

Pay Equity

The harsh reality of the special tax calculation

By Jamie Golombek

CA, CPA, CFP, CLU, TEP, Vice-President, Taxation & Estate Planning



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Pay equity legislation requires female-dominated jobs to receive the same pay as male-dominated jobs – equal pay for work that is deemed to be of equal value. In October 1999, the Human Rights Tribunal argued that employees in female-dominated categories were underpaid compared to men doing similar work, and should be eligible for retroactive payments with interest. As a result, approximately 230,000 Canadians – primarily women – received equalization payments from the federal government.

Tax implications of a pay equity payment

A pay equity payment is a lump sum amount that represents wage adjustments for several years of employment and the accumulation of interest on that pay adjustment. Both the

employment income and interest portions of the payment are taxable in the year received.

Using a special tax calculation

Under tax legislation introduced in 1999 primarily to deal with lump-sum retroactive pay equity payments, the government may perform a special tax calculation wherein the Canada Customs and Revenue Agency (CCRA) will reduce a taxpayer's taxable income for a particular year by the amount of the pay equity payment that corresponds to prior years. This avoids having to include the full lump sum payment in income all in one year. Tax is calculated on the balance of that year's taxable income in the normal manner, and a tax adjustment is added for the previous years' part of the payment.

Tax adjustment

This tax adjustment includes the additional tax that would have been paid in each of the previous years if the retroactive pay equity had been included in employment income in those specific years, as well as a deemed tax. This deemed tax represents interest calculated on the additional tax for each of the previous years, presumably to compensate the government for not having had their money "on time." If the tax adjustment (i.e., the additional tax

plus the deemed tax) that the CCRA calculates using this special method is less than the amount calculated if the entire amount was taxable in one year, this special method is used.

The "deemed tax" (representing interest on amounts relating to prior years) is calculated at the CCRA's prescribed rates for refund interest, which fluctuated between five per cent and 16 per cent from 1984 to 1999. Note that the further back the retroactive payment period, the lower the tax adjustment benefit becomes. This is due to the increasing effect of the deemed tax (representing possibly many years' worth of interest owing). A recent case heard by the Tax Court of Canada dealt specifically with the harshness (and consequences) of the deemed tax.

Milliken vs. The Queen

In 1997, Mr. Robert Milliken was awarded a lump sum payment of \$147,191 from the Government of Ontario as a result of an arbitration settlement reached with respect to his employment from 1987 to 1996. Of the settlement amount, \$101,716 represented principal and \$45,475 was with respect to interest. The CCRA applied the special tax calculation as well as the deemed tax, and reached a conclusion that applying these provisions would

result in greater tax owing by Mr. Milliken than the tax owing by bringing all of the principal into income in one year (1997). Mr. Milliken disagreed with the tax calculation and specifically objected to the CCRA including an interest component in the calculation.

As already mentioned, the special rules provide that interest is payable on the sum of the increased taxes to reflect that the tax was not paid in the particular relevant years. The judge stated "while I can fully appreciate [Milliken's] incredulity that the interest calculation results in such a significant element of the calculation ... I can find no error in the calculation itself. The Act simply requires this interest calculation to be included. I cannot ignore that requirement. In applying the calculation to [Milliken's] circumstances, I find that those provisions do not offer [him] any relief. If Mr. Milliken, as I am sure he does, has concerns

with the policy that led to this result, as indicated, that is to be addressed to the legislators, and I understand that he may have already taken steps in that regard."

CCRA's appeals officer testified that, from his experience, there is no advantage to a taxpayer notionally bringing income in over more than four years due to the requirement to include interest on that tax. According to the judge, "[there] appears to be a disparity between the legislation and what appears to have been an intent of Parliament to offer some relief to people such as [Milliken]. The legislative requirement to include interest, though contemplated by the Finance Minister in theory, in practice appears to greatly reduce any benefit contemplated by the introduction of these sections."

A lesson learned

The lesson we learn here is a difficult one, albeit, correct. The

court is not the legislative body. If legislation is imperfect, it is for the legislators to deal with it. The courts must interpret the legislation as it is written. The judge concluded by saying "while this may seem unfair to [Milliken], and I know that it does, it is the law that I have to deal with." He proceeded to dismiss Milliken's appeal.

