M E M O R A N D U M

TO: Ontario Council of Healthcare Unions, c/o Michael Hurley, President

FROM: Goldblatt Partners LLP

DATE: March 11, 2025

RE: **BILL 124 – RETROACTIVE PAY LUMP SUM PAYMENTS – TAX TREATMENT – QUALIFYING RETROACTIVE LUMP SUM PAYMENTS**

How are Bill 124 retroactive amounts paid to employees?

Ontario unions negotiated clauses requiring re-negotiation of compensation in the event Bill 124 was found to be unconstitutional. Bill 124 was found to be unconstitutional. As a result, unions re-negotiated compensation, and in some cases, this resulted in arbitration of the matter. These arbitrations resulted in awards of lump-sums payable to employees in 2024. These lump-sums were in respect of retroactive pay awards for the period Bill 124 was in effect (e.g., approximately 2019 to 2023, depending on the term of the applicable collective agreement).

In some cases, the lump sum payments are large enough to cause an employee to be taxed at a higher tax rate (higher tax bracket) than the rate normally applicable to their salary.

How are Bill 124 retroactive lump sum payments taxed?

Normally, all compensation amounts paid to an employee in a year are taxable in that same year. However, some lump sum payments in respect of retroactive pay are eligible for more advantageous tax treatment. If a retroactive lump sum payment meets certain conditions – called "qualifying retroactive lump sum payments" – then a taxpayer may allocate some amounts of the lump sum payments to prior tax years, and pay tax on them from that prior year, and not pay tax on those amounts in the current year.[1]

Allocating some of the lump sum to prior years can have the effect of reducing the amount of tax owed in the most recent year (2024), and in some cases, reducing the

[1] ITA, s. 110.2(1) and (2). See CRA guidance, online at: https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/payroll-deductions-contributions/special-payments/qualifying-retroactive-lump-payments.html.

overall tax owed, particularly if the allocation over previous years means the taxpayer stays below higher tax brackets.

When you allocate some of the lump sum to a prior year, tax is owed on that amount from the prior year, and some interested in charged on the amount of tax owing.[2]

What are the conditions that must be met to allocate some of the lump sum to prior years?

The conditions that must be met are:

- an employee receives a taxable income payment of $3,000 or more in total (over all years the amount compensates);
- the lump sum is income from employment; and
- the lump sum is paid due to an arbitration award, court order, lawsuit settlement agreement.

The CRA has confirmed that lump sums resulting from an arbitration over Bill 124 amounts are qualifying retroactive lump sum payments.[3]

Note that retroactive payments made in the normal course of collective bargaining do not qualify.

How do I allocate part of my lump sum to prior years?

An employer must provide to an employee Form T1198 with the required information filled out, or provide the same information in writing to the employee. The information required is:

- the year in which the lump-sum payment was made to the employee;
- a complete description of the lump-sum payment and the circumstances that required it to be paid;
- the total amount of the lump-sum payment, including a breakdown between the principal and the interest element, if any, of the payment;

[2] This interest amount is approximately 3% per year on the amount of tax owing in that year.
[3] See footnote 1.

- the principal amount of the lump-sum payment that relates to the current year and each of the preceding years covered by the payment;

If the employee is filing their tax return electronically, they must keep the Form T1198 in case the CRA asks to see it later.

Is it worth it to allocate to a prior year?

You have to make a determination on a case by case basis. However, there is no downside to filing a T1198 and seeking to allocate income to a prior year. If the interest owed on the tax from the prior year results in more tax owing than is saved, the CRA will automatically disregard the allocation to the prior year.