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Pay Equity and Tax:

What you need to know

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Pay equity: central to your strategy

Pay equity has evolved considerably over time. The related measures, policies and practices are now considered key to any strategy based on environmental, social and governance (ESG) factors. **Pay equity is a win-win policy for employees and employers.**

What is pay equity? It involves paying women and men equally for doing work of equal value. In short, the objective of pay equity is to correct the systemic gender-based pay discrimination that is typically seen in female-dominated jobs. With certain exceptions, both public and private businesses are subject to pay equity legislation. The purpose of the federal *Pay Equity Act* is to eliminate this wage gap in federally regulated sectors. In Quebec, sectors under provincial jurisdiction are subject to Quebec's *Pay Equity Act.*

Benefits of pay equity

- Key component of diversity, equity and inclusion strategies as well as ESG strategies
- Improved attraction and retention
- Improved gender wage gap reporting
- Reduced legal, financial and reputational risks

Pay equity legislation includes both legal and **compliance*** obligations. It is important to invest time and resources in order to meet these responsibilities.

*Compliance obligations may include creating a pay equity committee, submitting yearly reports to the government, implementing a gender-neutral job evaluation system, analyzing and calculating wage gaps between male and female jobs, and paying retroactive payments to female jobs requiring an adjustment.

Tax considerations

Tax impact for employers

Eligible retroactive lump-sum payments are deductible on the same basis as ordinary salaries and wages. These are generally deductible when they are paid. However, employers may be able to deduct accrued and unpaid amounts in a given tax year as long as they are paid within 180 days after the end of the taxation year in which the expense was incurred.

Tax impact for employees

From a tax perspective, a taxable, retroactive lump-sum payment must generally be included in the employee’s income in the year that the payment is received. There is, however, a special relief measure for taxable retroactive lump-sum payments related to pay equity settlements.

In certain circumstances, tax laws provide for tax savings for an individual who receives a retroactive lump-sum payment that includes pay equity amounts above a threshold established by law. However, specific conditions must be met in order to benefit from this relief. It should be noted that the interest portion of the retroactive payment is not eligible for the relief; in other words, this portion will be taxable in the year in which the payment is received.

To summarize, a special tax calculation will be made to determine whether the tax payable in the year in which the retroactive payment is received is higher than it would have been had the individual received the funds in the years to which they are related. The individual will only be required to pay the lesser of these two amounts.

The retroactive payment will be allocated to the relevant years by filing a prescribed form. However, some vigilance is required. In order to take advantage of the preferential treatment, the amount received must qualify as a “qualifying amount”. Tax authorities have published several technical interpretations involving amounts received in pay equity settlements that, unfortunately, did not qualify. It is therefore necessary to perform an analysis of the conditions under which the law can be applied.

Employers should notify employees about the possibility of taking advantage of this special relief measure.

Conclusion

It is essential to understand the many steps involved in the pay equity process and then implement policies, a pay structure and a program that will meet the company’s objectives. Taking such steps will benefit everyone concerned.

Contact us

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