

Canada Emergency Wage Subsidy Feedback

April 6, 2020

Updated April 14, 2020 *(updates in green)*



We have received many emails from members and others in the business and tax community regarding the Canada Emergency Wage Subsidy (CEWS). Some are asking questions while others raising concerns. For some of the issues, the concern or question was raised many times. Some queries also included detailed fact patterns.

To help communicate the issues received more clearly, we have summarized the feedback into key themes. We have also organized them with reference to the basic components of the rules. Note that we have excluded specific questions that relate to fairly basic issues that will presumably be communicated (such as supporting documentation required to justify claims).

As legislation (Bill C-14: A second Act respecting certain measures in response to COVID-19) was subsequently enacted on April 11, 2020, we have revised the original version of this document to provide updates on the issues raised. Unresolved issues will be carried forward to a new summary and will be included with new issues that are currently being identified and summarized.

Eligible Employer Issues and Concerns

It appears that the definition of eligible employer was adapted from the definition provided for the Temporary Wage Subsidy. In particular, it seems that the intention was to broaden the rule to include large employers by substituting “Canadian-controlled private corporation” with “taxable corporations”. Although this approach has the benefit of simplicity, several types of common business structures may have been inadvertently left out.

We received many communications on this approach, and the key themes are as follows:

- **Indigenous businesses** – An indigenous community owned enterprise that operates a retail store, hotel, etc. on-reserve as a corporation that is tax exempt under s. 149(1)(d.5) of the *Income Tax Act* appears not to be eligible because they are not a taxable corporation. Similarly, an indigenous community owned enterprise that operates a business as a limited partnership of the indigenous communities themselves and a general partner corporation appear not to be eligible as the partnership is not comprised of eligible employers. These concerns apply in respect of the Temporary Wage Subsidy as well.

Update: Bill C-14 includes a definition of “eligible entity” which is broader than the original backgrounder. However, organizations that are exempt due to s.149(1)(d.5) are still not included.

- ***Common commercial arrangements include partnerships with non-eligible employers as partners*** – Although the stated intention is to provide the CEWS to all businesses that suffer revenue declines of 30% or more, there appear to be common partnership arrangements that will not qualify as one or more of the partners are not eligible employers. This could impact a large number of private equity funds and portfolio companies.

Examples brought forward include:

- Partnerships where pension plans or funds are included as one of the partners.
- Partnerships where a trust is a member of the partnership.

Update: Other than for trusts, Bill C-14 did not include changes that would allow these structures to qualify. We have asked for more information on how the reference to prescribed organizations in the definition of eligible entity will be used. See next item for trusts.

- ***Trusts*** – Can commercial trusts be considered eligible employers?

Update: Since the legislation specifically mentions individuals, s.104(2) needs to be considered. Given that s.104(2) deems the trust to be an individual “in respect of the trust property” (which is not totally clear), CRA should verify that this confirms that trusts can be eligible employers.

- ***Corporations operating separate businesses or divisions*** – Where different businesses are carried on under common ownership, some organizations use separate corporations for each business while others operate the individual businesses within a single corporation. Where one business has suffered a revenue decline of 30% or more, the CEWS will be available if that business was carried on in a separate corporation while that may not be the case if all businesses are carried on within the same corporation (i.e. if revenue of the corporation did not decline by 30% or more). Where a corporation has sufficient revenue and payroll records for each division or separate business, consideration should be given to allowing them to recognize these segments as separate eligible employers under the rules.

Update: The final legislation did not incorporate this suggestion, possibly because of the complications that will arise. We do not expect that determining the CEWS by division or business line will be possible.

Issues and Concerns Related to the Use of Gross Revenue

The proposed CEWS uses gross revenue as the measure to determine whether an eligible employer's business volume has declined by 30% or more. Although that may be a good yardstick in some situations (such as a mature business with consistent year-over-year revenue), some specific issues and concerns have been identified. Most of these issues relate to situations where business volume has decreased by 30% or more but the revenue test may not apply appropriately to capture this. In addition, some specific computational questions have been identified. The issues identified include:

- ***Bad debts*** - Should revenue be reduced by bad debts and doubtful accounts expenses recorded in the claiming period? For bad and doubtful accounts, the rules should recognize that where a sale has arisen, but it cannot be collected, this has the same impact as not being able to make the sale in the first place. In the case of goods, it can actually be worse, as the revenue was not received, and the good sold must be recovered.

Update: Based on enacted legislation, bad debts cannot be netted against revenue, but eligible entities are allowed to use the cash basis to measure revenue. Using this method should help meet the revenue test if collections are problematic.

- ***Work in progress (WIP) for professionals and other service providers*** - In the case of work in progress for professionals and other service providers, some recognize revenue for accounting purposes on a billed basis while others recognize work as it is performed as revenue. All would then true up their income for what is required for tax purposes. For those that record income as billed, they may discover that some work performed may not be recoverable from their clients due to the client's inability to pay and may reduce their bill or not bill at all. This would be a revenue reduction that should be considered for the 30% rule. Conversely, if a firm recognizes revenue as work is performed, adjustments for work that cannot be recovered may not be measured appropriately. Allowing firms to recognize revenue

on a billed basis as an option for the 30% rule appears fair if they choose to use it. Further, the point above on bad and doubtful accounts should be considered for these businesses as well.

Update: The ability to use the cash basis for the revenue test should assist with this issue. The legislation states that revenue “from the sale of goods, the rendering of services and the use by others of resources of the eligible entity” is generally included, which does not address WIP specifically. However, the legislation also states that revenue should be “determined in accordance with its normal accounting practices”. We will ask if more specific guidance can be provided.

- **Concerns around complex business arrangements and revenue recognition** – Many businesses have complex business arrangements where the method of revenue recognition is not straight forward, and therefore, the use of revenue per month may not accurately capture a severe downturn in business. Various scenarios on this have been identified, but it may be best illustrated with an example:

Consider a company that sells software with a maintenance agreement. Under the normal method of accounting used by the corporation, the revenue is recorded ratably over the length of the maintenance contract. Each month the company is selling \$120,000 of software. In March 2020, actual sales fall to one half and in April and May fall to 0. However, from an accounting perspective, the revenue recognized in March would be \$115,000, and \$105,000 in April and \$95,000 in May. The company would not be eligible for the CEWS notwithstanding their actual completed sales have dropped by 50% in March and 100% in April.

Update: The ability to use the cash basis for the revenue test should assist with this issue.

- **Issues with hedging** – In the oil and gas industry, many companies engage in significant hedging. Income in any given month may include both realized and unrealized hedge gains and losses. The cash they would receive on the unrealized gains may not be received for many years. It also means that two companies in an identical economic situation could be treated very differently from a CEWS point of view based on their hedging activities. Again, it would appear that a basic revenue test will not determine the loss of business from the crisis accurately.

Update: No update has been received on this issue. The use of the cash basis method may be of assistance. Further guidance should be considered.

- ***Can cash flow from operations be used rather than sales*** – As some of the examples have shown, there may be concerns that the method of revenue recognition used may not accurately capture a severe business downturn if the test used is to compare month to month revenue. Some have asked whether an eligible employer could opt to use cash flow instead of revenue?

Update: Yes, the enacted legislation does allow eligible organizations to use the cash method provided that it is used consistently.

- ***Functional currency elections*** – An issue was raised on how the revenue rule would work for a corporation that has made a functional currency election.

Update: No update has been received on this issue. It is not addressed in the legislation.

- ***Investment income*** – Will the subsidy be available to a business that earns portfolio income that is considered a specified investment business?

Update: If an eligible entity meets the tests generally, it would appear that being in receipt of investment income will not affect qualification.

Computation of the 75% Subsidy – Allowable Payroll Costs

- ***Basic computational issues*** – A number of straight forward issues were raised that may simply need clarification. These include **(updates are in parenthesis)**:
 - Is it all wages/salaries for all employees that qualify or just the employees at risk? **(all wages/salaries generally – see specific rules for exceptions)**
 - When did the crisis start for the purposes of determining pre-crisis wages? Presumably, it is pre-March 2020 wages? **(baseline remuneration is from January 1, 2020 to March 15)**
 - Will more clarity be provided where payrolls are not weekly? **(not addressed in legislation)**

- Should the program be based on when remuneration is earned rather than paid to reduce distortions. **(not addressed in legislation)**
- The discussion in the backgrounder around salary increases during the crisis was confusing. Specifically, will the 75% subsidy be limited to pre-crisis earnings for employees who were employed when the crisis started as implied in one reference. **(the formula in the legislation resolves this issue)**
- Where employees are paid uneven amounts, such as bonuses and commissions, how will this be adjusted for? The concern is that there could be weekly periods with no pay and others where the weekly maximum was exceeded. **(not addressed in legislation but guidance is needed)**
- Does remuneration for the purposes of the subsidy include employer contributions on CPP, EI, EHT? **(these amounts are not included but a specific subsidy amount is available for Employment Insurance, the Canada Pension Plan, the Quebec Pension Plan and the Quebec Parental Insurance Plan for employees who are on paid leave)**
- How does the subsidy work where the hours of an employee have been reduced due to a decline in work (say by 60% for example)? Is the 75% funding applied to the normal salary or the reduced salary? Similarly, does the 25% employer portion apply to the normal salary or reduced amount? **(these questions are resolved by reference to the legislation and formula for the subsidy)**
- Where the same employees work for different corporations in the group (i.e. they get separate T4s from each employer), how will the \$847 per week limit be calculated? **(the amount claimed by all employers cannot exceed the amount that would have been claimed had there been only one employer by virtue of s.125.7(5)(b))**
- Where an employer sets up a Supplementary Unemployment Benefit Plan and makes a top-up payment (and thus the employee has been laid off) does that payment qualify for the CEWS? **(no specific reference is made to such amounts)**
- **Non-resident employees** - If a Canadian corporation employs non-resident individuals, is their compensation included in the calculation of the 75% wage subsidy, or is it limited to Canadian resident employees? **(conditions to be considered an eligible employee include an individual employed in Canada by the eligible entity in the qualifying period)**

- **Owner-manager remuneration** – Two issues were raised with respect to owner-manager remuneration:
 - Many owner/managers pay themselves through dividends rather than salaries and not on a regular basis throughout the year. Has the government considered how to provide an appropriate subsidy amount for active owner-managers since their remuneration methods differ from that of non-shareholders? There are other issues as well, but all likely relate to the fact that many owner managers aren't "on the payroll" the same way as arm's length employees. **(these issues were not resolved in the legislation)**
 - The discussion on non-arm's length remuneration in the Backgrounder was unclear. **(the legislation now provides a clear calculation)**

2020 vs. 2019 Comparison Issues and Concerns

A number of issues were raised on the comparison of revenue for one month in 2020 to the corresponding month in the previous year. These include:

- **Uneven revenue** – Businesses with a long sales cycle who earn a relatively small number of high dollar sales may not be treated appropriately where the revenue recognition period is only one month.

Update: This issue was not addressed, other than the option to use January and February 2020 as the qualifying period in limited circumstances.

- **Business startups** - More information is needed on new businesses and startups where the 2020 vs. 2019 comparison won't work simply due to a lack of a comparison period. However, there will also be issues where relatively new businesses have been in existence and expanding for more than 12 months. See the business expansion item below.
- **Business expansion** – How will the rules work for eligible employers that had a major business expansion in 2019? For example, if a business expanded by 30% since May 2019 (could be due to organic growth or acquisitions), they will need to have an actual business decline of 60% or more due to the crisis to qualify for the subsidy when compared to an eligible employer where business volume remained constant. This seems unfair and inappropriate.

Update: The legislation allows a comparison to the same month in 2019 or a comparison to the average revenue for January and February 2020.

- **Business Contraction** – Conversely to the previous point, some businesses may have experienced a contraction since May 2019. For these eligible employers, will they need to separate the impact of pre-crisis contractions when determining whether the 30% test was met? Some have asked more general questions on whether a loss of revenue due to other factors such as the decline in oil prices needs to be differentiated.

Update: Despite the ability to compare to average revenue for January and February 2020, it is optional. Therefore, it would appear that the loss of business volume during the balance of 2019 can be considered for determining if the revenue test was met if the comparison is based on the same month in the prior year.

- **Cyclical businesses/charities** – It is not clear how businesses/charities that generate revenue on a cyclical basis (such as annual fundraising) or at different times in the year will be able to test the 30% drop in revenue based on comparable periods in prior year. For example, some may downsize now for expected future decreases while not meeting the 30% test now.

Update: No specific changes for cyclical businesses were made but several changes were introduced for registered charities and NPOs.

- **Lack of rigour around monthly cut offs** – For smaller businesses in particular, doing a proper monthly cut off for revenue recognition may not be feasible. In particular, these businesses may report annually for GST purposes in addition to annual income tax compliance requirements, and therefore, consistent monthly cut-offs may not be needed for tax compliance purposes. This could impact businesses that are near the 30% threshold if obtaining accurate monthly information is difficult.

Update: The CRA has not yet released any administrative guidance on applying the rules. Using the cash method may help with cut-off issues.

- **Unique fiscal periods** - The reference period for eligibility is March 2020 over March 2019, which is a calendar year period. Should non-monthly fiscal periods also be included, such as a month end that concluding on the fourth Friday in March 2019 to the fourth Friday in March 2020?

Update: This issue wasn't addressed.

- **Comparison rate for March 2020** – Given that the main economic impact of the crisis began during the month of March, should the rate for comparing March 2020 to March 2019 be lower than 30% (15% for example)?

Update: The rate for March was reduced to 15%.

Corporate group issues

Where an organization has multiple eligible employers, a number of issues and questions were passed on. At a general level, there were some basic issues such as whether the calculation is to be done on a group basis, but it seems clear that it is intended to be prepared for each eligible employer in the group. Also, some asked if associated corporations are subject to specific rules, but since there is no overall dollar cap for the subsidy, it appears not.

Many significant concerns were raised on the reference to eliminating non-arm's length revenue when computing revenue. It seems that very common business structures were not considered when the basic subsidy rules were created. We have provided some issues below, and these are just a sample, as there will be many additional issues and concerns:

- **Integrated business organizations** – Many integrated businesses have used separate corporations to conduct business, and this may involve significant intercompany transactions. A classic example would be an organization that manufactures, wholesales and has retail stores. In such a case, the manufacturing corporation may sell all of its production to the wholesale corporation and the retail corporation. Similarly, the wholesale corporation may have significant sales to the retail corporation. In this scenario, it would appear that salaries paid inside the manufacturing corporation could never qualify no matter how badly the organization is affected by the crisis since its revenue for the 30% test will always be zero. There will be many corporate structures where this will be an issue.
- **Centralized provision of services within an organization** – Some businesses have established separate entities to provide services to other members of business group for a fee, and these other group members earn the third-party revenue. In such a case, it appears that the salaries and wages of the entity providing services could never qualify.

- **Paymaster corporations** – Similar to the previous point, some organizations have centralized their payroll function in one corporation and allocate the cost to other members of the group. Passing on the payroll cost will not give rise to revenue that can be considered when applying.

Update: Two possible remedies were included in s.125.7(4). First, the legislation allows a group of affiliated entities to calculate consolidated revenue and then each eligible entity in the group can use the consolidated amounts for the purposes of the revenue test. Although a decline in revenue will be measured for the group as a whole, it does help to eliminate issues where revenue generation and payroll functions do not coordinate properly.

Second, the legislation provides a special rule where all or substantially all of an eligible entity's qualifying revenue is from other non-arm's length entities. In these situations, the rule generally allows the entity to determine its decline in revenue based on the decline in arm's length revenue experienced by non-arm's entities from which it earned revenue.

Issues for Charities and NPOs

We also received questions and concerns for charities and NPOs. We understand that additional consideration is being given to the determination of gross revenue for organizations in the charitable and non-profit sector. Some of the unique concerns raised include the following:

- Many charities and NPOs may be more active than usual providing relief and assistance during the crisis. Is a revenue test the right approach for determining whether a subsidy is appropriate? Is the goal for NPOs and charities to help them perform these activities?
- If revenue is derived from several sources, for example donations and government funding, does the decrease of 30% apply only to donations or is it based on all revenue sources?
- If part of the funding for operating charities comes from grants received from charitable foundations, is the failure to receive a grant due to the current economic situation considered a loss of revenue?

- Similar to issues discussed above on revenue recognition, these entities may not be treated appropriately with respect to the 30% rule based on how revenue is recorded for accounting purposes. For example, where an NPO uses the deferral method, revenue is recognized in the income statement not when it is received, but in the period when the related expenses are incurred, and therefore revenue could be effectively be spread over a long period of time.
- We have also been told that related NPOs may have the paymaster issue and the cyclical timing issues discussed above.

Update: Several changes were made to the rules for these entities, in particular the option to exclude funding from government sources from the determination of qualifying revenue. These changes should help deal with most of the issues above.

Administration and other issues

We also received some questions related to program administration:

- Will the two subsidy programs (the Temporary Wage Subsidy and the CEWS) be on CRA's Represent a Client service for those advisors who choose to prepare and file the information needed for both subsidy programs?
- What changes will be required for year-end reporting, especially for purposes of the T4 summary that reconciles the amount withheld and reported on the T4 vs the income taxes remitted to the CRA?
- There is significant concern around the requirement to pay the other 25% of the salary. Employers are concerned that there is considerable uncertainty around this point and could leave them in a position where they brought people back and retroactively CRA determines they didn't do enough to pay the other 25%.
- We generally are concerned about situations where businesses have not been able to properly keep their accounting records up to date and may therefore have trouble applying for the subsidy. For example, we assume that they will have to report revenue for March 2020 specifically.

Update: On the 25% of salary concern, the legislation contains no requirements relating to the government's statement. Otherwise, the CRA has not released an administrative guidance at the time of writing.