Tax Alert - Cash Flow strategies and Government Incentives in the time of COVID-19

The spread of COVID-19 has forced companies to assess their business and manage their cash flow in unprecedented ways. Many businesses will likely incur a reduction in revenue in the short term as COVID-19 runs its course. New opportunities may decrease and even the most loyal customers may require less of the goods or services that businesses provide. Some customers will struggle to pay for goods already purchased or services already rendered.

While some industries always fare better than others during an economic slowdown, all business leaders will need to adapt during these unprecedented times.

To help you manage cash flow during this challenging time, we are providing a summary of some actions you can take right now. We recommend you maximize your financial resources available under these four categories:

- Corporate and personal income tax payments
- Indirect tax — sales tax and customs duties
- Government support — Government incentives, fiscal stimulus and SR&ED credits
- International tax — repatriation of cash for companies with foreign subsidiaries

Corporate and personal income tax payments

The federal government is allowing businesses and individuals to defer income tax payments including instalments—until September 1—as part of its fiscal stimulus package to respond to COVID-19. This deferral applies to corporate and personal income tax that became owing on or after March 18. This means that in the coming weeks and months, you do not need to submit tax balances or tax instalments owing to the CRA until September 1. Please refer to our Tax Alert - Federal and Québec Governments Extend Income Tax Filing and Payments Deadlines.

Reduction of instalment payments

Many self-employed individuals and businesses are required to make instalment payments on the estimated income tax they will owe for the current year. Individuals and many Canadian-controlled private corporations (CCPCs) pay these instalments on a quarterly basis. Many larger corporations generally pay monthly instalments. These instalment payment amounts are effectively calculated based on what the taxpayer believes will be the balance of tax owing for the year.

When considering how much to pay in tax instalment payments, keep in mind that instalments are calculated based on the *lowest amount* of: 1) the current year estimated taxes; 2) taxes owing for the immediately preceding year; or 3) a combination of tax owing for the immediately preceding two years.

What happens when projected income changes to a reduced amount as a result of the impact of COVID-19? In this case, there are two options to maintain higher cash flow for a business:

- **Save on future instalments**
  By reducing instalments for the balance of the fiscal year, the company can preserve cash. Recalculate and submit instalment payments based on the reduced current year estimated income.

  A word of caution: Projecting income during uncertain economic conditions can be difficult. It is important to preserve as much cash as possible to operate the business—but it is also key to pay sufficient amounts in instalments. If instalment payments are lowered your income then rebounds to outperform projections, the CRA will charge interest on any underpayment of taxes. That interest rate is currently 6% and is adjusted every quarter. The government recently announced the ability to defer payments due after March 18, 2020 without interest if paid prior to September 1, 2020.

- **Transfer past instalment overpayments to HST or payroll**
  Corporate income tax instalments that have already been submitted may end up being significantly more than the estimated income taxes for the current taxation year. In that case, consider transferring the corporate income tax instalment balances to your payroll and HST remittance accounts. It is necessary to request this change of the CRA, or contact your BDO advisor to transfer the funds.

Indirect Tax: GST/HST, QST, customs duties

Businesses can also potentially increase cash resources by taking the following steps with respect to indirect tax obligations:

- **File more frequently**
  GST/HST and QST registrants who have upcoming significant capital investments should consider changing the filing frequency to monthly in order to speed up refund claims. A request will need to be made to change the reporting period in order to change the frequency, and the request must be made in a specific period of time.

- **Recover GST/HST and QST**
  Businesses may not be recovering all the GST/HST and QST that is available. A review of GST/HST or QST paid on expenses may uncover opportunities to claim a recovery of overpaid taxes on eligible expenses.

- **File your return quickly if you are in a refund position**
  Consider filing your GST/HST and QST returns as soon as the company's filing period ends rather than waiting for the filing due date if there is a refund owing.

- **Check your intercompany transactions**
  Elections can be made between closely related corporations so that no GST/HST or QST needs to be charged on intercompany transactions. This may be a good time to look at the organizational structure and make these elections. This would allow for a reduction in GST/HST and QST obligations and increase the cash available for operations.

- **Customs and duties**
  This could be a good time to evaluate the customs import duties and taxes paid by the business. Canadian businesses of all sizes can reduce costs and recover overpaid past amounts by examining these expenditures on imports. COVID-19 may disturb supply chains, and any action taken to alleviate cash flow concerns may be helpful.

Government support: COVID-19 Fiscal stimulus and SR&ED incentives

The federal government responded to COVID-19 with measures to help businesses weather the expected economic downturn. Part of a larger stimulus package worth up to $82 billion, these measures include a number of new government incentive programs.

This Alert will focus on these four programs that can help businesses maintain their cash flow:

1. **Business Credit Availability Program**
   This program allocates $10 billion in loans to fund business transactions domestically and internationally. The program will be managed by the Business Development Bank of Canada, Export Development Canada, and Farm Credit Canada.
   Program details from EDC and FCC have not currently been released.

   COVID-19 Relief Program - Working Capital (BDC program):
   The working capital program is a 36-month, backend-loaded loan with principal deferment for the first 12 months. The amount of financing provided is based on a detailed projection or forecast identifying the ‘carrying cost’ or ‘burn rate’ of the operation for the upcoming 12-24 months.

   Loans are available in amounts from $100,000 to $2 million. They are currently being offered at BDC’s floating rate minus 1.75% (currently 3.3%).

   Repayment terms are over 36 months. Interest-only payments apply for the first 12 months, followed by 24 months of interest and principal payments. It is possible to structure payments with a large final balloon payment of up to 60% of the principal.

   BDC is offering existing clients with a total BDC loan commitment of $1 million or less a postponement of payments for up to six months.

   Standard BDC rules and due diligence will apply to the loans. Activities that do <u>not</u> qualify for these loans include refinancing existing debt, change of ownership transactions, and pre-revenue companies.

2. **Work Sharing Program**

   Work Sharing is a program designed to help eligible employers avoid layoffs when there is a temporary reduction in the normal level of business activity that is beyond the control of the employer. The program is available to both federally and provincially regulated employers.

   Program highlights:

   - Affected employees must agree to work a reduced schedule and share available work over a specified period of time.
   - Employment Insurance benefits are provided for eligible employees as income support.
   - Both the employer and the employees must apply to participate in a Work Sharing program together.
   - Employers will save money through lower wage costs.
   - The program must have a minimum duration of six weeks and, as a result of COVID-19, may last up to 76 weeks.

   Work reduction limitations:

   The program supports weekly work reductions between a minimum of 10% (one half day) and a maximum of 60% (three days).

   In any given week, the work reduction can vary depending on available work, as long as the work reduction on average is between 10%-60% for the duration of the program.

   To be eligible for a Work-Sharing program, employers must:

   - have been in business in Canada year-round for at least two years;
   - be a private business, publicly held company or a not-for-profit organization;
   - demonstrate that the shortage of work is temporary and beyond their control;
   - demonstrate a recent decrease in business activity of at least 10%; and
   - submit and implement a recovery plan designed to return the Work Sharing individuals to normal working hours by the end of the program.

3. **Wage subsidy – small businesses**

   Under this new subsidy, eligible small employers can receive a temporary wage subsidy for three months. The subsidy will equal 10% of pay during that period, up to a maximum of $1,375 per employee and $25,000 per employer.
   Program details have yet to be released.

4. **Scientific Research & Experimental Development Program**

   This program is available for Canadian companies performing research and development. The application for this credit can be filed up to 18 months after your fiscal year end. For Canadian-controlled private corporations, it offers a refundable credit that will enhance cash flow.

   While SR&ED is always available to companies, two changes in recent years increase its value and ease of access:

- **Administrative changes at Canada's largest innovation funding program**
  Many corporations stopped claiming SR&ED expenses a number of years ago when it became more difficult to predict how claims were assessed. Changes in administration and claimants' documentation practices have stabilized the program. The current environment for claiming SR&ED is strong.

- **Refundable credits for high performing companies**
  Rules limiting the refund-ability of the credit based on profit have been eliminated. Profitable companies that stopped claiming SR&ED because they were not receiving refundable credits should speak with an advisor and consider making a claim to enhance cash flow.

International Tax

Canadian companies with foreign subsidiaries around the world may also be able to boost cash flow immediately. This cash can repatriated to Canada and used in Canadian operations.

Foreign subsidiaries come in two varieties: a foreign affiliate (FA) and a controlled foreign affiliate (CFA). Generally speaking, an FA is a non-resident corporation of which the Canadian corporation owns at least 10% either directly or indirectly. A CFA is an FA that is controlled by the Canadian corporation.

The following are some repatriation opportunities:

- **Dividends**
  Canadian corporations can receive dividends from a FA or CFA that may be eligible for a full or partial deduction from income and free from Canadian income tax.

- **Foreign accrual property income**
  FAPI is generally passive income earned by a CFA – common examples are rents, interest, dividends, and royalties. Companies that have not repatriated FAPI that was taxed in previous years can use it as an opportunity to bring back money to Canada and add to their current cash flow and be free from Canadian income tax.

- **Loans**
  You may be able to use loans from a FA or CFA to repatriate cash into the Canadian entity in certain circumstances.

These are uncertain times. Our BDO Canada Tax professionals are here to help your business manage cash flow and respond to COVID-19. **Reach out if you have any questions.**

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