Fall Economic Statement 2020 – Tax measures

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The federal Fall Economic Statement 2020[1] (the "Statement") included a number of tax measures that will affect Canadian taxpayers. Rather than summarize every tax measure included in the Statement, this report will focus on some of the tax measures that are of most interest to individuals and small businesses.

Canada Child Benefit (CCB)

The CCB is a non-taxable benefit that is paid monthly and is based on adjusted family net income and the number of children in your family. The maximum amount of CCB per child under age six is $6,765 per child (2020 benefit year) and the maximum amount for older children, aged 6 through 17, is $5,708 per child. The CCB is reduced when adjusted family income exceeds $31,711 (2020) and the rate of reduction depends on the number of children.

Today's Statement announced additional, temporary support totaling up to $1,200 in 2021 for each child under the age of six. Families entitled to the CCB with net income at or below $120,000 will receive four tax-free payments of $300 per child, with the first payment being made shortly after the enabling legislation is passed, and subsequent payments in the months of April, July, and October 2021. Families entitled to the CCB with net income above $120,000 would receive a tax-free payment of $150 per child at each of these times, for a total benefit of $600.

Home office expenses

With millions of employees working from home as a result of the COVID-19 pandemic, the question on many employees' minds is whether they can deduct various home-office expenses from their 2020 income next tax season.

Under the *Income Tax Act*, employees who are required to pay for employment expenses, including those for a home office, that are not reimbursed by their employer may be able to claim a deduction on their return for such expenses. For a valid claim, employees must generally obtain a properly completed and signed Canada Revenue Agency (CRA) *Form T2200, Declaration of Conditions of Employment*.

To be entitled to deduct home-office expenses, an employee must be "required by the contract of employment" to maintain a home office, as certified by the employer on the T2200. The space must also be either where she "principally" (more than 50 per cent of the time) performs her duties of employment or be used exclusively to meet customers on a regular and continuous basis in the course of employment.

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[1] "Fall Economic Statement 2020" is available online at budget.gc.ca/fes-eea/2020/report-rapport/toc-tdm-en.html.

What home-office expenses can employees deduct?

An employee who qualifies to write off home expenses may deduct a variety of expenses, such as the cost of rent, electricity, heating and maintenance, but they can't deduct mortgage interest, property taxes, home insurance or capital expenses or depreciation (capital cost allowance). That means the cost of that new, ergonomic office chair they just had delivered won't be deductible, nor would the cost of a large, widescreen monitor, both of which would be considered capital expenses.

For utilities and certain other expenses, an employee needs to allocate the expenses on a "reasonable basis," which is typically done by taking the area of the work space divided by the total finished area (including hallways, bathrooms, kitchens, etc.) of the home. If the employee rents the house or apartment where they have their home office, they can also deduct the percentage of the rent they paid that relates to the work space.

Form T2200

If every employee needs to get a signed T2200 from their employer to justify a home-office deduction, this will put an enormous strain on employers come next tax season. To this end, many interested parties approached the government to ask whether a streamlined approach could be used in lieu of requiring each employer to issue its own Form T2200 evidencing that their employees were required to work from home during the pandemic.

Administrative relief

The calculation of home office expenses can be burdensome so, to help alleviate the burden, the government announced in today's Statement that it will allow employees working from home in 2020 due to COVID-19 with "modest expenses" to claim up to $400, based on the amount of time working from home, without the need to track detailed expenses and will generally not request that they provide a signed form from their employers.

Further details will be announced by the CRA in weeks ahead.

Employee stock options

In 2019, the federal government introduced draft legislation (never enacted) that proposed to limit the preferential tax treatment associated with certain employee stock options. The draft rules, originally introduced in the March 2019 federal budget, were aimed at fulfilling a 2015 Liberal election platform promise to limit the benefits of the stock option deduction by placing a cap on how much can be claimed. The public policy rationale previously cited by the government for the preferential tax treatment of employee stock options was to support younger and growing Canadian businesses. That being said, the government also previously stated that it "does not believe that employee stock options should be used as a tax-preferred method of compensation for executives of large, mature companies."

In the backgrounder accompanying the draft legislation, the government stated that in 2017, 36,630 Canadians claimed, in aggregate, nearly $2.1 billion-worth of stock option deductions on their 2017 tax returns. Among these taxpayers, 2,300 individuals, each with a total personal annual income of over $1 million, accounted for nearly two-thirds of the $2.1 billion in stock option deductions claimed.

Here's a quick overview of how employee stock options work, the current tax treatment, and the proposed tax treatment announced in today's Statement.

Who uses stock options?

Employee stock options are used by some corporations as part of their total compensation package to entice and retain skilled workers by offering those employees the right to purchase company stock at a predetermined price, generally for a predetermined period of time. In the past decade, it's become especially popular for start-ups and smaller growth companies, who don't have much in the way of cash flow (or profits) to offer potential recruits stock options in lieu of cash, which ties their compensation to the future success of the company.

Current rules

Under current tax rules, when an employee stock option is exercised, the difference between the exercise price and the fair market value of the share is included in income as an employment benefit. For qualifying options, you can claim an offsetting deduction (the “stock option deduction”) equal to one-half the benefit, so that only 50 per cent of the stock option benefit is taxed at your marginal rate. The tax result is to effectively tax the benefit associated with the exercise of employee stock options as if it were a capital gain, although technically, the income is still considered to be employment income.

New rules (July 1, 2021)

Today’s Statement proposed that the government will set a $200,000 annual cap on the amount of employee stock options that may “vest” for an employee in a year and continue to qualify for the stock option deduction. An option is said to vest when it first becomes exercisable. For the purpose of determining the amount of options that vest in any calendar year, the value of those options will be the fair market value of the underlying shares when the options were granted.

If an employee exercises an employee stock option that exceeds the $200,000 limit in a particular vesting year, the difference between the fair market value of the share at the time the option is exercised and the exercise price paid by the employee to acquire the share will simply be treated as employment income and be 100 per cent taxable, making it consistent with the treatment of other forms of employment income such as salary, wages and a bonus. In other words, the employee won’t be entitled to the stock option deduction on the exercise of these options. In these circumstances, the employer will be entitled to a tax deduction for the amount of the stock option benefit included in the employee’s income.

The Statement announced that the new tax rules will apply to employee stock options granted after June 2021. The existing rules will continue to apply to options granted before July 2021.

Exempt companies

Stock option plans offered by Canadian controlled private companies (CCPCs) will generally be exempt from the new rules. In addition, non-CCPC employers whose annual gross revenue does not exceed $500 million would generally not be subject to the new rules. Employers that are exempt from these new rules will not be permitted to opt in to the new rules.

Example

For example, let’s say Jay is an executive at Plumbing Co., a large, mature Canadian public company, who is awarded 20,000 stock options in July 2021. The exercise price is $10 (which is equal to the share price when the options are issued) and the options expire in ten years (in 2031) and vest after three years, in 2024.

Since Jay’s options were granted in July 2021 when the price was $10, then all of Jay’s 2021 options, which vest in 2024, would be eligible for the stock option deduction since the total amount of options that vest in 2024 is $200,000 (in other words, 20,000 shares times $10 per share).

This holds true regardless of the price of Plumbing Co. shares when Jay exercises the option. So, if Jay exercises the options in 2026 when the shares have doubled in price to $20, then Jay’s entire stock option benefit of $200,000 (20,000 times ($20 minus $10)) would be eligible for the 50 per cent stock option deduction and Jay would pay tax on $100,000 in 2026 at his marginal tax rate.

Charitable donations

Under the current tax rules, if an employee donates a publicly listed share acquired under an employee stock option agreement within 30 days of the exercise of the option to a registered charity, the entire employee stock option benefit is effectively tax-free and a donation receipt can be received for the fair market value of the shares being donated.

Going forward, if an employee donates a publicly-listed share acquired under a stock option that is no longer eligible for the 50 per cent stock option deduction, a donation receipt is still available but the full stock option benefit would be taxable. Any capital gain that has accrued since the shares were acquired under the stock option agreement, however, would continue to be eligible for the full exemption from capital gains tax.

GST / HST measures

Cross-border goods, digital products and services, and app-based short-term accommodations

With the ever-increasing digitalization of the economy, the use of digital apps, online gaming and video and music streaming, the government is missing out on collecting GST / HST on many of these services which are provided by non-resident corporations which, under the current rules, do not have to collect GST / HST.

Beginning on July 1, 2021, the government is proposing that various goods and services be subject to the GST / HST. These would include GST / HST on streaming services (think NETFLIX), goods sold by non-resident vendors using Canadian fulfillment warehouses (think AMAZON) as well as short-term accommodations booked through an app (think AiRBNB).

No GST / HST on masks and face shields

In order to support public health during COVID-19, the government proposed to zero-rate certain face masks and face shields from the Goods and Services Tax / Harmonized Sales Tax (GST / HST). This means that consumers will not have to pay GST / HST on eligible masks purchased after December 6, 2020. This zero-rating is proposed to only be in effect until their use is no longer broadly recommended by public health officials for COVID-19.

Canadian housing owned by non-residents

To deal with the rising price of homes in some Canadian cities, the government announced that it will be cracking down to make foreign, non-resident owners, “who simply use Canada as a place to passively store their wealth in housing, pay their fair share.” This will be done by taking steps over the upcoming year to implement a national, tax-based measure targeting the unproductive use of domestic housing owned by non-resident, non-Canadians, which removes these assets from the domestic housing supply. No further details have been released.

Tax evasion and aggressive tax avoidance

In the Statement, the government proposed new funding for new CRA initiatives designed “to crack down on tax evasion and combat aggressive tax avoidance.” In the Statement, the government proposed spending an additional $606 million over five years to fund new CRA initiatives that are estimated will recover $1.4 billion in revenues. As the government stated, “The CRA will hire additional offshore-focused auditors to focus on individuals who avoid taxes by hiding income and assets offshore, enhance the audit function targeting higher-risk tax filings, including those of high-net worth individuals, and strengthen its ability to fight tax crimes such as money laundering and terrorist financing by upgrading tools and increasing international cooperation.”

The government also said it will launch consultations in the coming months on the modernization of Canada’s anti-avoidance rules and, in particular, the General Anti-Avoidance Rule (GAAR).

COVID-19 relief measures for businesses[2]

Canada Emergency Wage Subsidy (CEWS)

The CEWS provides both large and small employers with a subsidy that is based on employee wages, to help employers to keep their workers when they have had a decline in revenues.[3] The method for calculating the CEWS has changed significantly since it was first launched. It is calculated separately for each four-week period. CEWS is now calculated as a percentage of eligible remuneration and the rate of the subsidy depends on the percentage of revenue drop that a business has borne. It now consists of a base subsidy (Base CEWS) and a top-up subsidy (Top-up CEWS). The maximum Base CEWS from September 27, 2020 through December 19, 2020 was 40% of eligible remuneration, and was reached at a revenue percentage drop of at least 50%. When the Top-up CEWS was added, the maximum CEWS was at a 65% rate.

Today's Statement announced that the maximum Top-up CEWS will be increased to 35% for the period beginning December 20, 2020 and that this rate will be extended until March 13, 2021. Together with the Base CEWS, which will remain at 40%, the total maximum CEWS for this period will be at a 75% rate.

Canada Emergency Rent Subsidy (CERS)

The CERS provides rental assistance to both qualifying property owners and non-residential tenants who have incurred a drop in revenue.[4] CERS launched in late September 2020 and runs through June 2021. Similar to the CEWS, the CERS consists of a base subsidy (Base CERS) and a top-up subsidy otherwise known as Lockdown Support, and is calculated per four-week period. The Base CERS is calculated based on a sliding scale of eligible expenses depending on the level of revenue decline. When the CERS was originally announced on October 9, 2020, the maximum Base CERS for the periods running from September 27, 2020 to December 19, 2020 was set at a 65% rate. This maximum Base CERS would be reached with a revenue decline of 70% or more. Together with the Lockdown Support, which is at a 25% rate and is available to a business that has temporarily shut down or had their activities significantly limited because of a public health order, the maximum CERS is at 90% rate.

Today's Statement announced the extension of these CERS rates for an additional three periods, from December 20, 2020 until March 13, 2021.

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[2] For additional information on COVID-19 measures for businesses, see our report "Relief measures for businesses: Canada's COVID-19 response plan," which is available online at cibc.com/content/dam/personal_banking/advice_centre/tax-savings/covid-business-tax-en.pdf.

[3] Further information on the CEWS can be found in our report "Wage subsidy programs for employers: Canada's COVID-19 response plan", which can be found online at cibc.com/content/dam/personal_banking/advice_centre/tax-savings/covid-wage-subsidy-en.pdf.

[4] Further information on the CERS can be found in our report "Relief measures for businesses: Canada's COVID-19 response plan," *supra* footnote 2

Highly Affected Sectors Credit Availability Program (HASCAP)

The Statement proposed that the government work with financial institutions to offer loans on more generous terms to the hardest hit businesses, such as tourism, hospitality, hotels, arts and entertainment. This new Highly Affected Sectors Credit Availability Program (HASCAP) would offer 100% government guaranteed financing for heavily impacted business. HASCAP would also provide low-interest rate loans (below typical market rates and below than those offered in the current Business Credit Availability Program) of up to $1 million over terms of up to ten years. Further details on the HASCAP are to be announced soon.

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