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Tax Alert – Canada

Federal Budget 2021-22: highlights

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

"This budget is about finishing the fight against COVID-19. It's about healing the wounds left by the COVID-19 recession. And it's about creating more jobs and prosperity for Canadians in the days — and decades — to come."

Deputy Prime Minister and Federal Finance Minister Chrystia Freeland

2021 federal budget speech

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On 19 April 2021, Deputy Prime Minister and Federal Finance Minister, Chrystia Freeland, tabled the federal budget 2021-22. The budget contains tax measures affecting individuals and corporations.

The Deputy Prime Minister and Federal Finance Minister anticipates a deficit of $354.2 billion for fiscal 2020–21 and $154.7 billion for fiscal 2021-22, with reduced deficits for each of the next four fiscal years.

Following are the highlights of the budget tabled by the Deputy Prime Minister and Federal Finance Minister. A summary of the key tax measures announced will be available in our Tax Alert 2021 Issue No. 19 — Federal budget 2021-22: a recovery plan for jobs, growth, and resilience.

Proposed measures

Business income tax measures

- **Corporate tax rates**. No change to the general corporate tax rate was proposed.
- **Canada Emergency Wage Subsidy (CEWS)**: Extension of the CEWS until September 2021 and addition of qualifying periods for the wage subsidy until 20 November 2021, should the economic and public health situation warrant it. The subsidy rates would gradually decline over the July-to-September period and the subsidy rates would be gradually phased out starting on 4 July 2021. Only employers with a decline in revenues of more than 10% would be eligible for the CEWS as of that date. Other modifications are proposed to the existing rules and new rules are introduced.
- **Canada Emergency Rent Subsidy (CERS) and Lockdown Support**: Extension of the CERS and the Lockdown Support until September 2021 and addition of qualifying periods for the wage subsidy until 20 November 2021, should the economic and public health situation warrant it. The CERS rates would gradually decline over the July-to-September period and would be gradually phased out starting on 4 July 2021. Only organizations with a decline in revenues of more than 10% would be eligible for the CERS and the Lockdown Support as of that date. Other modifications are proposed to the existing rules and new rules are introduced. Finally, it is proposed to extend, for the qualifying periods from 6 June 2021 to 25 September 2021, the current 25% rate for the Lockdown Support.
- **Canada Recovery Hiring Program:** Introduction of a new Canada Recovery Hiring Program to provide eligible employers with a subsidy of up to 50 % on the incremental remuneration (i.e. generally the difference between remuneration for the qualifying period and the baseline period) paid to eligible employees between 6 June 2021 and 20 November 2021. An eligible employer would be permitted to claim either the hiring subsidy or the Canada Emergency Wage Subsidy for a particular qualifying period, but not both.

- **Immediate Expensing**: Immediate expensing in respect of certain property acquired by a Canadian-Controlled Private Corporation (CCPC). The measure would be available for "eligible property" acquired by a CCPC on or after 19 April 2021 and that becomes available for use before 1 January 2024, up to a maximum amount of $1.5 million per taxation year. The immediate expensing would only be available for the year in which the property becomes available for use. The $1.5 million limit would be shared among associated members of a group of CCPCs and would be prorated for taxation years that are shorter than 365 days. The half-year rule would be suspended for property for which this measure is used. For those CCPCs with less than $1.5 million of eligible capital costs, no carry-forward of excess capacity would be allowed.

- **Rate Reduction for Zero-Emission Technology Manufacturers**: Introduction of a temporary measure to reduce corporate income tax rates for qualifying zero-emission technology manufacturers. Taxpayers would be able to apply reduced tax rates on eligible zero-emission technology manufacturing and processing income of: (i) 7.5 %, where that income would otherwise be taxed at the 15 % general corporate tax rate; and (ii) 4.5 %, where that income would otherwise be taxed at the 9 % small business tax rate.

- **Capital Cost Allowance for Clean Energy Equipment**: Expansion of Classes 43.1 and 43.2 Schedule II to the *Income Tax Regulations* to include certain types of equipment. Changes in the eligibility criteria for certain types of equipment as described in Budget 2021 are also proposed to ensure the incentive provided by Classes 43.1 and 43.2 is consistent with the government's current environmental objectives.

- **Film or Video Production Tax Credits**: Extension of certain timelines for the Canadian Film or Video Production Tax Credit and the Film or Video Production Services Tax Credit

- **Mandatory Disclosure Rules**: Consultation on proposals to enhance Canada's mandatory disclosure rules which will address: (i) changes to the *Income Tax Act*'s (ITA) reportable transaction rules; (ii) a new requirement to report notifiable transactions; (iii) a new requirement for specified corporations to report uncertain tax treatments; and (iv) related rules providing for, in certain circumstances, the extension of the applicable reassessment period and the introduction of penalties.

- **Avoidance of Tax Debts**: Proposal of a number of measures to address complex transactions that attempt to circumvent the rule that causes the transferee to be jointly and severally liable with the transferor for tax debts of the transferor for the current or any prior taxation year, to the extent that the value of the property transferred exceeds the amount of consideration given for the property. Also, a penalty for those who devise and promote such schemes is proposed.

- **Audit Authorities**: Amendments confirming that CRA officials would have the authority to require persons to answer all proper questions, and to provide all reasonable assistance, for any purpose related to the administration or enforcement of the relevant statute. The amendments would also provide that CRA officials have the authority to require persons to respond to questions orally or in writing, including in any form specified by the relevant CRA official.

Personal tax measures

- **Personal income tax rates.** No change proposed.

- **Disability Tax Credit (DTC)**. For 2021, the value of the credit is $1,299. To ensure that the eligibility criteria for the DTC are better adapted to the reality, changes to the list of Mental Functions Necessary for Everyday Life and to the list of Life-Sustaining Therapy.

- **Canada Workers Benefit (CWB**). Enhancement of the CWB starting in 2021 for single individuals without dependants as well as families. Moreover, changes would be made to the disability supplement's phase-in and reduction rates as well as the reduction threshold. Finally, a "secondary earner exemption" will be introduced in order to improve work incentives for secondary earners in a couple.

- **Northern Resident Deductions**. Expansion of the access to the travel component of these deductions by giving a taxpayer the option to claim an amount in respect of each "eligible family member", up to the prescribed maximum amount. It is also proposed that a maximum of two trips be allowed to be claimed in total for non-medical personal travel in a year.

- **Postdoctoral Fellowship Income.** Inclusion of those income in "earned income" for RRSP purposes. Measure applicable to income received in the 2021 and subsequent taxation years.

- **Tax Treatment of COVID-19 Benefit Amounts**. Amendment of the ITA to allow a benefit amount that is repaid to be claimed as a deduction in respect of the repayment of a COVID-19 benefit amount in computing their income for the year in which the benefit amount was received rather than the year in which the repayment was made.

- **Fixing Contribution Errors in Defined Contribution Pension Plans**. Additional contributions to compensate for an under-contribution error made in any of the preceding five years, subject to a dollar limit, will be permitted. It will also be permitted to correct for pension over-contribution errors in respect of an employee for any of the five years prior to the year in which the excess amount is refunded to the employee or employer, as the case may be, who made the contribution. A prescribed form shall be filed.

- **Taxes Applicable to Registered Investments.** Taxation under Part X.2 of the ITA pro-rated based on the proportion of shares or units of the registered investment that are held by investors that are themselves subject to the qualified investment rules. This measure would apply to taxes under Part X.2 of the ITA in respect of months after 2020 and to taxpayers whose tax liability under Part X.2 in respect of months before 2021 has not been finally determined by the Canada Revenue Agency (CRA) as of 19 April 2021.

- **Registration and Revocation Rules Applicable to Charities.** Permission granted to the Minister of National Revenue to immediately revoke the registration of a charity or other qualified donee upon its listing as a terrorist entity under the *Criminal Code*, or to suspend the authority of a registered charity to issue official donation receipts for one year or to revoke its registration where a false statement was made for the purpose of maintaining its registration and amendment to the "ineligible individual" definition so as to broaden its reach. These amendments would apply on Royal Assent.

Sales and Excise tax measures

- **Application of the GST/HST to Non-Resident Suppliers and Platform Operators.** On 30 November 2020, the federal government proposed new GST/HST registration rules for non-residents of selling services, digital products, or tangible goods delivered in Canada to persons in Canada who are not registered for GST/HST purposes. Budget 2021 proposes amendments to those draft proposals to take into consideration comments received from stakeholders:

  - Under the new rules, platform operators would be jointly and severally liable for the GST/HST collectible on sales they facilitate for third-party vendors. New safe harbour rules will relieve platform operators from this liability if they in good faith rely on false information provided by the third-party vendor.

  - The new rules created a "simplified" registration for non-resident suppliers of services and digital products; they are required to charge and collect GST/HST, but are not entitled to input tax credits or most rebates. Budget 2021 ensures these non-resident vendors can deduct the GST/HST associated with bad debts and certain provincial HST point-of-sale rebates they provide to purchasers.

  - Non-residents are required to register under the new rules if their revenue from Canadians exceed C$30,000. Budget 2021 clarifies that consideration for zero-rated supplies of services and digital products are not included in the threshold amount.

  - An amendment is proposed to clarify that the requirement to file an annual information return applies only to platform operators that are registered or are required to be registered for the GST/HST.

- The proposed rules have also been revised to grant the Minister of National Revenue the authority to register a person that the Minister believes should be registered under the simplified framework.

These measures would come into force on 1 July 2021.

Budget 2021 specifies that the Canada Revenue Agency the CRA will take a practical approach to compliance and exercise discretion in administering these measures during a 12-month transition period, starting from the 1 July 2021.

- **Input Tax Credit (ITC) Information Requirements**. To simplify tax compliance for businesses, Budget 2021 proposes to increase the current ITC information thresholds to $100 (from $30) and $500 (from $150), and to allow billing agents to be treated as intermediaries for purposes of the ITC information rules.

  These measures would come into force on 20 April 2021.

- **GST New Housing Rebate Conditions.** Budget 2021 proposes to remove the condition that where two or more individuals buy a new home together, each of them must be acquiring the home for use as their primary place of residence or the primary place of residence of a relation. Instead, the GST New Housing Rebate would be available as long as the new home is acquired for use as the primary place of residence of any one of the purchasers or a relation of any one of the purchasers.

  This measure would apply to a supply made under an agreement of purchase and sale entered into after 19 April 2021.

- **Rebate of Excise Tax for Goods Purchased by Provinces**. Under the Excise Tax Act, provinces are provided relief from the federal excise tax embedded in the price of motive fuels, air conditioners in automobiles, and fuel inefficient vehicles (i.e., the "green levy"), which they purchase or import for the province's own use. In particular, when these goods are sold to a province, for the province's own use, either the province or the vendor is entitled to a rebate equal to the amount of the embedded tax (the "provincial-use rebate").

  To clarify which party is eligible to claim the provincial-use rebate, Budget 2021 proposes to create a joint election mechanism to specify that the vendor alone would be eligible to apply for the rebate only if it jointly elects with the province to be the eligible party. If no joint election were made, then only the province would be eligible to apply for the rebate.

  This measure would apply in relation to these goods purchased or imported by a province on or after 1 January 2022.

- **Excise Duty on Tobacco**. Budget 2021 proposes to increase the tobacco excise duty rate by $4 per carton of 200 cigarettes, along with corresponding increases to the excise duty rates for other tobacco products.

  Inventories of cigarettes held by certain manufacturers, importers, wholesalers and retailers at the beginning of the day after Budget Day would be subject to an inventory tax of $0.02 per cigarette (subject to certain exemptions). Taxpayers would have until 30 June 2021 to file a return and pay the cigarette inventory tax.

  This measure would come into force on 20 April 2021.

- **Excise Duty on Vaping Products**. Budget 2021 proposes to implement a tax on vaping products in 2022 through the introduction of a new excise duty.

  The new excise duty framework on vaping products is proposed to be introduced as part of the existing Excise Act, 2001 ("the Act"), which currently applies excise duties on tobacco, wine, spirits, and cannabis products. The new duty would apply solely to vaping liquids that are produced in Canada or imported and that are intended for use in a vaping device in Canada.

  The proposed framework would impose a single flat rate duty on every 10 millilitres (ml) of vaping liquid or fraction thereof, within an immediate container (i.e., the container holding the liquid itself). This rate could be in the order of $1.00 per 10 ml or fraction thereof, and the excise duty would be calculated and imposed based on the volume of the smallest immediate container holding the liquid.

- **Tax on Select Luxury Goods**. Budget 2021 proposes to introduce a tax on the retail sale of new luxury cars and personal aircraft priced over $100,000, and boats priced over $250,000, effective as of 1 January 2022. For vehicles, aircraft and boats sold in Canada, the tax would apply at the point of purchase if the final sale price paid by a consumer (not including the GST/HST or provincial sales tax) is above the $100,000 or $250,000 price threshold, as the case may be. Importations of vehicles, aircraft and boats would also be subject to the tax.

  For vehicles and aircraft priced over $100,000, the amount of the tax would be the lesser of 10 per cent of the full value of the vehicle or the aircraft, or 20 per cent of the value above $100,000. For boats priced over $250,000, the amount of the tax would be the lesser of 10 per cent of the full value of the boat or 20 per cent of the value above $250,000.

International tax measures

- **Interest deductibility Limit**. Introduction of an earnings stripping rule consistent with the OECD BEPS Action 4 recommendations. The new rule would limit the amount of net interest expense that a corporation may deduct in computing its taxable income to no

more than a fixed ratio of 30% of its "tax EBITDA" (40% for the transition year). Interest denied under the earnings-stripping rule would be able to be carried forward for up to twenty years or back for up to three years.

Exemptions from the new rule would be available for:

- Canadian-controlled private corporations that, together with any associated corporations, have taxable capital employed in Canada of less than $15 million;
- groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $250,000 or less; and
- Interest expense and interest income related to debts owing between Canadian members of a corporate group would generally be excluded.

The new rule would also be applicable to trusts, partnerships and branches of non-resident corporations and be phased in, with a fixed ratio of 40% for taxation years beginning on or after 1 January 2023 but before 1 January 2024 (the transition year), and 30% for taxation years beginning on or after 1 January 2024.

- **Hybrid Mismatch Arrangements.** Introduction of new hybrid mismatch arrangements rules consistent with the OECD BEPS Action 2 recommendations.

  In general terms, payments made by Canadian residents under hybrid mismatch arrangements would not be deductible for Canadian income tax purposes to the extent that they give rise to a further deduction in another country or are not included in the ordinary income of a non-resident recipient. Conversely, to the extent that a payment made under such an arrangement by an entity that is not resident in Canada is deductible for foreign income tax purposes, no deduction in respect of the payment would be permitted against the income of a Canadian resident. Any amount of the payment received by a Canadian resident would also be included in income, and, if the payment is a dividend, it would not be eligible for the deduction otherwise available for certain dividends received from foreign affiliates.

  The proposed rules to address hybrid arrangements would be implemented in two separate legislative packages: the first would be released for stakeholder comment later in 2021 for application as of 1 July 2022 and the second would be released after 2021 for application no earlier than 2023.

- **Consultation on transfer pricing rules:** Budget 2021 announces the government's intention to consult on Canada's transfer pricing rules with a view to protecting the integrity of the tax system while preserving Canada's attractiveness as a destination for new investment and business activity.

Other tax measures

- **Duty and Tax Correction on Imported Goods**. Budget 2021 proposes amendments to the Customs Act to improve the collection of duties and taxes on imported goods.

  The amendments to the Customs Act and related regulations would ensure that all importers value their goods using the value of the last sale for export to a purchaser in Canada.

  A second element to the proposal would support a broad modernization of payment processes for commercial importers in the Customs Act and regulations. These changes would coincide with implementation of key functionalities of the CBSA Assessment and Revenue Management initiative that is set to serve as a single portal for commercial importers.

  Electronic Filing and Certification of Tax and Information Returns. Amendment to the various legislation in order to improve the CRA ability to operate digitally regarding the Default Method of Correspondence, the T4A and T5 Information Returns, the Electronic Filing Thresholds, the Electronic Payments and the Handwritten Signatures.

- **Digital Services Tax (DST).** Budget 2021 provides more details about the DST that it is proposed to be applicable at a rate of 3% on revenue from certain digital services reliant on the engagement, data and content contributions of Canadian users. The DST is proposed to apply starting 1 January 2022, until an acceptable multilateral option takes effect (e.g., multilateral solution under the auspices of the Organisation for Economic Co-operation and Development). No draft legislative proposals were announced with respect to the digital services tax. The government invites input from stakeholders.

- **Tax Incentive for Cabon Capture, Utilization, and Storage (CCUS).** The government intends to take significant action to support and accelerate the adoption of CCUS. In this respect, Budget 2021 proposes to introduce an investment tax credit for capital invested in CCUS projects with the goal of reducing emissions by at least 15 megatonnes of CO_2 annually. This measure will come into effect in 2022.

Learn more

For more information on the above measures or any other topics which may be of concern, contact your EY or EY Law advisor.

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