, businesses should prepare narratives to document the extent of work performed during historical qualifying periods by family member employees if they were paid retroactively for those periods.

Wages loaned or injected back to business excludable by paragraph (c) of the eligible remuneration definition

As discussed earlier, paragraph (c) of the eligible remuneration definition excludes any amount received that can reasonably be expected to be paid or returned, directly or indirectly, in any manner whatever, to the (i) eligible entity, (ii) a person or partnership not dealing at arm's length with the eligible entity, or (iii) another person or partnership at the direction of the eligible entity. Note that there is no requirement for a CEWS motivated purpose behind the arrangement for this exclusion to apply, and this may catch some family businesses off-guard. It is common for earnings to be paid to family member employees as wages or bonuses, only for some or all of that amount to be loaned back to the business. This may be done to keep earnings below the small business limit and to creditor-proof the earnings. However, that loan back to the business is most likely considered "amount received [by the employee] that can reasonably be expected to be paid or returned, directly or indirectly, in any manner whatever" to the business. Therefore, the wages that are loaned back would likely be prevented from being included in eligible remuneration. Similar result occurs if funds are injected back into the business as equity.

Where possible, non-arm's length employees should keep in their hands and not loan back to the business the amount needed for the CEWS claim (e.g. $847 per week, assuming there is sufficient baseline remuneration).

CEWS Elections Audit Issues

Paragraph 125.7(4)(b) election – making sure all affiliated entities are included

If a group of eligible entities do not normally prepare consolidated financial statements, none of the entities may use consolidated qualifying revenue because the preamble of subsection 125.7(4) requires qualifying

revenue be determined using normal accounting practices of the entity. However, paragraph 125.7(4)(b) offers an election to overrides this. Under that paragraph, an affiliated group may jointly elect to determine qualifying revenue on a consolidated basis to be used for each member of the group.

If this election is made, the claimant must carefully review the definition of "affiliated persons" in subsection 251.1(1) and ensure that the qualifying revenue of all affiliated persons were included in the consolidation. Many private business owners are surprised to find how broad the affiliated person definition is, for example:

- Revenue of corporations under common *de facto* control must be included;[22]
- Revenue of corporations controlled by a spouse or common law must be included;
- Revenue of non-profit or charitable entities in which the individual or spouse or common law has *de facto* or *de jure* control must be included;
- Revenue of any partnership in which the corporation is a majority-interest partner in must be included;
- Where the entity is controlled by a family trust, the revenue of the family trust must be included;
- Where the entity is controlled by a discretionary family trust, the revenue of corporations controlled by any of the beneficiaries of the family trust must be included;[23] and
- Where the entity is controlled by an individual, the revenue of the individual and the individual's spouse or common law must be included (see earlier discussion about determining qualifying revenue for an individual).

Where the paragraph 125.7(4)(b) election is made, the CRA's audit process will likely include checking whether all affiliated persons' qualifying revenue have been consolidated (as not properly doing so may significantly change the result of the various revenue decline tests). In its response to Q.10 of the CEWS FAQ, the CRA emphasized that no part of an affiliated group may opt out of the election and that the election applies to "the broadest affiliated group".

Paragraph 125.7(4)(c) and (d) – the "all or substantially all" requirement

Paragraph 125.7(4)(c) election permits an eligible entity to include the qualifying revenue of a joint venture, and paragraph 125.7(4)(d) election permits an eligible entity to take into consideration the decline in qualifying revenue of non-arm's length entities. Both elections require that the eligible entity meets an "all or substantially all" source of revenue test. For paragraph 125.7(4)(c), all or substantially all of the qualifying revenue of the eligible entity for a qualifying period must be in respect of the joint venture. For paragraph 125.7(4)(d), all or substantially all of the qualifying revenue of the eligible entity for a qualifying period must be from non-arm's length persons or partnerships.

The CRA will begin with a general presumption that all or substantially all means at least 90% (the CRA reiterated this in Q.8–1 of the CEWS FAQ). There has been numerous court cases on what all or substantially all means, and the courts have sometimes consider as little as 80% to be all or substantially

[22] This is because subsection 251.1(3) expands the definition of "control" to mean controlled directly or indirectly in any manner whatever, the meaning of which is in turned described in subsections 256(5.1) and (5.11).

[23] Per paragraph 251.1(1)(c), two corporations are affiliated if the controller of one is affiliated with the controller of the other. Per paragraph 251.1(1)(g), a trust is affiliated with its majority-interest beneficiary. As a result of the definition of "majority-interest beneficiary" and the interpretation provision in paragraph 251.1(4)(d), every beneficiary of a discretionary trust is affiliated with the trust. As such, any corporation controlled by such beneficiaries is affiliated with a corporation controlled by the trust.

all.[24] Claimants making either of these elections should be prepared to cite relevant court cases to a CRA auditor if they are relying on something less than 90%.

Paragraph 125.7(4)(c) and (d) – technically not applicable to qualifying periods (c.2) to (d)

This is likely not an audit issue, but we thought it is interesting to point out nonetheless. The elections under paragraph 125.7(4)(c) and (d) affect the qualifying revenue for the purposes of paragraph (c) of the definition of qualifying entity. That paragraph governs the revenue decline test for only qualifying periods (a) to (c.1), i.e. the first four CEWS claim periods. Neither elections have any impact on qualifying periods (c.2) to (d) because those periods calculate CEWS based on revenue reduction percentage and top-up revenue reduction percentage instead.

This is likely a technical glitch in the legislation because none of the CRA or Department of Finance material published at the time of the preparation of this paper made any mention that the paragraphs 125.7(4)(c) and (d) were ineffective for qualifying periods (c.2) to (d). The authors' view is that the legislation will be corrected to prevent this anomaly, or the Department of Finance will at least publish a comfort letter to that effect.

Paragraph 125.7(4)(e) – cash method election

Subparagraph 125.7(4)(e)(i) allows CEWS claimants to use the cash method to determine qualifying revenue. The subparagraph specifies that the rules of subsection 28(1), with any modifications that the circumstances require, should govern the application of this. Subsection 28(1) has long been used by farmers and fishers to compute income for tax purposes, and for the most part its application is straightforward. Paragraphs 28(1)(b) and (c) contain rules for optional and mandatory inventory adjustments but we do not think these adjustments should impact qualifying revenue, because (i) these rules are explicitly for farming business only, and (ii) they are better characterize as adjustment to income rather than adjustment to revenue and thus should be irrelevant to the concept of qualifying revenue.

For CEWS claimants who made the cash method election, it is important to keep in mind that revenue under the cash method still only includes what would otherwise be revenue. According to paragraph 28(1)(a), amounts included under the cash method are amounts that were received in a period *and* that were in payment of or on account of an amount that would otherwise be included in computing income for that or any other year under the regular application of the Act. For example, whereas deposits for goods to be delivered would be included in qualifying revenue under the cash method,[25] loan of cash will not.

Also, the requirement that qualifying revenue includes only revenues from ordinary activities and excludes extraordinary items should continue to apply, irrespective of whether the revenue is determined based on cash or accrual method.

Another interesting matter is whether the cash method converts partnership capital draws into qualifying revenue. Many partnerships used in private businesses are structured to not allocate partnership income until end of the partnership's fiscal period. An eligible entity that is a member of such a partnership likely cannot include any partnership income in qualifying revenue of a current or prior reference period unless the month includes the partnership fiscal period end, or unless the eligible entity can demonstrate that it had a normal accounting practice of recording partnership income monthly despite the income not being allocated, and usually not calculated, until later.

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[24] Louiseville Automobile Limitée v. The Queen, 2010 TCC 505 at para. 24

[25] Note that although paragraph 12(1)(a) includes amount received for goods to be delivered into income for tax purposes, such deposits are usually not included in revenue under normal accounting practices and would therefore normally be excluded from qualifying revenue if not for the cash method election.

However, if the eligible entity makes a cash method election under subparagraph 125.7(4)(e)(i), it may be able to treat partnership capital draws throughout the year as qualifying revenue. In order to justify this, the eligible entity will need to demonstrate that the capital draws are on account of partnership income allocated or to be allocated to the entity. This will be a question of fact. Capital draws that were in substance return of previously invested partners' capital would likely be not qualifying revenue even under the cash method. However, capital draws representing prepayment of partnership income to be allocated or catch-up payment of previously allocated partnership income should meet the requirements for cash method income inclusion under paragraph 28(1)(a): the capital draw was received in a current or prior reference period, and the draw was on account of partnership income that would otherwise be included in computing income for that or any other year under the Act if not for the application of the cash method. To increase the likelihood of succeeding on this argument, the eligible entity should ensure that the capital draws are not legally or treated for accounting as a loan or payable from the partnership, and that the capital draws do not exceed the total of previously undistributed partnership income and partnership income to be allocated for the year.

Finally, CEWS claimants must ensure that if the cash method election is made, that election is applied consistently for all qualifying period as required by paragraph 125.7(4)(e).

Asset sale qualifying revenue continuity election under subsections 125.7(4.1) and (4.2)

If an eligible entity purchases business assets from a seller, subsections 125.7(4.1) and (4.2) may allow the buyer entity and the seller to jointly elect to assign the seller's qualifying revenue in a prior or current reference period that is reasonably attributable to the acquired assets to the buyer entity. Outside of sale transactions between non-arm's length entities, this election is likely not going to be widely used due to the difficulty of verifying whether the seller truly meets the requirements of the provision. If a CEWS claimant did rely on the joint election, in addition to making sure it itself meets all requirements in the two subsections, it should protect itself against future CRA audit by requesting from the seller the following as part of the sale closing:

- The seller signs a joint election under 125.7(4.1) with the buyer entity.
- The seller's representation and warranty includes an assertion that the acquired assets were used in the course of a business carried on in Canada by the seller, and those assets constituted all or substantially all of the fair market value of the property of the seller used in the course of carrying on any business (including a business carried on by the seller not associated with the acquired assets).[26]
- The seller's books and records that substantiate the satisfaction of the all or substantially all requirement above.
- The seller's books and records that shows the details of all revenues of the seller in the prior and current reference period, while identifying which portion of the revenues is reasonably attributable to the acquired assets (i.e. the "assigned revenue"). Assertion as to the accuracy of such documents should be included in the seller's representation and warranty.
- The seller's cooperation in identifying any revenue from entities that do not deal at arm's length with the buyer entity (since such revenue must be excluded from qualifying revenue of the buyer entity).[27]

[26] This is to support the conditions in paragraphs 125.7(4.1)(b) and (c). The all or substantially all requirement in paragraph 125.7(4.1)(b) simply refers to the business of the seller, and therefore is not limited to the business associated with the acquired assets.
[27] Paragraph 125.7(4.2)(c) allows inclusion of assigned revenue from entity that did not deal at arm's length with the seller but dealt at arm's length with the buyer entity.

- The seller's representation and warranty includes an assertion that the seller has and will subtract the assigned revenue from its own qualifying revenue for its prior or current reference period for purpose of claiming CEWS.[28]

- An agreement that the seller will indemnify the buyer entity for any disallowed CEWS claim and related penalties due to the failure of any of the above representation and warranty. Ideally, a portion of the purchase price should be held in escrow for a period of time to fund this indemnification.

CEWS Anti-Avoidance Rule

The CEWS rules include a number of specific anti-avoidance rules. Many of them are drafted very broadly to catch a wide swath of scenarios that may result in increased CEWS entitlement but uses a purpose test to separate mischievous actors from the ones who undertook those actions for non-CEWS motivated reasons.

Subsection 125.7(6) – transaction, event, series, action, or inaction that has the effect of reducing qualifying revenue

The broadest of the CEWS' specific anti-avoidance rules is subsection 125.7(6). The subsection applies if

(a) The eligible entity, or a person or partnership not dealing at arm's length with the eligible entity, enters into a transaction, participates in an event or a series of transactions or events, takes an action, or fails to take an action, that has the effect of reducing qualifying revenue for the current reference period;[29] and

(b) It is reasonable to conclude that one of the main purposes of the transaction, event, series or action is to (i) cause the eligible entity to qualify for CEWS, or (ii) increase the amount of CEWS in respect of qualifying periods (c.2) to (d).

If the subsection applies, the consequence is that the entity's qualifying revenue for the current reference period would be deemed equaled to that of the relevant prior reference period, so that CEWS entitlement for the qualifying period becomes nil. Additionally, new subsection 163(2.901) imposes a penalty of 25% of the CEWS claimed for a qualifying period to which subsection 125.7(6) applies.

Blatant behaviours to reduce revenue such as requesting a customer delays a major purchase while broadcasting the reason for doing so to be to qualify for or increase CEWS entitlement will surely cause this subsection to apply. Anything less blatant (e.g. reducing business hours or cutting product offerings) will depend on whether the claimant can convincingly argue that their action or inaction were not motivated by CEWS.

The purpose test used in this anti-avoidance rule is whether "it is reasonable to conclude that one of the main purposes" is to qualify for or increase CEWS. Similar wording has been employed in other anti-avoidance rules of the Act, so we have jurisprudence to infer how this phrase will be applied in the CEWS context.

In *Groupe Honco Inc. v. Canada*, the Federal Court of Appeal analyzed the phrase "one of the main purposes" as it was used in the anti-avoidance rule in subsection 83(2.1). The Court stated that the phrase implies that a taxpayer may have more than one main motive, and the fact that the taxpayer has provided

[28] Paragraph 125.7(4.2)(b).

[29] Subsection 125.7(6) also clarifies that making an election permitted within the CEWS rules is not an action caught within the subsection.

reasons for getting involved in a transaction or series of transactions in no way excludes a finding that one of the main purposes—one generally not disclosed by the taxpayer—is to obtain a tax advantage.[30]

It is uncertain whether the words "it is reasonable to conclude" in front of the "one of the main purposes" really add anything in subsection 125.7(6). Some anti-avoidance provision, such as subsection 74.4(2), uses similar combination, while others, like subsection 83(2.1), do not. Some may argue that that adding "it is reasonable to conclude" shifts the test from a subjective to an objective one. However, as John Sorensen pointed out in his recent paper,[31] this may simply be the result of inconsistent legislative drafting and that there is no apparent reason why having that extra phrase or not makes the inquiry into a taxpayer's state of mind less or more of a subjective inquiry. Sorensen pointed out that this view was borne out by the Group Honco at the trial level, where the Tax Court stated: "*Subsection 83(2.1) applies if one of the main purposes of the series of transactions was to receive the capital dividend. This contrasts with other provisions of the Act which refer to circumstances where it is reasonable to conclude or presume that one of the main purposes of transactions was to obtain a certain result. Nonetheless, the wording of subsection 83(2.1) does not result in an entirely subjective test. The Supreme Court of Canada said in Symes v. Canada, [1993] 4 S.C.R. 695, at page 736: "As in other areas of law where purpose or intention behind actions is to be ascertained, it must not be supposed that in responding to this question, courts will be guided only by a taxpayer's statements, ex post facto or otherwise, as to the subjective purpose of a particular expenditure. Courts will, instead, look for objective manifestations of purpose, and purpose is ultimately a question of fact to be decided with due regard for all of the circumstances*."[32] The Federal Court of Appeal echoed that view.[33]

Another notable matter relating to the subsection 125.7(6) anti-avoidance rule is that the July 17, 2020 amendment to the subsection *may* have dramatically broadened the scope of the provision. The July 17 overhaul of the CEWS mechanics introduced a sliding scale computation to CEWS entitlement that applies for qualifying periods (c.2) to (d). Prior to this, i.e. qualifying periods (a) to (c.1), CEWS eligibility was simply an all or nothing test where an entity either qualifies or doesn't. Thus, prior to the July 17 amendment, the "one of the main purpose" test in paragraph (b) of the anti-avoidance rule referred only to a purpose of causing the eligible entity to qualify for CEWS. With the new sliding scale mechanic introduced on July 17, the entitlement to CEWS is no longer an all-or-nothing but scales with the revenue decline. In order to adapt subsection 125.7(6) to this new mechanism for qualifying periods (c.2) to (d), the "one of the main purpose" test in paragraph (b) is expanded to include a purpose of causing CEWS entitlement to increase.

Why is this change to paragraph (b) potentially a dramatic broadening of the scope of subsection 125.7(6)? The entitlement to CEWS can increase either because there is a bigger decline in qualifying revenue or because there is an increase to eligible remuneration. Paragraph (a) of the anti-avoidance rule includes "a series of transactions or events" that has the effect of reducing the qualifying revenues for the current reference period. Due to subsection 248(10) expanding the concept of series of transactions or events to include any related transactions or events completed in contemplation of the series, the scope of a series is very broad. It is possible for a hiring of an eligible employee or an increase in eligible remuneration to be considered part of the same series of transaction or event that included a historical action that had the effect of reducing qualifying revenue for the current reference period.

In interpreting subsection 248(10), the Supreme Court of Canada in *Canada Trustco Mortgage Co. v. Canada* stated that "in contemplation" is read not just in the sense of actual knowledge but also in the broader sense of "because of" or "in relation to" the series, and it can apply to events before or after.[34] Later, in *Copthorne Holdings Ltd. v R*, the Supreme Court of Canada clarified that the "because of" or "in

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[30] 2013 FCA 128, at para. 24.
[31] John Sorensen, "Tax Planning and Tax Avoidance," in Taxation of Private Corporations and Shareholders, 5th ed. (Toronto: Canadian Tax Foundation, 2020), 21:1-114.
[32] 2012 TCC 305, at para. 16.
[33] 2013 FCA 128, at para. 31.
[34] 2005 SCC 54, para. 26.

relation to" tests do not require a strong nexus, but requires more than a "mere possibility" or a connection with "an extreme degree of remoteness”.[35]

For example, on January 1, 2020, an entity decided to significantly lower product prices and that had the effect of significantly reducing 2020 qualifying revenue compared to 2019. Post-Covid, the entity hired additional employees and claimed CEWS for eligible remuneration paid to those employees. If the hiring of additional employees post-Covid is found to be in the same series of transaction or event that included that January 1, 2020 price decrease action (e.g. the business hired additional employees in that entity because it wanted to take advantage of the product price decrease which resulted in that entity’s decreased revenue in order to claim CEWS), the entity may be considered to have participated in a series of transactions or events that:

(i) had the effect of reducing qualifying revenue of an eligible entity for a current reference period, and

(ii) resulted in an increase of CEWS entitlement for the entity.

Although the price decrease occurred prior to the introduction of the CEWS rules and, in itself, obviously fall outside of the purpose test, the series which include the hiring of additional employees could potentially be found to have CEWS increase as one of the entity’s main purposes. If so, subsection 125.7(6) could apply to the entity for qualifying periods (c.2) to (d).

The authors would submit that an application of 125.7(6) to this scenario would not be correct. According to the Supreme Court of Canada in *Canada Trustco*: “*There is but one principle of interpretation: to determine the intent of the legislator having regard to the text, its context, and other indicators of legislative purpose.*”[36] Therefore, let’s examine subsection 125.7(6) in that manner.

As discussed above, the text of 125.7(6) appears to allow the CRA to find a subsequent hiring of eligible employee to be in the same series as a historical revenue reducing action. It should be pointed out that it may be equally plausible to argue that the series should not include the subsequent hiring because the series that had the effect of reducing qualifying revenue for the current reference period ended with that historical action (because hiring employees have no relevance to the reduction of qualifying revenue).

What about context? This issue arises because of the July 17 amendment to subparagraph 125.7(6)(b)(ii). As discussed, the primary reason for this amendment appears to be to accommodate the new sliding scale mechanism computing CEWS for qualifying periods (c.2) to (d). A key support for this is that the inclusion of this purpose to increase CEWS only applies for qualifying periods (c.2) to (d). If the legislative scheme was to expand the scope of the anti-avoidance rule to include hiring of employees, shouldn’t the July 17 amendment to subparagraph 125.7(6)(b)(ii) apply across all qualifying periods?

Finally, does expanding the anti-avoidance rule to make hiring of additional employees a trigger to the 125.7(6) anti-avoidance rule align with the purpose of the CEWS program, especially where the original action or transaction that caused the qualifying revenue decrease was clearly not motivated by CEWS? We think not. If paragraph 125.7(6) really is supposed to apply in this broad manner, any entity that had undertaken anything that caused qualifying revenue to decline in a current reference period for qualifying periods (c.2) to (d) is effectively prevented from hiring an additional employee (lest they want to take on the CRA for an expensive dispute on the purpose test). This runs opposite to the government’s statement that the purpose of the July 17 amendment was to “*ensure that employers have the certainty they need to hire back quickly as the economy improves*”.[37]

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[35] 2011 SCC 53, para. 47.
[36] 2005 SCC 54, para. 40.
[37] https://www.canada.ca/en/department-finance/news/2020/07/supporting-canadian-workers-and-businesses-with-a-redesigned-canada-emergency-wage-subsidy.html

Paragraph (c) of the definition of eligible remuneration – wages returnable to employer

This anti-avoidance rule has been discussed earlier in the context of remuneration eligible for government grants and wages paid to non-arm's length employees.

Paragraph (d) of the definition of eligible remuneration – increase in wages during Covid

Paragraph (d) of the eligible remuneration definition excludes any remuneration paid if, as part of an arrangement involving the employee and the employer:

(i) The amount is in excess of the employee's baseline remuneration;

(ii) After the qualifying period, the employee is reasonably expected to be paid a lower weekly amount than their baseline remuneration, and

(iii) One of the main purposes of the arrangement is to increase CEWS entitlement.

Given the purpose test, this paragraph should only have application where the employee's eligible remuneration would otherwise be below the maximum wage threshold - e.g. $847 per week for qualifying period (a) – without that remuneration increase. If that is indeed the case and the employee is paid remuneration exceeding their baseline remuneration (and that could be because the employee worked more hours than pre-Covid or was paid a bonus for extra effort during Covid), the employer needs to be prepared to provide a business purpose behind increase in order to convince a CRA auditor that increasing CEWS entitlement was not one of its main purposes behind the arrangement.

Note that this anti-avoidance rule requires the arrangement involving the employee and the employer to have a purpose of increasing CEWS entitlement. This seems to suggest that some coordination between the employee and the employer towards that purpose may be required for this anti-avoidance rule to apply.

Paragraph 125.7(5)(b) – no doubling up on CEWS

The maximum CEWS amount - e.g. $847 per week for qualifying period (a) – is applied per eligible entity. Paragraph 125.7(5)(b) is enacted to prevent the circumvention of this maximum threshold by businesses using multiple non-arm's length eligible entities to pay the same employee. Where two or more non-arm's length entities employ the same eligible employee, paragraph 125.7(5)(b) overrides the CEWS mechanics to the restrict the total CEWS amount to the CEWS that would arise if the eligible employee's total eligible remuneration for that week were paid by only one entity.

Subsection 125.7(4.1) election – asset acquisition cannot be motivated by CEWS

As discussed earlier, if a joint election under subsection 125.7(4.1) is made in respect of an asset acquisition, paragraph 125.7(4.1)(c) invalidates the election unless it is reasonable to conclude that none of the main purposes was to increase CEWS entitlement.

Paragraph 87(2)(g.6) – amalgamating or winding-up cannot be motivated by CEWS

Paragraph 87(2)(g.6) is added to provide for continuity in the computation of qualifying revenue for the current and prior reference period in the event of an amalgamation under section 87. By virtue of paragraph 88(1)(e.2) this continuity rule applies also to a winding up under subsection 88(1). However, paragraph 87(2)(g.6) would not provide this continuity if it is reasonable to consider that one of the main purposes of the amalgamation or the winding-up is to qualify for CEWS or to increase CEWS entitlement.

Application of the GAAR to CEWS

Even if none of the above specific anti-avoidance rules apply, CEWS claimants should be aware that the general anti-avoidance rule ("GAAR") in section 245 could possibly apply to deny a CEWS claim. An entitlement to CEWS is within the definition of a "tax benefit" as the term is defined in subsection 245(1), as that term includes "an increase in a refund of tax or other amount under this Act". This is because CEWS is administered in subsection 125.7(2) as an overpayment on account of the employer's liability under Part I of the Act, which is refunded by the CRA to the claimant under new subsection 164(1.6). A discussion of the GAAR is beyond the scope of this paper, but we raised this as a reminder that the GAAR needs to be considered before entering any CEWS-related planning.

Inclusion of CEWS into Employer's Income

A low hanging fruit on a CEWS audit is checking whether the claimant has included all CEWS claim into income. Paragraph 12(1)(x) requires any amount received from a government in the course of earning income from a business or property be included in income, if the amount can reasonably be considered to have been received as assistance in respect of an outlay or expense. So that there is no ambiguity around CEWS being taxable under paragraph 12(1)(x), the CEWS rules included a "for greater certainty" provision - subsection 125.7(3) – that states that CEWS is assistance received from a government immediately before the end of the qualifying period to which it relates. Therefore, CEWS claimed must be included in income by the claimant in the taxation year that includes the end of the qualifying period to which the claim relates.

Since qualifying periods do not align with calendar months, this likely creates differences between accounting and taxable income for entities with year ends that fall during the qualifying periods. For example, a corporation with a June 30, 2020 year-end is likely to have recorded CEWS benefits on accrual basis up to June 30 in its accounting income for the year. However, because of the deeming rule in subsection 125.7(3), the amount of CEWS entitlement relating to the qualifying period June 7, 2020 to July 4, 2020 would be required to be reported in fiscal year ending June 30, 2021. Furthermore, even if CEWS for a qualifying period within a fiscal year end is applied for subsequent to the year end, the CEWS entitlement for that qualifying period is still deemed received and taxable at the end of that qualifying period.[38]

Lastly, as discussed earlier, it should be possible to claim CEWS for employees outside of business context, e.g. child-care and home-care employees. In that case, the CEWS is perhaps not received by the claimant "in the course of earning income from a business or property" and thus the amount technically falls outside paragraph 12(1)(x). If that is indeed the case, the amount would not be from a taxable source at all unless the government either amends the legislation or regulations, e.g. by adding CEWS to Income Tax Regulations paragraph 5502 so that it becomes taxable under subparagraph 56(1)(a)(vi).

T4 Reporting of CEWS

The CEWS that an employer receives for each employee will be reported on the T4 for year 2020. Also, according to the CRA webpage, in addition to reporting employment income in Box 14 or Code 71 of a T4, employers must use new other information codes when reporting employment income and retroactive payments in the following periods:

- Code 57: Employment income – March 15 to May 9
- Code 58: Employment income – May 10 to July 4
- Code 59: Employment income – July 5 to August 29

[38] These timing issues are brought to the authors' attention by Hugh Neilson of Video Tax News.

- Code 60: Employment income – August 30 to September 26

These periods pertain to the day the employee was paid, and not when the work was performed. For example, the CRA gave the example of employment income for the period of April 25 to May 8, payable on May 14. In that case, that income would be reported under Code 58.

CEWS Dispute Process

Based on the authors' experience to date, the CRA's focus so far has been on timely processing of CEWS claims. While there is a pre-claim review process, the level of review is extremely cursory. According to Q.36 of the CEWS FAQ, if a claimant disagrees with the CRA review findings, the claimant may request a second level review with all supporting documents submitted within 30 days of the date of the letter that communicated CRA's original decision.

On an audit, if the CRA disagrees with a CEWS claim, new subsection 152(3.4) will allow the CRA to determine a lesser or nil CEWS amount by sending a Notice of Determination to the claimant. Upon receiving a Notice of Determination, a claimant may file Notice of Objection and further appeal to the Tax Court of Canada, within the normal rules and deadlines in the Act governing objections and appeals.

Note that the CRA cannot increase a CEWS entitlement for a qualifying period on an audit due to paragraph 127.5(5)(a) and this may lead to unfair audit results for findings relating to remuneration or revenue timing issues across qualifying periods. For instance, the CRA may determine a lower CEWS in one qualifying period because certain qualifying revenue was recorded in the wrong reference period – the CRA cannot correspondingly increase the CEWS for the other qualifying period from which the qualifying revenue is taken from.

Temporary Wage Subsidy

The temporary wage subsidy (TWS) was the first wage subsidy program introduced at the beginning of Covid. The TWS is administered as a deemed payroll remittance through new subsection 153(1.02), allowing employers to manually reduce payroll deduction remittances. Compared to the CEWS program, the rules for TWS are very simple but the benefits under the TWS were very small relative to the CEWS. This paper does not discuss the rules of the TWS program as the CRA resources provide it good coverage.[39] TWS claimants are required to complete and submit to the CRA Form PD27 *10% Temporary Wage Subsidy Self-Identification Form for Employers*. Future CRA audits on the TWS will likely just focus on ensuring computational accuracy and ensuring that the claimant is an "eligible employer" as defined in subsection 153(1.03).

Canada Emergency Business Account

The Canada Emergency Business Account (CEBA) is a program that provides interest-free loan of up to $40,000 to eligible small businesses and not-for-profits, and repaying the balance of the loan on or before December 31, 2022 will result in loan forgiveness of 25% (up to $10,000). The CEBA is not administered through the tax system and a discussion of the program is beyond the scope of the paper. Tax advisors should however be aware of the tax treatment of the forgivable portion of the CEBA loan.

Paragraph 12(1)(x) was discussed earlier in the context of CEWS' taxability. The portion of the CEBA loan that will be forgiven should be similarly included in that paragraph, as it is:

- Received in the course of earning income from a business or property;
- From a government; and

[39] https://www.canada.ca/en/revenue-agency/services/subsidy/temporary-wage-subsidy.html

- Can reasonably be considered to have been received as an inducement – stated explicitly to include a forgivable loan.

When does the forgiven loan need to be included in income? The timing of income inclusion under paragraph 12(1)(x) is the year in which the amount is "received". Although the cash from a CEBA loan is received by a taxpayer during 2020, forgiveness of any portion of the CEBA loan is determined base on the amount of repayment on or before December 31, 2022. If a taxpayer is unable to repay any of the CEBA loan by December 31, 2022, there will be no forgiveness. While the CRA has not opined specifically on the timing of the taxation relating to the CEBA loan, the CRA has previously commented on government forgivable loan in general. According to the CRA's Archived Information Bulletin IT-273R2,[40] forgivable loans by government organization should be included in income under paragraph 12(1)(x) at the time the loan is granted. If it is later determined that the forgiven portion of the loan is less than what was included in income, the CRA said the taxpayer may then claim a deduction under paragraph 20(1)(hh). If this is still CRA's policy, it means that the CRA expects a CEBA loan recipient to report the expected 25% forgivable portion of the loan in the fiscal year during 2020 that includes the receipt of the loan.

However, it is arguable that the position in IT-273R2 may not be correct in light of the Tax Court's decision in *GMAC Leaseco Corp / Cie GMAC Location v R*.[41] In *GMAC*, the Court examined residual value support payments received by GMAC from GM at the beginning of a car lease, but which GMAC have to return in entirety if the customer buys the vehicle at the end of a lease or return partially if the customer returns the vehicle and actual resale value turns out higher than expected. In finding that the residual value support payment was not earned until the end of the lease *and* not "received" until that latter time for purpose of paragraph 12(1)(x), the Tax Court explained: "*In my view, the word "received" in paragraph 12(1)(x) must mean something more than merely accepting possession of an amount and using it for a period of time. The recipient must have a legal right to keep the amount.*"[42]

We find this decision relevant to the nature of the CEBA loan. A taxpayer has legal right to any forgiveness of any portion of its CEBA loan, and it certainly is not a foregone conclusion whether and how much CEBA loan the taxpayer will have the means to repay by December 31, 2022. Applying the Tax Court's rationale, the forgiven portion of the CEBA loan is not "received" until the taxpayer earns the right to that forgiveness by repaying some portion of the loan by December 31, 2022, and therefore should not report it as income under paragraph 12(1)(x) until then.

A potential challenge to extending *GMAC Leaseco*'s reasoning to a forgivable loan is the fact that subparagraph 12(1)(x)(iii) explicitly mention receipt of a "forgivable loan". That wording clearly indicates the legislator's intent to include a loan that is "forgivable", even if it has not been forgiven. However, the authors believe it is arguable based on *GMAC Leaseco* that a forgivable loan is "received" for purpose of paragraph 12(1)(x) only when the debtor has the legal right to that forgiveness. For CEBA, that legal right does not crystalize until the taxpayer makes the necessary loan repayment by December 31, 2022.

Penalties, if any, Related to Certain COVID-19 Programs

Program	Legislation	Penalties (if any)
Canada Emergency Response Benefit (CERB)	*Canada Emergency Response Benefit Act*, S.C. 2020, c. 5, s. 8	"12 (1) If the Minister determines that a person has received an income support payment to which the person is not entitled, or an amount in excess of the amount of such a payment to which the person is entitled, the person must repay the amount of the payment or the excess amount, as the case may be, as soon as is feasible."

[40] IT-273R2, para. 16
[41] 2015 TCC 146
[42] *ibid*, para. 40.

		"12(2) the amount of the erroneous payment or overpayment, as determined by the Minister, constitutes a debt due to Her Majesty in right of Canada, as of the day on which it was paid, that may be recovered by the Minister." "13(1) Subject to subsections (2) to (7), no action or proceedings are to be taken to recover money owing under this Act after the expiry of the six year limitation prescription period that begins on the day on which the money becomes due and payable." "13 (2) Money owing by a person under this Act may be recovered at any time by way of deduction from, set-off against or compensation against any sum of money, including an income support payment under this Act, that may be due or payable by Her Majesty in right of Canada to the person, other than an amount payable under section 122.61 of the Income Tax Act." "14 No interest is payable on any amount owing to Her Majesty in right of Canada under this Act as a result of an erroneous payment or overpayment."
Temporary 10% Wage Subsidy (TWS)	Income Tax Act, s. 153(1.02) (added by *COVID-19 Emergency Response Act*, S.C. 2020, c. 5, s. 6) Regulations Amending the Income Tax Regulations (COVID-19 — Deemed Remittance), SOR/2020-106	"If you reduced your payroll remittances, but it is later determined you were not eligible for the TWS, the CRA will assess you for the income tax you deducted from your employees' pay, but did not remit. This assessment may include penalties and interest."[43] Presumably, the taxpayer has under remitted so the ordinary withholding penalties of 10% of the amount that should have been withheld or 20%[44] if it is the result of gross negligence plus interest should apply.
Canada Emergency Wage Subsidy (CEWS)	Income Tax Act, s.125.7 (as added by *COVID-19 Emergency Response Act, No. 2*, S.C. 2020, c. 6, s. 2) Regulations Amending the Income Tax Regulations (COVID-19 — Eligible Entities), SOR/2020-107	Penalties are referred to by section 163(2(i), 2.9 and 2.901) and 164(3) of the *Income Tax Act*. You can return all or part of the subsidy you have already received. Any excess amount of wage subsidy you received that is not returned may be subject to interest.[45] Every eligible entity that is deemed by subsection 125.7(6) to have an amount of qualifying revenue is liable for a penalty equal to 25% of the amount that would be deemed by subsection 125.7(2) to have been an overpayment by the eligible entity during that qualifying period if that amount were calculated by reference to the information provided in the application.

[43] canada.ca/en/revenue-agency/services/subsidy/temporary-wage-subsidy/tws-reporting.html
[44] Subsection 227(8) of the *Income Tax Act* (Canada)
[45] canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-after-apply.html

		New paragraph 163(2)(i) does not require fraud. Gross negligence is sufficient to trigger a 50% penalty. "Penalties may apply in cases of fraudulent claims. Finally, if a person (such as an accountant or tax preparer) files or prepares the wage subsidy application on behalf of the employer, they could be subject to a third-party penalty under the Act, if they know, or would reasonably be expected to know, that the application contains false statements, including an omission of information. Third-party penalties are explained in detail in the CRA's Information Circular IC01-1, Third-Party Civil Penalties."[46] The penalties may include fines or even imprisonment[47]. The third party penalties may apply to the person attesting under paragraph (6) of the definition of qualifying entity in new section 125.7.
Canada Emergency Commercial Rent Assistance (CECRA)		If the property owner defaults (which includes failure to comply with terms and conditions, making fraudulent or misleading statements, fraud or misconduct, or bankruptcy), CMHC may "(i) terminate the Loan and require immediate repayment in full of the principal balance of the Loan and any interest payable hereunder without further notice or demand; and (ii) exercise any rights and remedies available to it under any documents or conferred by law, including assigning the Loan to the Canada Revenue Agency or taking any recourse made available to it through the Canada Revenue Agency or other form of collection." "If the Loan becomes repayable, the Loan shall bear interest at the rate of five (5)% per annum on the unpaid principal amount thereof from the date of the notice of default until the date on which the Loan is repaid in full, accruing monthly not in advance, commencing on the first day of the month following the month in which such notice was made. Interest payments will be due and payable in arrears monthly on the 1st day of the month until and including the date on which the Loan is repaid in full."[48]
Canada Emergency Business Account (CEBA)	*COVID-19 Emergency Response Act, S.C. 2020, c.5* *Business Development Bank of*	"CEBA applicants agree that the government may conduct audits to confirm the nature of the expenses applicants use to establish their eligibility for CEBA, and acknowledge that inaccuracies may lead to legal consequences."[49]

[46] canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-frequently-asked-questions.html
[47] Subsections 239(1) and 239(2)
[48] assets.cmhc-schl.gc.ca
[49] ceba-cuec.ca

	<u>*Canada Act, S.C. 1995, c. 28*</u> <u>*Export Development Act, R.S.C. 1985, c.E-20*</u>	

The CERB Act currently has provisions requiring recipients to return erroneous payments or overpayments (as determined by the Minister), and these payments constitute a debt and may be recovered by deduction from or set-off against any sum of money payable by Canada to that person (ss. 12, 13).

Bill C-17[50] seeks to amend the CERB Act to "enhance the administration and enforcement of the Act" by adding penalty and offence provisions. These are the relevant provisions:

Penalties
12.1 (1) The Minister may impose on a person who made an application for an income support payment under section 5, or on another person acting for that person, a penalty for each of the following acts or omissions if the Minister becomes aware of facts that in the Minister's opinion establish that the person or other person has

> **(a)** in relation to the application, made a representation that they knew was false or misleading;
> **(b)** being required under this Act to provide information, provided information or made a representation that they knew was false or misleading;
> **(c)** knowingly failed to declare to the Minister all or some of the person's income for the period in respect of which they applied for the payment;
> **(d)** made an application or declaration under this Act that they knew was false or misleading because of the non-disclosure of facts;
> **(e)** knowingly, in any manner, received an income support payment that they were not eligible to receive under this Act; or
> **(f)** participated in, assented to or acquiesced in an act or omission mentioned in paragraphs (a) to (e).

Amount
(2) The Minister may set the amount of the penalty for each act or omission at not more than three times the amount of an income support payment for a week that falls within the period in respect of which the application was made.
. . .

Warning
12.4 The Minister may issue a warning instead of setting the amount of a penalty for an act or omission under subsection 12.1.

Recovery as debt due to Her Majesty
12.5 (1) A penalty imposed under section 12.1 constitutes a debt due to Her Majesty in right of Canada that may be recovered by the Minister.
. . .

Garnishment
12.6 If the Minister is of the opinion that a person is or is about to become liable to pay an amount to another person who is indebted to Her Majesty under subsection 12(2) or 12.5(1), the Minister may, by

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[50] Bill C-17, *An Act respecting additional COVID-19 resources*, dated June 10, 2020.

written notice, order the person to pay to the Receiver General on account of the other person's liability all or part of the amount otherwise payable to the other person.
. . .

No interest payable
14 No interest is payable on any amount owing to Her Majesty in right of Canada under this Act as a result of an erroneous payment, overpayment or a penalty imposed under this Act.

Offences
14.1 (1) Every person is guilty of an offence who

(a) in relation to an application for an income support payment made under section 5, makes a representation that they know to be false or misleading;
(b) being required under this Act to provide information, provides information or makes a representation that the person knows to be false or misleading;
(c) knowingly fails to declare to the Minister all or some of the person's income for the period in respect of which the person applied for the payment;
(d) makes an application or declaration under this Act that the person knows is false or misleading because of the non-disclosure of facts;
(e) knowingly, in any manner, receives an income support payment that the person is not eligible to receive under this Act; or
(f) participates in, assents to or acquiesces in an act or omission mentioned in paragraphs (a) to (e).

Prosecution
(2) No prosecution for an offence under this section may be instituted if a penalty for that conduct has been imposed under section 12.1.

Punishment
(3) Every person who is guilty of an offence under subsection (1) is liable on summary conviction to, as the case may be,

(a) a fine of not more than $5,000, plus an amount of not more than double the amount of the income support payment that was or would have been paid as a result of committing the offence; or
(b) both the fine and imprisonment for a term of not more than six months.

Under the Transitional Provisions, sections 12.1 (Penalties) and 12.4 (Warning) apply regardless of the date on which the Minister's decision to issue a penalty or warning was made, and section 12.6 (Garnishment) applies regardless of the date on which the debt from erroneous payment/overpayment arose. There is no indication that section 14.1 (Offences) will apply retroactively. It is our view they can for two reasons: first, the penalties are not criminal law so applying them retroactively is not unconstitutional; and second, legislation including tax legislation can generally apply retroactively if expressly stated.

Whether penalties are criminal law/punishments

Under subsections 11 (g) and (i) of the Charter, a person has the right to not be found guilty of an act/omission unless it constituted an offence at the time of the act/omission, and the right to benefit from a lesser punishment if the punishment has been varied between the time of the act/omission and sentencing. This means the Government of Canada cannot criminalize erroneous payments/overpayments or upgrade the punishment to a prison sentence retroactively. However, the Charter only applies in this regard to criminal offences and "punishments", so it is unlikely to apply to the penalty provisions. First, the Minister decides whether a person received an erroneous payment/overpayment (the person is not prosecuted with a criminal offence). Second, a penalty decided by the Minister would not be considered a "punishment" under the Supreme Court of Canada's definition

of punishment.[51] A measure will be a punishment if: "(1) it is a consequence of conviction that forms part of the arsenal of sanctions to which an accused may be liable in respect of a particular offence, and either (2) it is imposed in furtherance of the purpose and principles of sentencing, or (3) it has a significant impact on an offender's liberty or security interests".

Whether tax laws can apply retroactively

The Supreme Court of Canada indicated in *British Columbia v. Imperial Tobacco Canada Ltd.* [52] that "there is no requirement of legislative prospectivity embodied in the rule of law or in any provision of our Constitution" (except retroactive legislation that implicates an individual's liberty interest discussed above). Statutes can have retroactive operation when the statute is clear that such effect is intended. With respect to tax laws, Catherine Brown and Arthur J. Cockfield discuss in *Rectification of Tax Mistakes Versus Retroactive Tax Laws: Reconciling Competing Visions of the Rule of Law*[53] that Canadian courts may apply the presumption of minimal retroactivity to provide equitable relief when retroactive tax laws increase tax liabilities for taxpayers who honestly and reasonably relied on existing tax laws to guide their tax-planning efforts. However, the presumption of minimal retroactivity probably doesn't apply in the case of CERB penalties because they do not increase an individual's tax liability.

Additionally, in our opinion the penalty provisions should not come as a surprise given the original legislation already calls for a return of erroneous payments/overpayments. Moreover, CERB essentially replaced EI after March 14, 2020 (EI applications are automatically processed as CERB) and section 38 of the *Employment Insurance Act* contains essentially the same penalty provisions.

Recent Technical Interpretations of Interest

Technical Interpretation - 2020-0838951R3F - Pipeline

Scenario

Holdco is a taxable Canadian corporation and CCPC that held investments. X and his two brothers each owned Class A voting common shares and Class C voting common shares. The brothers already owned shares and had ACBs in their shares, prior to X's death, as all those got converted into the note as part of the post-mortem pipeline transaction.

X dies. Beneficiaries are his two brothers. There is a deemed disposition at fair market value which results in a capital gain. X has not claimed the capital gains deduction under subsection 110.6(2.1) in reporting its taxable income in respect of the capital gain resulting from the deemed disposition of common shares.

Under paragraph 70(5)(b), the estate is deemed to have acquired all of the common shares of Holdco at a cost equal to their respective FMV immediately before the death of X.

According to X's Will, all of the shares in the capital stock of Holdco held by the estate are distributed by the estate to his brothers. At this time, brothers' pre-existing ACB and the bumped up ACB from X's death are averaged under s.47(1)

Newco is incorporated by the two brothers. The authorized capital of Newco incudes an unlimited number of Class A voting common shares and an unlimited number of Class E non-voting preferred shares.

The brothers subscribe for Class A shares.

[51] *R. v. K.R.J.*, 2016 SCC 31 at para 41.
[52] 2005 SCC 49
[53] *Canadian Tax Journal* (2013) 61:3, 563 - 98)

Each brother will transfer to Newco his respective Class A and C shares of Holdco. Newco will issue to each brother the following:

(c) Demand Note whose principal and FMV will be equal to the lesser of the following amounts:

(i) the ACB for his Class A and C shares;

(ii) the total amount of the FMV at the time of transfer of the Class A and C shares.

(d) Class E shares having a FMV equal to the possible excess between the total amount of the FMV of the Class A and C shares on the date of the transfer and the amount of the Demand Note.

The total amount of the FMV of the Demand Note and Class E shares in the capital of Newco will not exceed the FMV of the Class A and E shares.

CRA confirms this pipeline implemented by the beneficiaries, and not the estate, is acceptable and the provisions of section 84.1 and subsections 84(2) and 245(2) shall not apply. Insofar as:

(e) the principal amount of each demand note shall not exceed the ACB of the Class A and C shares; and

(f) the stated capital of the E shares issued will not exceed the minimum amount that can be added to the stated capital of the shares under paragraph 84.1(1)(a).

Sometime in the future Holdco and Newco amalgamate, with the notes then being paid off.

The result is that the two brothers extracted all the ACB of their shares of Holdco, and not just the stepped up ACB that occurred on the death of their deceased brother.

Technical Interpretation 2019-0824211R3 F - Pipeline

Taxpayer died holding the shares of an Opco and of a portfolio company (Holdco). The operating business of Opco was subsequently sold to a third party for cash. Opco then paid capital dividend and accessed the refundable tax on hand by redeeming shares. The capital losses generated was carried back under s. 164(6). Opco and Holdco then amalgamated to form Amalco.

The estate then implemented a pipeline transactions for Amalco. The estate sold Amalco to a Newco in consideration for a note. Amalco and Newco amalgamate to form Amalco 2, and Amalco 2 starts paying off the note. CRA approved this pipeline where the underlying operating business was sold for cash after the death but before the pipeline transactions.

Technical Interpretation 2019-0832601R3 - Pipeline One Year

CRA ruled on a pipeline transactions for a portfolio holding company (Holdco). The period of time between the sale of Holdco to Newco for a note, and the amalgamation of Newco with Holdco was stated as at least “one year”.

2020 CALU CRA Roundtable (Technical Interpretation 2020-0842241C6) - Pipeline Gradual Repayment of Note

In a post-mortem pipeline transaction the following steps are generally undertaken: (i) the estate incorporates a “Newco”; (ii) the estate transfers shares of the deceased’s corporation to Newco in exchange for a Note that has a principal amount equal to the adjusted cost base of the corporation’s shares at the

time of death; (iii) the two corporations amalgamate at a future point in time; and (iv) the Note is paid by the amalgamated corporation over a period of time.

In prior CRA rulings, the repayment terms of the Note described the percentage of the principal amount of the Note to be outstanding. For example, the amount paid in any single quarter of the first year that the Note is outstanding after the amalgamation will not exceed 15 per cent of the principal amount or the amount paid on the Note during the first year immediately following the amalgamation, would not exceed 10 per cent of the Note when it was first issued.

Questions

(a) Can the CRA confirm that a limitation on the repayment terms for the Pipeline Note is a required feature to meet the administrative conditions for CRA not to apply subsection 84(2) on the repayments? In addition, can the CRA provide guidance on the maximum percentage of the principal amount of the Note that can be repaid per quarter or per annum without causing subsection 84(2) to apply?

(b) In many post-mortem situations, the funds held in the corporation subject to the pipeline transactions are needed to pay debts of the estate, including income taxes owing. Can the CRA comment on whether it is permissible for the creditor of the Note (e.g., the estate) to borrow funds from the debtor (the corporation) in order to pay its liabilities during the period in which the Note is being repaid while still avoiding the application of subsection 84(2)?

The CRA replied subsection 84(2) applies where funds or property of a corporation resident in Canada have at any time after March 31, 1977 been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of any class of shares in its capital stock, on the winding-up, discontinuance or reorganization of its business. Where it applies, the corporation is deemed to have paid at that time a dividend on the shares of that class.

After reviewing the Federal Court of Appeal ("FCA") decision *MacDonald v. The Queen*, 2013 FCA 110, it noted the CRA continues to receive ruling requests where the taxpayers' proposed transactions describe a continuation of the original corporation's business for a period of at least one year following the implementation of the pipeline structure and a distribution of the corporation's assets over a period of time. The CRA stated these repayment terms have been part of the proposed transactions submitted by taxpayers and were not considered to be requirements stipulated by the CRA.

The application of subsection 84(2) to a situation whereby a loan between the estate and the corporation (separate from the Note) is issued prior to the repayment of the Note can only be determined after an analysis of all the facts and circumstances surrounding the specific situation, including, the terms of this separate loan. If the required elements for the application of subsection 84(2) noted in question (a) above are present in a particular situation involving a separate loan, then it cannot be said that subsection 84(2) does not apply. One example of when this might occur would be if the corporation has to liquidate business assets in order to make the loan to the estate and in doing so causes a wind-up, discontinuance or reorganization of the corporation's business.

The CRA has issued favourable subsection 84(2) rulings when a separate note is issued as part of the proposed transactions. In a "hybrid pipeline" transaction, a partial subsection 164(6) loss carry back plan is undertaken prior to the pipeline transaction. This would allow the estate to access certain any capital dividend account or refundable dividend tax on hand, in addition to the corporate property.

Technical Interpretation 2019 - 0819191 R3 - Post Mortem Pipeline and the Payment of Terminal Taxes is Paid by the Corporation

Scenario

The company is a holding company with various stock and real estate investments immediately prior to A's death. Prior to the pipeline, the company lends funds to the estate to pay A's terminal taxes. The estate sells its shares of the investment to Newco in exchange for 2 promissory notes. The estate assigns two of the notes to the investment company to repay the loan. On amalgamation or windup this note is cancelled and payments under the second note by Newco to the estate apply.

Technical Interpretation 2019-0833181E5 - TOSI - Excluded Shares

This ruling discussed the application of subparagraph (a)(i) of the definition of "excluded shares" in subsection 120.4(1) of the *Income Tax Act* (Canada) in the context of the following situation.

A corporation carried on a business of producing and "selling" training videos on a variety of topics as digital downloads from its website. The taxpayer wanted to know if the income from this business was considered to be income from the provision of services for the purposes of the "excluded share" definition.

The term "provision of services" is not defined in the Act. Whether a business will be considered to be engaged in the provision of services will depend on the facts and circumstances of the particular business. In most cases, the distinction between whether income is from the provision of services or from the sale of property or goods should be clear. However, in situations involving purchasing or licensing of digital products for a customer's own use or enjoyment, such a determination would require a complete understanding of the nature of the legal relationship between the payer and the provider, including the terms of use of the digital product being provided.

CRA offers the following general comments. Electronic commerce allows suppliers to deliver certain products to their customers that have traditionally been regarded as tangible property, in an electronic or "digitized" form. Where intangible property ("digital product") is delivered to a customer's computer, the characterization of the payment for income tax purposes requires a complete understanding of the agreement between the supplier and the customer, and whether the legal substance of that arrangement is for work, or work and materials (i.e., a service), or for intangible property (including a right or interest of any kind).

For the purposes of applying the "excluded share" definition in subsection 120.4(1), the CRA is prepared to accept that payment for the right to download a digital product that traditionally would have been sold to the customer as a tangible property, will generally be treated as a sale of intangible property and not a provision of a service. For instance, the portion of the business income of a corporation for a taxation year generated by the following activities will generally be from the provision of services rather than provision of intangible property for the purposes of the TOSI rules:

- payments obtained as consideration for after-sales service,
- payments for services rendered by a supplier under a guarantee, and
- payments for pure technical assistance.

Technical Interpretation 2019-0819431E5 – TOSI [the CRA later clarified these comments in 2020-0839581E5, discussed below]

Scenario

A professional corporation ("PC1") is licensed to carry on a business of providing medical services in Canada. PC1 does not own any tangible or intangible assets used in the medical services business carried on by PC1. PC1's taxation year end is December 31.

Dr. A is over the age of 24 and resident in Canada. Dr. A is a licenced physician. Dr. A owns all of the voting shares of PC1 and 50% of a class of non-voting participating shares of PC1. Dr. A is actively engaged in PC1's business on a regular, substantial and continuous basis and is remunerated by way of salary and/or dividends paid by PC1.

Dr. A's spouse ("Spouse A") is an adult individual over the age of 24 and resident in Canada. Spouse A is not a licenced physician and is not involved in PC1's medical services business. Spouse A is precluded by law from owning any voting shares of PC1, however, Spouse A can, and does, own the remaining 50% of the class of non-voting participating shares of PC1.

PC1 also has a substantial investment portfolio ("Portfolio") of publicly traded securities that it acquired with the undistributed after-tax earnings it earned from the medical services business and reinvested earnings from the Portfolio investments.

The Portfolio is managed by a financial institution that has the authority to make the day-to-day investment decisions without any input from Dr. A and/or Spouse A. Consequently, Dr. A and Spouse A have limited involvement with the investment activities pertaining to the Portfolio.

On December 30 of Year 1, PC1 surrendered its permit to practice medicine and ceased carrying on its medical services business such that going forward its only activity was the investment activities pertaining to the Portfolio.

On December 31 of Year 1, Spouse A acquired 50% of Dr. A's voting shares of PC1 for their fair market value.

On January 1 of Year 2, Dr. A incorporated a new professional corporation (PC2) to carry on the medical services business formerly carried on by PC1. The share structure and ownership of PC2 mirrored that of PC1 prior to December 30 of Year 1. PC2 will not contribute any capital towards the investment activities in PC1 in Year 2.

Question #1

Whether the investment activities of PC1 constitute a business and whether such a determination would impact whether the "related business" exception is applicable to dividends paid by PC1 to Spouse A after December 30 in Year 1?

Question #2

On the assumption that the investment activities of PC1 constitute a business, will the shares of PC1 held by Spouse A qualify as "excluded shares" as that term is defined in subsection 120.4(1) in Year 2? Specifically, the taxpayer wishes to know whether the dividends paid by PC1 to Spouse A in Year 2 could be considered to be derived directly or indirectly from the related business of PC2, such that paragraph (c) of the definition of "excluded shares" could not be met.

CRA's Response to Question 1

The question of whether a corporation carries on one or more than one business requires the review of all the relevant facts and circumstances. The term "business" is not defined in the Act. Subsection 248(1) only broadens the term "business" to include, among other things, an undertaking of any kind whatever. The courts have generally held that the level of activity required to conclude that a corporation has a business is low.

In order to determine whether the "related business" exception will apply in a particular situation, a taxpayer must make a determination after considering all the relevant facts and circumstances. This exception, which is found in subparagraph (e)(i) of the definition of "excluded amount" in subsection 120.4(1) provides that an amount that is not derived directly or indirectly from a related business in respect of the individual for the year is an excluded amount. Accordingly, it must first be determined whether the dividend income was derived directly or indirectly from a related business, and second whether such amount was from a related business in respect of the individual for the year. In the event that both tests are satisfied, the amount in question would not be excluded from split income under the "related business" exception.

In a situation where the only activity of the corporation in question is earning investment income from portfolio investments, the availability of the "related business" exception will turn on whether the investment activities of that corporation constitute a business. Such a situation was addressed in the response to Question 9 at the 2018 CTF Roundtable.

Whether the investment activities of PC1 in Year 1 constitutes a business is not determinative of whether the "related business" exception is available because PC1 also carries on a medical services business in Year 1 which would be considered a "related business" in respect of Spouse A who is a "specified individual" as defined in subsection 120.4(1). Whether the "related business" exception is available does not turn on whether the dividends were paid out before or after December 30 on Year 1 (i.e., the date the medical services business ceased) because the definition of "related business" specifically states that a business is a related business of a specified individual for a taxation year if at any time in the year, the source individual (Dr. A) in respect of the specified individual (Spouse A) is actively engaged on a regular basis in the activities of the corporation (PC1) that is related to earning income from business (see subparagraph (a)(ii) of the definition of "related business" in subsection 120.4(1)). Furthermore, the definition of "related business" also includes a business of a corporation if at any time in the year, the source individual (Dr. A) in respect of the specified individual (Spouse A) owns, generally speaking, at least 10% of the fair market value of the corporation (PC1) (see paragraph (c) of the definition of "related business" in subsection 120.4(1)).

As such, if it can be determined that the dividends paid by PC1 are "derived directly or indirectly" from a related business, which is likely given that the capital invested in the Portfolio was wholly-derived from either after-tax earnings of PC1's medical services business or reinvested investment income, the "related business" exception would not be available and such amounts would be included into the split income of Spouse A unless another exception applies.

CRA's Response to Question 2

To determine whether the shares of a corporation (PC1) qualify as "excluded shares" for a specified individual for a particular time after Year 1, one must determine whether the following conditions set out in that definition are met at the particular time: (a)(i) less than 90% of the business income of PC1 for its last taxation year was from the provision of services; (a)(ii) PC1 is not a professional corporation; (b)(i) the shares of PC1 owned by the specified individual represent 10% or more of all the voting shares of PC1; (b)(ii) such shares represent 10% or more of the fair market value of all the shares of PC1; and (c) for the relevant taxation year in (a)(i), all or substantially all of the income from PC1 was income that was not derived directly or indirectly from one or more related businesses in respect of the specified individual other than a business of PC1.

In respect of Year 2, it appears that the conditions in subparagraphs (a)(ii), (b)(i) and (b)(ii) of the “excluded share” definition are met in that year. However, the relevant taxation year for applying the conditions in subparagraph (a)(i) and paragraph (c) for PC1 in Year 2 is Year 1. Provided that less than 90% of the income of PC1 for Year 1 was earned from the medical services business (such that the condition in subparagraph (a)(i) is met), the shares of PC1 would qualify as “excluded shares” in Year 2 as the condition in paragraph (c) also would appear to be technically satisfied. More specifically, all or substantially all of the income of PC1 is derived directly or indirectly from one or more related businesses (i.e., the medical services business and the investment business) in Year 1, and PC1 is still carrying on these businesses in Year 1. Accordingly, if the PC1 shares held by Spouse A qualify as “excluded shares” in Year 2, any dividends paid from PC1 to Spouse A in Year 2 would be an “excluded amount” and not subject to TOSI.

CRA suggests the shares of PC1 held by Spouse A would not qualify as “excluded shares” in Year 3 and subsequent years. The exception in paragraph (c) is no longer available for any taxation year after Year 2. This would be the case where, in the relevant taxation year referred to in paragraph (c) of the “excluded share” definition (being the last taxation year referred to in subparagraph (a)(i)), Dr. A (a source individual in respect of Spouse A) is actively engaged in the medical services business being carried on by PC2. It is the CRA’s view that in these circumstances, any dividend paid by PC1 to Spouse A would be considered to be derived directly or indirectly from a “related business” carried on by PC2 (and not PC1) in Year 2 and subsequent years. As the PC1 shares held by Spouse A would not qualify as “excluded shares” in Year 3 and subsequent years, any dividends paid from PC1 to Spouse A in those years would be subject to TOSI unless another exception applies.

CRA suggests the facts in this scenario strongly suggest that these transactions were undertaken primarily to ensure that the shares of PC1 could meet the definition of “excluded shares” such that the “excluded amount” exemption would be available to Spouse A. If it is determined that any transaction, either alone or as part of a series, has been undertaken primarily to obtain the “excluded amount” exemption under paragraph 120.4(1) in a manner that would frustrate the object, spirit and purpose of section 120.4, the CRA would seek to apply the GAAR.

Technical Interpretation 2020-0839581E5 - TOSI - "Excluded Shares"

Clarification for Year 3 and Subsequent Years

In the CRA’s earlier technical interpretation, with respect to Year 3 and subsequent years, the CRA had expressed the view that the shares of PC1 held by Spouse A would not qualify as “excluded shares” (and thus dividends paid on such shares to Spouse A would be subject to TOSI), in part, because “…any dividend paid by PC1 to Spouse A would be considered to be derived directly or indirectly from a “related business” carried on by PC2 (and not PC1) in Year 2 and subsequent years”. CRA wanted to clarify the comment which was made in relation to paragraph (c) of the definition of “excluded shares”.

In the event that the income of PC1 for Year 2 and any subsequent year is income earned solely from its investment business, such income would not be considered to be derived directly or indirectly from the medical services business now carried on by PC2. This would be the case even though the historical retained earnings of PC1 that are used in PC1’s investment business were originally derived from its former medical services business. Accordingly, in those circumstances, CRA would consider all the conditions of the “excluded share” definition to be technically met for those years.

It remains a question of fact as to whether all or substantially all of the income of PC1 would be derived directly or indirectly from a related business other than a business of PC1. CRA noted it was not provided with any information with respect to how the medical services business was carried on by PC1, including any related assets and liabilities were transferred to PC2 and it remains to be determined whether PC1 would continue to derive any income from PC2 following the transfer of PC1’s business to PC2 (for example, in the form of service fees, interest income, dividends or rental income), in the context of establishing whether the conditions set out in paragraph (c) of the definition of “excluded shares” are met.

Finally, as noted in the previous technical interpretation, the situation described therein appeared to be undertaken primarily to ensure that the shares of PC1 held by Spouse A would meet the definition of "excluded shares" such that the "excluded amount" exemption would be available to Spouse A. If it is determined that any transaction, either alone or as part of a series, has been undertaken primarily to obtain the "excluded amount" exemption under paragraph 120.4(1) in a manner that would frustrate the object, spirit and purpose of section 120.4, the CRA would seek to apply the GAAR.

2020 CALU Roundtable Q. 7, Technical Interpretation 2020-0842251C6 - Voting Only Rights

CRA confirms its historical positions on skinny voting shares:

- "provided that the owners of all the shares of the corporation act in a manner consistent with the assumption that no value attaches to the voting rights, and the rights are eventually extinguished for no consideration, the CRA will generally not attribute value to the rights,…"

- "In the context of an estate freeze of a Canadian-controlled private corporation, where the freezor, as part of an estate freeze, keeps controlling non-participating preference shares in order to protect his economic interest in the corporation, the CRA generally accepts not to take into account any premium that could be attributable to such shares for the purposes of subsection 70(5)."

Technical Interpretations 2020-0841961I7 and 2020-0850281I7 - Salary Deferral Arrangements

In document 2020-0841961I7, the CRA clarifies that statements made in ATR-45 entitled "Share Appreciation Rights Plans" should not imply that a right to receive an amount after the end of a particular year is not created until the units are exercised. In addition, the statement that a unit issued under a Share Appreciation Rights (SAR) plan that grants to the employee the right to receive only the increase in value of the underlying share from the date the unit is granted to the date the unit is redeemed is not considered to be a Salary Deferral Arrangement because the SAR unit has no value at the time of grant in ATR-45 should not be applied to other incentive plans even if the value of the units of an incentive plan is subject to change. Finally, a deferred amount can be determined at any given year even if at the time the unit is not exercisable. If a plan is designed which results in a positive value of the unit in any given year end after the issuance of the units, the employee has, at that time, a right to receive an amount after that year that is attributable to services rendered by the employee. An incentive plan can be a SDA before the final value of the units has been determined. Therefore, in CRA view, an incentive plan can be a SDA even before the units are exercised, even if it does not have any value when granted and the incentive plan needs to be tested on an annual basis.

In document 2020-0850281I7, CRA clarifies that prior statements did not indicate that "solely forward-looking or future or intended incentive plans with certain characteristics are not salary deferral arrangements". In the past the CRA issued favourable rulings that certain formula based appreciation plans were not salary deferral arrangements. Most of these forward looking plans were based on earnings before interest, taxes, deprecation and amortization.

In this ruling, the CRA has announced a change in its administrative policy with respect to ruling requests on formula based appreciation plans. The proposed plan in this second ruling would issue units whose units' value on their redemption date would be based on changes to the company's restated earnings between the grant and redemption date plus dividends. The CRA has a concern that formula based appreciation plans may be manipulated and that it is their decision to no longer consider ruling request for forward based appreciation plans. Forward looking incentive plans may still be characterized as a salary deferral arrangement.

The CRA will only consider ruling requests if: (a) the plan is a type described in ATR-45; (b) the ruling request relates to one of the stated exceptions in the definition of salary deferral arrangement. ATR-45 describes SARS that have the following characteristics: the unit has no intrinsic value at the date of grant, the value of the unit is not guaranteed and the value of each unit at any particular time is determined by

subtracting the fair market value of a share of the employer at the date of grant from the fair market value of a share of the employer at that particular time.

Flow Through Shares

On July 10, 2020, the government extended the timeline for Canadian resource exploration companies to spend the capital they raise through flow-through shares by 12 months. This is aimed to protect jobs and avoid meeting costs for not meeting their original flow-through share timelines.

Corporations issuing flow through shares are generally required to incur qualifying expenses in the same year that they are renounced or in the year following the year in which the expenses are renounced (the look back rule). The Department of Finance has proposed an extension for the company issuing the flow through shares to incur qualifying expenses renounced to the investor by 12 months, The 12 month extension will apply to incurring expenses under both the general rule and the look back rule. The extension applies to flow through share agreements entered between March 1, 2018 and December 31, 2020 under the general rule and agreements entered into in 2019 and 2020 under the look back rule.

New Legislation for Time Limits and Other Periods

Time Limits and Other Periods Act

On July 27, 2020, Bill C-20: An act respecting further COVID-19 measures received Royal Assent and enacted the Time Limits and Other Periods Act. This Act suspends time limits established under federal legislation for starting a civil proceeding, including audits, disputes and appeals. This suspension of time limit is valid for a maximum of 6 months starting March 13, 2020 and ending on September 13, 2020 or an earlier date fixed by order of the Governor in Council on the recommendation of the Minister of Justice.

Specifically, this Act suspends the following time limits for the period between March 13, 2020 and September 13, 2020:

(a) any limitation period for commencing a proceeding before a court;

(b) any time limit in relation to something that is to be done in a proceeding before a court; and

(c) any time limit within which an application for leave to commence a proceeding or to do something in relation to a proceeding is to be made to a court.

The Act allows federal ministries to make temporary orders to extend or suspend other time limits identified in specific federal legislation for which they are responsible. Orders made under this Act can be retroactive to March 13, 2020 and valid for a maximum of 6 months, but cannot have effect beyond December 31, 2020. Such orders cannot be made after September 30, 2020.

There are stated safeguards to these provisions:

- There is two sunset clauses of September 30, 2020 and December 31, 2020. Ministerial orders cannot be made after September 30, 2020 and cannot have effect beyond December 31, 2020.
- If a limitation period ended on March 13, 2020 then it can be extended to September 13, 2020.
- If a limitation period ended on March 14, 2020, but before July 1, 2020, then the order can extend the period by no more than 6 months to the date that is 6 months later.
- If a limitation period ends on July 1, 2020, but on or before December 31, 2020, then the order can only extend the period up to and including December 31, 2020.

The Act allows the Minister of Revenue to suspend or extend the following:

1. filing deadlines for scientific research and experimental development (subsection 37(11))

2. filing deadline for investment tax credits (paragraph (m) of subsection 127(9))

3. the normal reassessment period; and

4. applications for an extension of time to object (subsections 166.1(7) and 166.2 (5))

Similar extension periods apply under the Excise Tax Act (subsections 298(1) and (2), 303(7) and 304(5) of the ETA). However, the Income Tax Regulations to the Income Tax Act and the tax treaties were not referenced in this legislation. The Ministerial Order can have retroactive effect to March 13, 2020.

If anyone believes this was the last word on filing or limitation periods the story continues, The Attorney General of Canada, in a letter, dated September 1, 2020 addressed to the Federal Court, stated that s. 6 of the *Time Limits* and *Other Periods Act (COVID-19)*, suspended retroactively all "time limits…established by or under an Act of parliament" during the March 13 to September 13 period, and overrides all "orders and directives issued" by the Courts concerning time limits or setting deadlines.

On September 3, 2020, Chief Justice Noel issued the following direction pursuant to Rule 54 as a reply:

> The Court directs that the Attorney General's position concerning the interpretation and effect of section 6, in so far as it extends to the time limits under the Rules and order made thereunder, is incorrect in law and should not be followed. The Federal Courts Rules, S.O.R./98-106 and this Court's Practice Directions, judgments, orders and directions remain in full force and effect…..
>
> Were it otherwise, confusion and potential harm - surely not desired by Parliament - would result. For example, orders requirement a proceeding to be prosecuted urgently on shortened time limits to further the public interest and to avert some harm or prejudice would be invalidated with retroactive effect. …
>
> Beyond this, construing section 6 as allowing Parliament to unilaterally interfere with the management and governance of ongoing proceedings would invade a core judicial function … . Where possible - and it is possible here - section 6 should be given a meaning that is respectful of judicial independence and obeys constitutional imperatives.

Extended SR&ED Reporting Deadlines

Under the Time Limits and Other Periods Act (COVID-19), the CRA received a ministerial order to extend certain deadlines for scientific research and experimental development (SR&ED (scientific research and experimental development)).

The SR&ED reporting deadlines affected by this ministerial order include any that occurred on or after March 13, 2020. No SR&ED reporting deadlines are extended past December 31, 2020.

Extensions for SR&ED reporting deadlines

Corporations - Extended by six months or to December 31, 2020, whichever date comes first

Corporations with tax year ends from September 13, 2018, to December 31, 2018, that had an SR&ED reporting deadline from March 13, 2020, to June 30, 2020, are extended to December 31, 2020.

Individuals - Extended by six months to December 15, 2020

Only applies to individuals who operated a sole proprietorship with a December 31, 2018, tax year-end and who had an SR&ED reporting deadline of June 15, 2020.

Trusts - Extended by six months or to December 31, 2020, whichever date comes first

Trusts with tax year-ends from December 31, 2018, to April 1, 2019, that would usually have an SR&ED reporting deadline from March 13, 2020, to June 30, 2020, are extended by six months.

Trusts with tax year-ends of April 2, 2019, to October 1, 2019, that would usually have an SR&ED reporting deadline of July 1, 2020, to December 30, 2020, are extended to December 31, 2020.

To avoid interest and penalties, the taxpayer must file the taxpayer's tax return by the filing due date. If the taxpayer is making an SR&ED claim, the CRA encourages the taxpayer to include it with the filing, even though the usual SR&ED reporting deadline is 12 months after the tax return filing due date.

CRA now emails and will start videoing

CRA will accept emails from taxpayer representatives and, provided that it reads out a caveat first about the dangers of email, is generally now willing to send emails to representatives.

Having discussions by video was cleared at the beginning of August.

Late-filing penalties and Extended Payment Deadlines

The CRA announced that late-filing penalties will not apply as long as a return eligible for the relief announced on July 27, 2020 is filed by September 30, 2020.[54] The CRA indicated that interest will begin to accrue on amounts owing on October 1, 2020. This includes amounts owing from assessments made after September 30, 2020.

Extended Temporary measure enabling electronic signatures for the T183, Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return, and the T183 CORP, Information Return for Corporations Filing Electronically

If an individual or a corporate taxpayer wishes to file their income tax return through an electronic filer, they must authorize the electronic filer to do so by completing a T183, Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return, or a T183CORP, Information Return for Corporations Filing Electronically.

The CRA will continue to recognize a Form T183 or T183 CORP that contains an electronic signature as having met the signature requirements of the Income Tax Act as a temporary administrative measure for the remainder of the filing season.

Electronic filers are already responsible for verifying the identity of the taxpayer, both to protect their own interests and the integrity of the tax system. This will not change.

In order for the CRA to continue to accept an electronic signature from a taxpayer whose identity has been verified by the filer, the electronic signature will generally need to be provided in one of the following ways:

[54] Refer to CRA webpage for returns eligible for this extension: https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/covid-19-filing-payment-dates.html

- It may be provided if the taxpayer sends the information return, including the electronic signature using the electronic address most recently provided by the taxpayer to the electronic filer;

- It may be provided in person by the taxpayer, in the presence of the electronic filer. e.g. using a stylus or finger on a tablet; or

- It may be provided through an access controlled, secured electronic location such as a secure website, that is accessible to the taxpayer only because the location of the secure website has been made known to the taxpayer and access has been granted by the filer.

The CRA continues to pursue the regulatory requirements to implement these measures permanently.

Home Office Expenses

Generally speaking, CRA has considered reimbursements and allowances for home office equipment to be partially beneficial to the employee and therefore taxable. CRA has recently announced[55] an administrative concession that a reimbursement by an employer to purchase a personal computer equipment, up to the sum of $500, will not be taxable to the employee.

Traditionally, CRA only permitted home office expenses for an employee under subsection 8(1) if the following requirements were met:

1. The employee is not reimbursed by the employer for the expenses

2. The employee is required by the employment agreement to pay for the expenses

3. One of the following two tests is met:

    (a) The employee performs the employment duties “principally” at the home office. “Principally” means more than 50% of the time. It is not clear whether “principally” means more than 6 months or if working at home for more than 50% of the time during a period (such as the COVID period) would meet the “principally” definition.

    (b) The employee uses the home office: (i) “exclusively” for employment purposes, and (ii) for “meeting” customers and other people on a regular and continuous basis in the ordinary course of performing the employment duties.

    “Exclusively” is interpreted by the CRA as requirement a segregated area in the home and used only for employment purposes, on a regular and continuous basis, for meeting customers or other persons in the ordinary course of performing the office or employment duties. CRA’s current interpretation of “meeting” requires in-person meetings and does not recognize virtual meetings. There are informal tax cases which have recognized virtual meetings.

4. The employer signs CRA Form T2200 to support the deduction.

An employee may deduct reasonable expenses such as rent, fuel, electricity light bulbs, cleaning materials, maintenance expenses and minor repairs, Mortgage interest, property taxes, insurance or capital cost allowance are not deductible unless the taxpayer is self employed. If an employer’s office is closed and the employee must work from home, arguably the employee should meet the requirements. If the employee has access or is encouraged to work from home, but access is permitted, it is not so clear whether the employee has met the requirements.

[55] CRA document no. 2020-0845431C6, April 22, 2020

Subsection 18(1) of the Act describes the limitations on deductions from business or property income for owner managers. The owner manager can deduct expenses relating to the use of a home office in a self contained domestic establishment if one of the following tests is met:

1. The space is the principal place of business of the owner manager;

2. The space is used exclusively to earn business income and is used on a regular and continuous basis for meeting clients, customers or patients of the individual in respect of the business.

Provided one of the two above tests are met the expense must be reasonable in the circumstance and made for the purpose of gaining or producing income from the business and not be on account of capital or for personal or living expenses.

In the owner manager context the word “principally” is complicated if the owner manger did not work from home before COVID-19. The CRA takes the position that whether an individual has two or more places of business in respect of the same business, the work space must be the principal place of business in order to meet the requirement in subparagraph 18(12)(a)(i) of the Act.[56]

Also challenging for the owner manager is whether the work space is used “exclusively to earn business income and used in a regular and continuous basis for meeting clients in respect of the business. CRA has long stated the work space must be a segregated and used in a business and for not other purpose.[57]

CRA’s current view is that meetings must be in person[58] although the Courts in some informal procedure cases have expressed a different view on this in certain cases.[59]

Select Federal and Provincial Budget Items

Typically in each year there are federal and provincial budgets to review. The governments this year either delayed tabling their budgets or announced their previous budgets no longer applied or would be updated. Below is a summary of some of the interesting budgetary announcements made in 2020.

Federal

The 2020 Federal Budget was originally planned to be tabled on March 30, 2020. Instead, Finance Minister Bill Morneau released Canada’s Economic and Fiscal Snapshot 2020 before the 2020 Budget on July 8, 2020. The deficit for 2020-2021 is expected to increase to $343.2 billion from the $34.4 billion deficit.

Alberta

Corporate Tax Rate

Under Alberta’s economic recovery plan, the government of Alberta, effective July 1, 2020, the general corporate tax rate was reduced from 10% to 8%. Despite this decrease in general corporate rates as of July 1, 2020, the Alberta government is not adjusting dividend tax credit for eligible dividends until January 1, 2021.

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[56] Paragraph 2.11 of Income Tax Folio S4-F2-C2 and Layton v. R, 2015 TCC 184 (Informal Procedure).
[57] Paragraph 2.13 of Income Tax Folio S4-F2-C2.
[58] Paragraph 2.14 of Income Tax Folio S4-F2-C2).
[59] *Vanka v. R.* [2001] 4 CTC 2832, and *Hemond v. R.*, 2003 TCC 705.

Innovation Employment Grant

The economic recovery plan also announced a new Innovation Employment Grant (IEG) which targets investment in the technology and innovation sector. There will be a new refundable tax credit available to companies who invest in research and development to incentivize small businesses and start-ups.

The IEG will use the same criteria as qualifying expenditures under the federal SR&ED program and will use qualifying SR&ED expenditures as the basis for IEG calculations. The grant will provide benefits on up to $4 million annually in research and development spending. The IEG is focused on small and medium-sized entities and will be phased out for entities with between $10 million and $50 million of taxable capital.

British Columbia

Effective January 1, 2020, there is a new tax bracket on taxable income of more than $220,000. The top marginal tax rate for individuals will increase from 18.6% to 20.5%

Saskatchewan

No changes are proposed to the corporate tax rates, the $500,000 small-business limit, and personal income tax rates. If the Income Tax Amendment Act, 2020 is passed, it will allow the re-indexation of Saskatchewan's personal income tax system to correspond with the Government of Canada's rate at the beginning of 2021.

Nova Scotia

The general corporate income tax rate is being reduced from 16% to 14% effective April 1, 2020 and the small business rate is being reduced from 3% to 2.5%.

Conclusion

The writers expect the post pandemic era to continue to struggle with the interpretation, application and effectiveness of various COVID-19 initiatives. We also expect a flurry of announcements to deal with the limitation periods or other periods to file documents to address the closure periods during the pandemic.