



Canadian tax alert

COVID-19 – Canada Emergency Wage Subsidy (CEWS) update and FAQ

October 29, 2020

The CEWS program was first enacted on April 11, 2020 to help Canadian businesses affected by the global COVID-19 pandemic. On July 27, 2020, the program was extended until November 21, 2020, with a potential additional extension to December 19, 2020, and significant changes were introduced to the original program mechanics. To learn more about the initial CEWS program and the July 27 amendments, please refer to our previous tax alerts dated [April 13, 2020](#) and [July 29, 2020](#).

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As we experience the second wave of the pandemic, the government plans to introduce legislation to continue to provide support to help businesses retain employees on payroll and re-hire workers. In this regard, on October 6, 2020, the Department of Finance (Finance) further extended the CEWS program from December 20, 2020 to June 2021. The extension of the CEWS is part of the government's commitment to restore employment to the level it was prior to the pandemic.

As the CEWS program evolves, the complexity associated with determining eligibility for the program and with preparing the claims continues to increase. Canada Revenue Agency (CRA) has provided additional guidance in an effort to address some of the common challenges that employers continue to face.

This tax alert summarizes the recent developments in the CEWS program, outstanding questions and issues related to the CEWS, and recent updates to CRA interpretations and guidance.

Key updates to the CEWS program

In October, the most significant updates to date announced by Finance include:

- **extension of the CEWS program** until June 2021;
- **maximum CEWS rate of 65%** currently in effect for Qualifying Period 8 (September 27, 2020 – October 24, 2020) will remain in place for subsequent periods until December 19, 2020;
- **harmonization of the revenue decline test** for the base subsidy and the top-up subsidy beginning September 27, 2020; and
- alignment of wage subsidy for **furloughed employees** with the benefits provided through Employment Insurance (EI) beginning October 25, 2020.

Extending the CEWS until June 2021

The government has provided some details on the mechanics of the CEWS program to be applied until December 19, 2020. Further, they have proposed additional changes to the program, summarized here.

It has been proposed by Finance that the subsidy rate for Qualifying Period 8 (September 27, 2020 – October 24, 2020) will continue to apply until December 19, 2020. That is, the rate of up to a maximum of 65 per cent, comprised of maximum base subsidy rate of 40% and top-up subsidy rate of 25%, should apply to Period 9 and Period 10. Note that this proposed change will increase the initial Period 9 maximum subsidy from 45% to 65%.

Top-up subsidy rate

It was announced that the mechanics of the top-up subsidy rate would change beginning in Period 8 (i.e., September 27, 2020). Currently, the top-up subsidy rate for Periods 5 to 7 is calculated based on the average revenue decline in the three months preceding the applicable period. Beginning in Period 8, the top-up subsidy is proposed to be calculated based on the revenue decline in respect of the current period, or the previous period, whichever is greater. For example, if an employer experiences a 70% revenue decline in Period 8 or Period 7, it would be eligible for a 65% subsidy in respect of Period 8 (i.e., 40% base and 25% top-up subsidy).

In the event an employer may have received a higher top-up rate using the three-month average approach, a safe harbor provision is proposed to allow the

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employer to use the higher subsidy rate calculated under both methods. This is intended to benefit employers that had severe 3-month declines but may have rebounded in the prior or current period.

For example, consider the following revenue declines of an eligible employer in periods 5 to 8:

Period 5: 80% decline
Period 6: 78% decline
Period 7: 60% decline
Period 8: 55% decline

In period 8, under the old top-up mechanics, the average preceding three-month's decline would be 73%, resulting in a maximum top-up subsidy rate of 25%. Under the proposed mechanics, the maximum top-up subsidy rate in Period 8 would be only 12.5% (i.e., $(60\% - 50\%) \times 1.25$). In this case, the safe harbour rule would apply to entitle the employer to the 25% top-up subsidy rate, being the higher rate under both methods. Accordingly, in Periods 8 to 10, the safe harbour rule ensures that the top-up rate under the new calculation is not less than what would have been calculated using the three-month average approach.

This change is applicable to eligible entities that experience a revenue decline of at least 50% in Periods 8, 9, or 10.

Note that this change adds another layer of flexibility and accessibility to the top-up mechanics, but also introduces an additional set of calculations and complexity to calculating an eligible employer's maximum subsidy rates.

Furloughed employees

After several announcements, the government has confirmed that the subsidy calculation for furloughed employees in Periods 5 to 8 remains the same as in the previous periods. Note that regulations or legislative changes to this effect have not yet been published.

Furthermore, beginning in Period 9 (October 25, 2020), the available wage subsidy for furloughed employees would be modified, such that the wage subsidy per week in respect of an arm's length furloughed employee (or a non-arm's length employee who was on payroll and received remuneration pre-crisis) is the amount of eligible remuneration paid in respect of the week, or, if the employee receives more than \$500/week, the greater of:

- a) \$500 and
- b) 55% of pre-crisis remuneration for the employee, capped at \$573.

Accordingly, beginning in Period 9, a furloughed employee's wage subsidy is capped at \$573 per week, which is intended to be aligned with the benefits provided through EI. This is in accordance with the announcement made by the government in July 2020 to harmonize the wage subsidy with other available programs, such as EI and Canada Emergency Response Benefit (CERB).

Summary of changes on weekly subsidy amount

A summary of the impact of the proposed changes on the maximum amount of subsidy available per employee per week has been included in the table below. Special attention should be made to this table, as the actual amount of subsidy available to each eligible entity will vary by each entity's unique combination of revenue declines in the current reference period as well in the preceding three calendar months. In addition, note that these calculations are based on the proposed changes and may not represent the actual subsidy amounts an employer is entitled to once the legislation is enacted.

Max Subsidy per Employee per Week	March	April	May	June	July	August	September	October	November	December
Revenue Reference	15-Mar-20	12-Apr-20	10-May-20	7-Jun-20	5-Jul-20	2-Aug-20	30-Aug-20	27-Sep-20	25-Oct-20	22-Nov-20
Salary Start	11-Apr-20	9-May-20	6-Jun-20	4-Jul-20	1-Aug-20	29-Aug-20	26-Sep-20	24-Oct-20	21-Nov-20	19-Dec-20
% Revenue Decline										
5%	\$ -	\$ -	\$ -	\$ -	\$ 68	\$ 68	\$ 56	\$ 45	\$ 45	\$ 45
10%	\$ -	\$ -	\$ -	\$ -	\$ 135	\$ 135	\$ 113	\$ 90	\$ 90	\$ 90
15%	\$ 847	\$ -	\$ -	\$ -	\$ 203	\$ 203	\$ 169	\$ 135	\$ 135	\$ 135
20%	\$ 847	\$ -	\$ -	\$ -	\$ 271	\$ 271	\$ 226	\$ 181	\$ 181	\$ 181
25%	\$ 847	\$ -	\$ -	\$ -	\$ 339	\$ 339	\$ 282	\$ 226	\$ 226	\$ 226
30%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 339	\$ 271	\$ 271	\$ 271
35%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 395	\$ 316	\$ 316	\$ 316
40%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 452	\$ 361	\$ 361	\$ 361
45%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 508	\$ 406	\$ 406	\$ 406
50%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 565	\$ 452	\$ 452	\$ 452
55%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 635	\$ 522	\$ 522	\$ 522
60%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 847	\$ 706	\$ 593	\$ 593	\$ 593
65%	\$ 847	\$ 847	\$ 847	\$ 847	\$ 889	\$ 889	\$ 776	\$ 663	\$ 663	\$ 663
70% or more	\$ 847	\$ 847	\$ 847	\$ 960	\$ 960	\$ 847	\$ 734	\$ 734	\$ 734	\$ 734

Source: Deloitte.

The above table assumes that the current month's decline and average preceding three-month's decline are identical.

When considering the above table, it should also be noted that an entity's actual subsidy for a particular period may be calculated using the current period's revenue decline or the immediately preceding period's revenue decline, whichever is higher.

Further, the actual subsidy amount per employee will vary, as the base and top-up percentages scale independently, based on the average decline in the current month (compared to the elected reference period) and the average decline for the last three months (compared to the elected reference period), respectively.

CRA audits of the CEWS applications

At the end of August 2020, CRA commenced an audit pilot project on CEWS claims, putting priority on higher dollar claims. CRA initiated these audits by sending the employer a very lengthy (9 pages) information request letter, asking the recipient to provide to the CRA a significant amount of information within a very short time period (typically 10 to 15 days). Some of the items requested include:

- documents from minute books;
- working papers to substantiate the computation of qualifying revenue;
- general ledgers reconciled to trial balances;
- trial balances reconciled to financial statements and qualifying revenue;
- revenue recognition policies for all items included in revenues;
- bank statements and cash receipts journals; and

- various payroll information by pay period, by employee for all claim periods, hours/days worked in a week, irregular pay periods, employment and loan contracts for all employees, etc.

As can be seen, these information requests are extremely detailed and do not appear to be tailored for a particular claim. Representations have been made to CRA indicating that these requests are onerous for CEWS claimants and the information requested may not always be relevant to a particular claim. In the most recent version of the CRA letters, we note that the CRA has started to alter their request for information to make it more tailored to the actual claim. Although the recent request letters appear to be shorter, the recipient is nevertheless required to gather a significant amount of information.

If you have already received such an information request, we highly recommend having up front discussions with the CRA auditor assigned to the audit to understand and agree on the information necessary to support the particular claim, and proactively manage the overall audit process. After all, the intent of this pilot program is to better inform the approach for the potential broader scale audits that are likely to follow in future months.

If you have not yet received an information request, we recommend reviewing your CEWS claims, including those already submitted, to assess readiness for a CRA audit and building an audit support file.

Questions and answers

The following section relates to recent updates to the CRA's interpretations, guidance and the most common questions that Deloitte continues to receive from employers in relation to eligibility for the CEWS, computation of qualifying revenue and eligible remuneration calculations.

1. Are mark-to-market valuations on investments included in the calculation of qualifying revenue?

During a conference call with CPA Canada on May 11, 2020, CRA had emphasized that "qualifying revenue" is based on "accounting revenue" as opposed to the tax treatment of a revenue amount. CRA's response to queries regarding unrealized gains on investments was that an eligible entity should *include* such amounts in "qualifying revenue", if this is their normal accounting practice¹.

However, in CRA's Technical Interpretation 2020-0855831E5 – *CEWS – qualifying revenue* (September 21, 2020), CRA took an alternative position that "unrealized gains and losses arising from mark-to-market valuation adjustment to investments are *not* included in qualifying revenue". It is CRA's view that the mark-to-market valuation adjustment to the carrying value of the investment does not give rise to an "inflow of cash, receivables, or other consideration" and therefore, such amounts do not satisfy the definition of qualifying revenue as defined in the Income Tax Act (the "Act").

Since the "qualifying revenue" definition is based on normal accounting standards, CRA's position appears to be contradictory specifically in light of financial institutions and financial services businesses, as well as charities and not for profits with portfolio investments, where normal accounting

¹ Thomson Reuters, *COVID-19 – Canada Emergency Wage Subsidy*, October 13, 2020, page 33.

principles generally require companies to fair value their investments resulting in gain/loss on account of income.

This modification may have drastic implications on the eligibility for the program and as such, we caution companies who included unrealized mark-to-market adjustments in their computation of qualifying revenues and filed claims on this basis. For clarity, this interpretation has retroactive application. Where required, previously filed CEWS claims can be amended.

This technical interpretation has raised several questions that remain unclear, including:

- The impact on other *unrealized* adjustments (such as unrealized gains and losses on foreign exchange, hedges and other derivative instruments).
- Whether *realized* gains and losses arising from mark-to-market adjustments, foreign exchange², hedges, derivatives, etc. should be included in qualifying revenue. Any realized gain or loss could be interpreted to result in an "inflow of cash, receivables, or other consideration". Therefore, following CRA's explanation outlined in the document above, such items could be included in qualifying revenue.
- With respect to *realized* gains and losses, additional areas of uncertainty include:
 - If a realized loss is interpreted to not satisfy the definition of qualifying revenue (as a result of being an "outflow"), can it be offset against realized gains, if such gains are included in qualifying revenue?
 - Whether to include gross proceeds or simply the gain/loss component. CRA's technical interpretation refers to unrealized "gains and losses", which seems to imply that the "gain and loss" component should be considered. However, there is no clear indication from the CRA on this matter.

2. Can an eligible entity use the "Percentage of Completion method" to recognize revenue for the purpose of calculating qualifying revenue?

Yes. CRA's Technical Interpretation 2020-0855831E5 – CEWS – *qualifying revenue* (September 20, 2020), provides that where the "Percentage of Completion" method is the revenue recognition policy under an eligible entity's normal accounting practices, revenues recognized using this approach may be included in the calculation of qualifying revenue. CRA's position is grounded on the basis that these revenues typically result in a corresponding inflow of cash, accounts receivable, or other consideration.

3. Do joint ventures qualify for the wage subsidy?

CRA's view is that where a joint venture (JV) has no legal form³ and is a "limited business undertaking by two or more parties, in which the parties have a joint property interest in the subject matter of the venture and

² Frequently asked questions (FAQ) – Canada emergency wage subsidy (CEWS), as published by the CRA (updated on July 9, 2020). Question 6-7 provides guidance on the treatment of foreign exchange gains and losses in determining qualifying revenue. However, the FAQ does not explicitly delineate *realized* foreign exchange vs. *unrealized* foreign exchange.

³ If a JV is an incorporated entity, further consideration may be required to determine whether it qualifies for the wage subsidy.

share control and management of the enterprise”,⁴ such a JV is not an eligible employer for the purpose of CEWS.

However, where an eligible employer’s qualifying revenue is substantially (i.e., 90% or more) in respect of a joint venture, and all of the interests in an eligible employer are owned by participants in a joint venture, then the eligible employer may elect under subsection 125.7(4)(c) of the Act to use the qualifying revenue of the joint venture for purposes of determining their revenue decline.

4. Does the election under subsection 125.7(4)(d) apply to a chain of non-arm's length person's or partnerships?

Paragraph 125.7(4)(d) of the Act allows an eligible employer to elect to use a weighted average approach in determining qualifying revenue when all or substantially all of its revenue is earned from one or more non-arm's length persons or partnerships (NAL). In applying this approach, the amount used for each of the NAL entities' qualifying revenue includes revenues earned both inside and outside Canada but excludes amounts derived from persons or partnerships not dealing at arm's length with it.

In CRA Technical Interpretation 2020-0851731E5 – *CEWS – 125.7(4)(d) election – NAL chain* (September 28, 2020), CRA has clarified that this election may be made only by an eligible entity and those NAL entities with whom it *directly* earns qualifying revenues. That is, the 125.7(4)(d) election “may not be made by a multi-tiered structure or chain of entities that are not dealing with each other at arm's length”.

For example, Canco derives more than 90% of its revenues from Forco A. Canco and Forco A make the election in paragraph 125.7(4)(d) to determine Canco's decline in qualifying revenue based on Forco A's decline in qualifying revenue. However, if Forco A also derives more than 90% of its revenues from a non-arm's length party Forco B, Forco A would not have any (or very nominal) qualifying revenue because it must exclude all revenues derived from non-arm's length parties. In this situation, paragraph 125.7(4)(d) election would not work, as it cannot be applied again at the Forco A level⁵.

5. Is the subsection 125.7(4)(d) election available after Period 4?

Paragraph 125.7(4)(d) of the Act currently references paragraph (c) of the definition “qualifying entity” in subsection 125.7(1), which only refers to Qualifying Period 1 through 4. Therefore, this election may not be available after Qualifying Period 4. Deloitte and CPA Canada continue to have discussions with the CRA and have asked them to clarify whether the election is available for Period 5 onwards. This matter is currently under review.

6. Can an eligible employer use “fiscal month”, rather than a “calendar month”, for purposes of calculating its qualifying revenue?

Many employers use adjusted monthly periods as part of their normal accounting practices in order to present a more accurate picture of financial

⁴ Frequently asked questions – Canada emergency wage subsidy (CEWS), as published by the CRA (updated on October 6, 2020), question 3-10.

⁵ *Idem*, question 8-02.

results in each period (i.e., generally to provide better matching of revenues to expenses as well as better measure cyclicalities of revenues). The CEWS legislation provides that an eligible employer must use a calendar month when computing qualifying revenue.

CRA confirmed in a recent webinar with CPA Canada that an eligible employer must use a calendar month, regardless of whether they are a fiscal filer.

For employers that have experienced significant declines in the first four periods, using either approach may not impact their eligibility for the program in Periods 1 to 4. However, it should be noted that for Period 5 onwards, since the specific decline in revenue is directly correlated to the amount of subsidy available, it will be prudent to calendarize revenues.

7. Does an employer need to include revenues earned from manufacturing essential products related to the pandemic even if it generates no profit?

Yes. It is CRA's view that an eligible entity must include revenue that relates to the inflow of cash, receivables, or other consideration arising in the course of ordinary activities. Accordingly, this would include revenue arising from the sale of new products, including those manufactured and sold as a result of the pandemic⁶.

8. Would employers who use paymasters qualify for CEWS?

As discussed in our previous [tax alert](#), the definition of "qualifying entity" was amended to include eligible employers that outsource the payroll function for their employees to a "payroll service provider". The CEWS legislation extended eligibility to entities who did not have a CRA payroll account as of March 15, 2020 but instead use a payroll service provider, who makes the entity's payroll remittances on the provider's CRA payroll account.

CRA has now provided the mechanics on how such an employer can apply for the subsidy. They clarified that each eligible employer must make their wage subsidy application, which means that they need their own payroll account number to apply for and receive the subsidy. Once the payroll account is open, CRA will require verification from the party that made remittances on behalf of the eligible employer and confirm these remittances can be attributed back to January 1, 2020. Going forward, the eligible employer is expected to make all future payroll remittances out of their own new payroll account. Further details of the mechanics are outlined in Question 3-8 on CRA's FAQ page.

9. Can an eligible employer that participates in a cost-sharing arrangement with respect to salary or wages qualify for the wage subsidy?

Where the cost-sharing arrangement is bound by contract, each of the separate eligible employers may qualify for the wage subsidy in respect of their portion of the eligible remuneration.

⁶ *Idem*, question 6-2.1.

If only one of the eligible employers participating in the cost-sharing arrangement had a payroll account and made payroll remittances to CRA on or before March 15, 2020, the other eligible employers participating in the arrangement would need to register for their own payroll account in order to qualify for the subsidy. However, unlike the requirements under a third-party provider outlined in Question 3-8 on the CRA's FAQ page, the eligible employers are not required to use the new payroll account for future remittances and may continue to use their existing account⁷.

10. What does “employed in Canada” mean in respect of the definition of an “eligible employee”?

It is CRA's view that an employee is considered to be “employed in Canada” if they fulfil their duties of employment within Canada⁸. On this basis, a non-resident employee can be an eligible employee if they reside outside of Canada but physically performs their duties of employment within Canada. On the other hand, employees of a Canadian entity fulfilling their services outside of Canada may not be eligible employees.

Moreover, CRA has clarified that they expect employers to be testing “employed in Canada” on a weekly basis (i.e., an employee that works both inside and outside of Canada may swing between eligible and ineligible).

11. Does eligible remuneration include maternity or parental top-up payments paid to an eligible employee?

Maternity or parental top-up payments qualify as eligible remuneration in respect of a particular week in the claim period. An employee on maternity or parental leave is not considered to be a furloughed employee (i.e., on leave with pay) for purposes of calculating the wage subsidy⁹.

12. What are the changes to the T4 reporting requirements for eligible employers claiming the wage subsidy?

In order to assist CRA with validating payments under CEWS, CERB and Canada Emergency Student Benefit (CESB), new codes have been introduced in the T4 slips to identify employment income made to eligible employees in particular CEWS periods.

For tax year 2020, in addition to reporting regular employment income in Box 14 or Code 71, eligible employers will use new codes in the “Other Information” section included at the bottom of the T4 slip when reporting employment income and/or retroactive payments in the following periods:

T4 Code	Applicable CEWS Period	Applicable Dates
Code 57	Periods 1 and 2	March 15, 2020 – May 9, 2020
Code 58	Periods 3 and 4	May 10, 2020 – July 4, 2020
Code 59	Periods 5 and 6	July 5, 2020 to August 29, 2020
Code 60	Period 7	August 30, 2020 – September 26, 2020

⁷ *Idem*, question 3-9.

⁸ *Idem*, question 13-1.

⁹ *Idem*, question 17-4.

To cover the additional periods in the extended CEWS program, CRA may release additional codes in due course.

Note that these T4 requirements apply to ALL employers and not just those taking advantage of CEWS. In other words, ALL employers will have additional reporting requirements.

It is also important to note that while for purposes of CEWS, eligible remuneration is determined on an "earned basis", the new T4 reporting requires remuneration to be reported on a "paid" basis.

13. Should eligible remuneration of an employee be reduced by other government subsidies?

No. If the eligible employer can reasonably expect funding from another government program in respect of the salary, wages, or other remuneration paid to an eligible employee who qualifies for the wage subsidy, the amount of the other funding should not reduce the amount of the eligible remuneration in respect of that employee¹⁰. However, in cases where the eligible employee receives funding *directly* from a government entity, the eligible remuneration should only consider the amount that the employer actually paid to the employee.

How can Deloitte help?

If you have questions, please contact your Deloitte representative or any of the individuals noted in this alert.

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¹⁰ *Idem*, question 20-04.

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