Written Submission for the Pre-Budget Consultations in Advance of the Upcoming Federal Budget

By: RSM Canada

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List of Recommendations:

Recommendation #1: With respect to the Canada Emergency Wage Subsidy (CEWS), we recommend that the definition of baseline remuneration in subsection 125.7(1) of the *Income Tax Act* be amended for employees that do not deal at arm's length with the eligible entity to include the average weekly eligible remuneration paid to the eligible employee by the eligible entity (1) in 2019, or (2) in the 12 months immediately before March 15, 2020.

Recommendation #2: With respect to the CEWS program, we also recommend that paragraph 125.7(1)(c) of the *Income Tax Act* be amended to clarify whether cost recovery amounts related to payroll are contemplated within the scope of subparagraphs 125.7(1)(c)(i) to (iii) of the Act.

Recommendation #3: With respect to the Canada Emergency Response Benefit (CERB), we recommend amending the eligibility conditions in subsection 6(1) of the *Canada Emergency Response Benefit Act* to include non-arm's length workers who have not ceased working for reasons related to COVID-19.

Recommendation #4: To move into economic recovery, the government should boost productivity through investment in four key areas:

- Digital infrastructure
- Goods movement
- Reducing congestion in urban centres
- The technology sector - in particular for small and medium-sized technology businesses, which are an important driver of:
    - i) Entrepreneurship and innovation – one of Canada's greatest strengths.
    - ii) Vital research and development initiatives - these have a strong connection to the health of the economy.

RSM Canada appreciates the opportunity to provide input to the Standing Committee on Finance as part of its pre-budget consultations. RSM recognizes the significant efforts made by the federal government through its COVID-19 Economic Response Plan to address unprecedented needs that have arisen as a result of the pandemic. In particular, the Canada Emergency Wage Subsidy (CEWS) and the Canada Emergency Response Benefit (CERB) are welcome initiatives aimed at preserving jobs and supporting those who have lost them.

However, as we continue to navigate the pandemic, there is an important business segment that is unable to fully take advantage of the CEWS and CERB programs: that of owner-managed businesses, who represent a significant portion of the tax base in Canada. Under their unique business models, owner-managers operate in ways that are not currently reflected in terms of the eligibility requirements of these two programs – for example, with respect to how remuneration is paid to them and when. Another example surrounds the eligibility rules for the CERB program, which require that an individual must have ceased to work due to COVID-19. The reality is that many owner-managers are continuing to work through the pandemic in an effort to preserve their businesses, without remuneration.

In order to ensure the least amount of disruption and lessen the impact of the pandemic on owner-managers, we provide recommendations below that address their unique needs with respect to increasing accessibility to the CEWS and CERB programs.

As we look ahead to recovery, we also provide recommendations for boosting productivity and reducing the debt.

CEWS baseline remuneration for owner-managers

The CEWS legislation does not contemplate providing the CEWS to owner-managed businesses if no eligible remuneration as described in paragraphs 153(1)(a) or (g) of the *Income Tax Act* (Act) is paid to the owner-manager in the baseline remuneration period. As of July 20, 2020, baseline remuneration is generally defined to be the average weekly eligible remuneration paid during January 1 and March 15, 2020. The government has expanded the definition of baseline remuneration in Bill C-20 to include eligible remuneration paid during March 1 and May 31, 2019 for Periods 1 to 4, or alternatively during March 1 and June 30, 2019 for Period 4, and during July 1 and December 31, 2019 for Period 5 and subsequent periods. The prescribed baseline remuneration periods, specifically in respect of Periods 1 to 4, do not align with the practical realities of many owner-managed businesses.

Often times, an owner-manager's remuneration is not paid or determined until the end of the year. Rather than having a regular, recurring income throughout the year, the owner-manager will accept shareholder advances or draws periodically as required. At year-end, or generally after the baseline remuneration in respect of Periods 1 to 4 has passed, and once the business' financial and tax results can be estimated, the owner-manager typically settles the shareholder balance(s) by way of dividend or salary payments. In this circumstance, where an owner-managed business adopts a calendar year-end, the owner-manager is likely to only receive eligible remuneration outside of the baseline remuneration period. As a result, many owner-managers may be ineligible from claiming the CEWS for Periods 1 to 4.

A similar, although less pronounced, issue exists for Periods 5 and the subsequent periods. Bill C-20 now allows eligible entities to elect to use the July 1 to December 31, 2019 time frame to determine baseline remuneration.

However, if an eligible employee is remunerated unevenly and at *ad hoc* times throughout the year – as is often the case with owner-managers with unpredictable or fluctuating business cycles – this new extended definition of baseline remuneration may not accurately capture the employee's true averaged wages. Owner-managed businesses with June 30 year-ends may similarly experience challenges applying the newly extended definition of baseline remuneration in Period 5 and subsequent periods if salary is typically paid to the owner-manager, for example, in April and May of each year.

We recommend that the definition of baseline remuneration in subsection 125.7(1) of the Act be amended for employees that do not deal at arm's length with the eligible entity to include the average weekly eligible remuneration paid to the eligible employee by the eligible entity (1) in 2019, or (2) in the 12 months immediately before March 15, 2020.

Exception to eligible remuneration for purposes of the CEWS program

Pursuant to the 'eligible remuneration' definition in subparagraphs 125.7(1)(c)(i) to (iii) of the Act, there is an express exclusion for amounts that can reasonably be expected to be paid or returned, directly or indirectly, to the eligible entity, a non-arm's length person, or a person or partnership at direction of the eligible entity. The phrase "reasonably be expected to be paid or returned, directly or indirectly" creates uncertainty.

For example, assume an eligible entity employs and pays eligible employees to perform routine support services (e.g., human resource or back office services) for a related entity. The eligible entity would expect to be compensated in a manner that enables it to cover its costs incurred in providing these services, such as payroll, and to possibly to earn a reasonable profit. Such arrangements are commonplace to streamline operations and optimize business practices. However, it is unclear whether such cost recovery of the eligible entity's payroll costs would constitute "amounts that can reasonably be expected to be paid or returned, directly or indirectly, to the eligible entity" that would grind the eligible entity's eligible remuneration paid to its eligible employees down to nil under subparagraphs 125.7(1)(c)(i) to (iii). This would appear to be an unfair result because although the related group has expended net payroll costs to remunerate employees for services, the specific eligible entity that employs the eligible employees may be ineligible for the CEWS if its payroll costs are considered to have been reimbursed to it.

We recommend that paragraph 125.7(1)(c) of the Act be amended to clarify whether cost recovery amounts related to payroll are contemplated within the scope of subparagraphs 125.7(1)(c)(i) to (iii) of the Act.

Eligible work for purposes of the CERB program

The CERB is available where, among other conditions, individuals cease working for reasons related to COVID-19. However, owner-managers are often not eligible for the CERB because they control their companies, and in reality, would not stop working during COVID-19, even without remuneration because they want their businesses to be successful and will continue to seek new business. The essence of the owner-managed business is characterized by the inextricable relationship between the business and the owner-manager. In practice, because owner-managers are so heavily invested in the growth and management of their business, challenges like COVID-19 would motivate owner-managers to work harder to transition and adapt the business, rather than cease working as required by the CERB.

We recommend amending the eligibility conditions in subsection 6(1) of the *Canada Emergency Response Benefit Act* to include non-arm's length workers who have not ceased working for reasons related to COVID-19.

Investments to Boost Productivity and Canada's competitiveness

According to the Economic and Fiscal Snapshot issued on July 8, 2020, Canada's national debt is expected to reach $1.2 trillion by March 31, 2021. This reflects the significant spending made by the government under the Canada's COVID-19 Economic Response Plan to address unprecedented needs across all sectors of our economy and society – through much-needed initiatives such as the CEWS and CERB. In releasing its most recent The Real Economy Report, RSM Canada noted that in order to move into economic recovery, the government needs to boost investment sooner rather than later – making recommendations for investments in three key areas that are referenced below.

The pandemic has dealt a tough blow to Canada's industrial sector – an area already struggling as a result of the ongoing trade war between the U.S. and China. Despite some promising short-term economic indicators, and the Bank of Canada's steps to accommodate stimulus measures, it is imperative that the government make prudent investments to keep industrial recovery moving in the right direction as well as boost trade efforts as much as possible.

There are four key investment areas that will boost productivity and revenue. The government should focus on building projects that are not just shovel ready but shovel worthy. We recommend that the government consider making investments in the following areas to begin to set the groundwork for growth:

- Digital infrastructure – for example, continued investment in projects that will deliver broadband for more rural areas of Canada.
- Investment in goods movement.
- Investment to reduce congestion in urban centres.
- The technology sector - in particular for small and medium-sized technology businesses, which are an important driver of:
  - i) Entrepreneurship and innovation – one of Canada's greatest strengths.
  - ii) Vital research and development initiatives - these have a strong connection to the health of the economy.