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Tax Alert – Canada

Federal Budget 2022-23: 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.

"Our economy has recovered 112% of the jobs that were lost during those first awful months [of the pandemic]…. Our unemployment rate is down to just 5.5% – close to the 5.4% low in 2019 that was Canada's best in five decades. Our real GDP is more than a full percentage point above where it was before the pandemic. Today, Canada has come roaring back. But Canadians know that fighting COVID and the COVID recession came at a high price. …The money that rescued Canadians and the Canadian economy – 8 out of every 10 dollars invested – was deployed chiefly and rightly by the federal government. But our ability to spend is not infinite. The time for extraordinary COVID support is over. … So now is the time for us to focus – with smart investments and a clarity of purpose – on growing our economy and making life more affordable for Canadians."

Deputy Prime Minister and Federal Finance Minister Chrystia Freeland

2022 federal budget speech

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On 7 April 2022, Deputy Prime Minister and Federal Finance Minister, Chrystia Freeland, tabled the federal budget 2022-23. The budget contains tax measures affecting individuals and corporations, but no change to the general corporate tax rate or personal income tax rates.

The Deputy Prime Minister and Federal Finance Minister anticipates a deficit of $113.8 billion for fiscal 2021–22 and $8.4 billion by fiscal 2026-27.

Following are the highlights of the budget tabled by the Deputy Prime Minister and Federal Finance Minister. The key tax measures announced will be reviewed in more detail in our Tax Alert 2022 Issue No. 23 — Federal budget 2022-23 – *Growing a more resilient economy*.

Proposed measures

Business income tax measures

- **Corporate tax rates.** No change to the general corporate tax rate was proposed.

- **Canada Recovery Dividend and Additional Tax on Banks and Life Insurers:** Introduction of the Canada Recovery Dividend (CRD) in the form of a one-time 15% tax on bank and life insurer groups. A group would include a bank or life insurer and any other financial institution (for the purposes of Part VI of the Income Tax Act) that is related to the bank or life insurer. Bank and life insurer groups subject to the CRD would be permitted to allocate a $1 billion taxable income exemption by agreement amongst group members. The CRD liability would be imposed for the 2022 taxation year and would be payable in equal amounts over five years. Budget 2022 also proposes to introduce an additional tax of 1.5 % of the taxable income for members of bank and life insurer groups (determined in the same manner as the CRD). Bank and life insurer groups subject to the additional tax would be permitted to allocate a $100 million taxable income exemption by agreement amongst group members.

- **Investment Tax Credit for Carbon Capture, Utilization, and Storage**: Introduction of an investment tax credit for certain type of eligible expenses that relate to the capture, utilization, and storage of carbon dioxide (CO_2) (CCUS). This credit would be refundable and available to businesses that incur eligible expenses starting on 1 January 2022. The CCUS project would also be subject a required validation and verification process, would need to meet the storage requirements and a climate-related financial disclosure report would need to be produced.

- **Clean Technology Tax Incentives – Air-Source Heat Pumps:** Expansion of Classes 43.1 and 43.2 to include air-source heat pumps primarily used for space or water heating. This expansion of Classes 43.1 and 43.2 would apply in respect of certain eligible property that is acquired and that becomes available for use on or after 7 April 2022, where it has not been used or acquired for use for any purpose before 7 April 2022.

- **Critical Mineral Exploration Tax Credit**: Introduction of a new 30% Critical Mineral Exploration Tax Credit (CMETC) for specified minerals. The specified minerals that would be eligible for the CMETC are: copper, nickel, lithium, cobalt, graphite, rare earth elements, scandium, titanium, gallium, vanadium, tellurium, magnesium, zinc, platinum group metals and uranium. The CMETC would apply to expenditures renounced under eligible flow-through share agreements entered into after April 7, 2022 and on or before March 31, 2027. Eligible expenditures would not benefit from both the proposed CMETC and existing Mineral Exploration Tax Credit.

- **Flow-Through Shares for Oil, Gas, and Coal Activities:** Elimination of the flow-through share regime for oil, gas, and coal activities by no longer allowing oil, gas and coal exploration or development expenditures to be renounced to a flow-through share investor. This change would apply to expenditures renounced under flow-through share agreements entered into after March 31, 2023.

- **Small Business Deduction:** Extension of the range over which the business limit is reduced based on the combined taxable capital employed in Canada of the Canadian-controlled private corporation and its associated corporations. The new range would be $10 million to $50 million. This measure would apply to taxation years that begin on or after 7 April 2022.

- **International Financial Reporting Standards for Insurance Contracts (IFRS 17)**: On 28 May 2021, the Government issued a news release to announce that it intends to generally support the use of IFRS 17 accounting for income tax purposes. However, certain adjustments were contemplated to recognize underwriting profits as taxable income so that it remains aligned with economic activities. More specifically, it was contemplated that the contract service margin (CSM) would not be considered a deductible reserve for tax purposes. The Government's overall objective is to recognize income for tax purposes when the key economic activities occur. Budget 2022 proposes to maintain the policy intent described in the May 2021 Release, but proposes to make certain relieving modifications, as well as consequential changes to protect the minimum tax base for life insurers.

- **Hedging and Short Selling by Canadian Financial Institutions:** Amendments to the *Income Tax Act* to:

    - deny the dividend received deduction for dividends received by a taxpayer on Canadian shares if a registered securities dealer that does not deal at arm's length with the taxpayer enters into transactions that hedge the taxpayer's economic exposure to the Canadian shares, where the registered securities dealer knew or ought to have known that these transactions would have such an effect;

    - deny the dividend received deduction for dividends received by a registered securities dealer on Canadian shares that it holds if it eliminates all or substantially all of its economic exposure to the Canadian shares by entering into certain hedging transactions; and

    - provide that in the above situations, the registered securities dealer will be permitted to claim a full, rather than a two-thirds, deduction for a dividend compensation payment it makes under a securities lending arrangement entered into in connection with the above hedging transactions.

- **Application of the General Anti-Avoidance Rule to Tax Attributes ("GAAR"):** Amendments to provide that the GAAR can apply to transactions that affect tax attributes that have not yet become relevant to the computation of tax. This measure would apply to notices of determination issued on or after 7 April 2022.

- **Genuine Intergenerational Share Transfers:** Consultation process for Canadians to share views as to how the rule to prevent people from converting dividends into lower-taxed capital gains using certain self-dealing transactions could be modified to protect the integrity of the tax system while continuing to facilitate genuine intergenerational business transfers.

- **Substantive Canadian-controlled private corporation (CCPC):** Deferring Tax Using Foreign Entities: Amendment to the *Income Tax Act* to align the taxation of investment income earned and distributed by "substantive CCPCs" with the rules that currently apply to CCPCs. Substantive CCPCs would be private corporations resident in Canada (other than CCPCs) that are ultimately controlled (in law or in fact) by Canadian-resident individuals. The test would contain an extended definition of control that would aggregate the shares owned, directly or indirectly, by Canadian resident individuals. Also, the proposed amendments would cause a corporation to be a substantive CCPC in circumstances where the corporation would have been a CCPC but for the fact that a non-resident or public corporation has a right to acquire its shares. Substantive CCPCs earning and distributing investment income would be subject to the same anti-deferral and integration mechanisms as CCPCs, with respect to such income. This measure would apply to taxation years that end on or after 7 April 2022.

  Deferring Tax Using Foreign Resident Corporations: Amendments to the *Income Tax Act* to eliminate the tax-deferral advantage available to CCPCs and their shareholders earning investment income through controlled foreign affiliates. The deferral advantage would be addressed by applying the same relevant tax factor to individuals, CCPCs and substantive CCPCs (i.e., the relevant tax factor currently applicable to individuals). This rule would be accompanied by amendments to address the integration of foreign accrual property income (FAPI) as it is repatriated to and distributed by CCPCs and substantive CCPCs to their individual shareholders. These measures would apply to taxation years that begin on or after 7 April 2022.

Personal tax measures

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

- **Residential Property Flipping Rule:** Introduction of a new deeming rule to ensure profits from flipping residential real estate are always subject to full taxation. Specifically, profits arising from dispositions of residential property (including a rental property) that was owned for less than 12 months would be deemed to be business income. The new deeming rule would not apply if the disposition of property is in relation to certain life events. The measure would apply in respect of residential properties sold on or after 1 January 2023.

- **Tax-Free First Home Savings Account:** Introduction of the Tax-Free First Home Savings Account (FHSA), a new registered account to help individuals save for their first home. Contributions to an FHSA would be deductible and income earned in an FHSA would not be subject to tax. Qualifying withdrawals from an FHSA made to purchase a first home would be non-taxable. The existing Home Buyer's Plan (HBP), which allows individuals to withdraw from a registered retirement savings plan (RRSP), will continue to be available under existing rules. However, an individual will not be permitted to make both an FHSA withdrawal and an HBP withdrawal in respect of the same qualifying home purchase.
- **Multigenerational Home Renovation Tax Credit:** Introduction of a new refundable tax credit that would provide recognition of eligible expenses for qualifying renovation. A qualifying renovation would be one that creates a secondary dwelling unit to permit an eligible person (a senior or a person with a disability) to live with certain qualifying relation. The value of the credit would be 15 % of the lesser of eligible expenses and $50,000. This measure would apply for the 2023 and subsequent taxation years, in respect of work performed and paid for and/or goods acquired on or after 1 January 2023.
- **Home Buyers' Tax Credit (HBTC):** Increase of the HBTC amount to $10,000, which would provide up to $1,500 in tax relief to eligible home buyers.
- **Home Accessibility Tax Credit:** Increase of the annual expense limit of the credit to $20,000. This measure would apply to expenses incurred in the 2022 and subsequent taxation years.
- **Labour Mobility Deduction for Tradespeople:** Introduction of a deduction to recognize certain travel and relocation expenses of workers in the construction industry. This measure would allow certain eligible workers to deduct up to $4,000 for certain eligible expenses per year.
- **Other personal tax measures** : Budget 2022 proposes a number of changes and new rules to the Medical Expense Tax Credit for Surrogacy and Other Expenses, the *Children's Special Allowances Act* and the *Income Tax Act*, borrowing by Defined Benefit Pension Plans *and* reporting requirements for RRSPs and RRIFs.

Sales and Excise tax measures

- **GST/HST Health Care Rebate:** Expansion of the GST/HST eligibility rules for the expanded hospital rebate to recognize the increasing role of nurse practitioners in delivering health care services, including in non-remote areas. The expanded hospital rebate would no longer distinguish between health care services rendered by physicians and nurse practitioners.

- **Taxation of Vaping Products:** Introduction of a new excise duty on vaping products. The taxation base of this excise duty would be comprised of vaping products that include either liquid or solid vaping substances (whether or not they contain nicotine), with an equivalency of 1 ml of liquid = 1 gram of solids. A federal excise duty rate of $1 per 2 ml, or fraction thereof, is proposed for the first 10 ml of vaping substance, and $1 per 10 ml, or fraction thereof, for volumes beyond that. If a province or territory were to choose to participate in a coordinated vaping taxation regime administered by the federal government, an additional duty rate would be imposed in respect of dutiable vaping products. The proposed combined rate would be $2 per 2 ml, or fraction thereof, for the first 10 ml of vaping substance, and $2 per 10 ml, or fraction thereof, for volumes beyond that.

The proposed federal excise duty framework for vaping products would come into force on October 1, 2022.

- **Cannabis Taxation Framework and General Administration under the Excise Act, 2001:** Budget 2022 proposed several changes to cannabis excise duty framework specifically, and other excise duty regimes under the Excise Act, 2001:

- Cannabis Excise Duty
  - Some licensed cannabis producers may remit excise duties on a quarterly rather than monthly basis.
  - The Canada Revenue Agency may approve certain contract-for-service arrangements between two licensed cannabis producers.
  - The holders of a Health Canada-issue Research Licence or Cannabis Drug Licence would be exempted from the requirement to be licensed under the excise duty regime.
  - The CRA may issue licences that would be valid for a longer period.

- General Administration
  - Addition of all cancellation criteria for an excise licence, other than a proactive request by a licensee to cancel its licence, to the criteria that may be used to suspend an excise licence.

- All excise licensees and excise applicants would be required to comply with federal and provincial legislation and regulations regarding the taxation and control of cannabis products.
- Cash and transferable bonds issued by the Government of Canada would be removed to the types of financial security that could be accepted by the CRA, but bank drafts and Canada Post money orders would be added.
- The ability of the CRA to carry out virtual audits and reviews of all licensees would be confirmed, where the Agency deems it appropriate.

- **Repeal of the 100-per-cent Canadian Wine Exemption:** Budget 2022 proposes to repeal the 100-per-cent Canadian wine excise duty exemption. The proposed measure would come into force on June 30, 2022.
- **Beer Taxation:** Excise duty for beer containing no more than 0.5 per cent ABV would be eliminated, bringing the tax treatment of such beer into line with the treatment of wine and spirits with the same alcohol content. The proposed measure would come into force on July 1, 2022.

International tax measures

- **Pillar One – Reallocation of Taxing Rights:** Pillar One is intended to reallocate a portion of taxing rights over the profits of the largest and most profitable multinational enterprises (MNEs) to market countries (i.e., where their users and customers are located). Specifically, for in-scope MNEs, 25% of residual profit, defined as profit in excess of 10 per cent of revenue, will be allocated to market countries using a revenue-based allocation key.

  The government is actively working with its international partners to develop the model rules and the multilateral convention needed to establish the new multilateral tax framework and bring it into effect.

- **Pillar Two – Global Minimum Tax: Pillar Two** is intended to ensure that the profits of large MNEs are subject to an effective tax rate of at least 15%, regardless of where they are earned. Pillar Two is to be implemented by introducing two charging rules for the top-up tax: the Income Inclusion Rule (IIR) and the Undertaxed Profits Rule (UTPR).

  Budget 2022 proposes to implement Pillar Two, along with a domestic minimum top-up tax that would apply to Canadian entities of MNEs that are within the scope of Pillar Two. The government anticipates that draft implementing legislation would be publicly released for consultation and the IIR and domestic minimum top-up tax would come into effect in 2023 as of a date to be fixed. The UTPR would come into effect no earlier than 2024.

  To allow the government to implement Pillar Two in accordance with the intended timeline, Budget 2022 is launching a public consultation on the implementation in Canada of the Model Rules and a domestic minimum top-up tax. Interested parties are invited to send written representations by July 7, 2022.

- **Exchange of Tax Information on Digital Economy Platform Sellers:** Budget 2022 proposes to implement in Canada the model rules developed by the Organisation for Economic Co-operation and Development (OECD) for reporting by digital platform operators with respect to platform sellers.

  The model rules require online platforms to collect and report relevant information to tax administrations in order to ensure that revenues earned by taxpayers through those platforms can be properly taxed.

  Reporting platform operators would be entities that are engaged in the following activities:

  - contracting directly or indirectly with sellers to make the software that runs a platform available for the sellers to be connected to other users; or
  - collecting compensation for the relevant activities facilitated through the platform.

  Relevant activities would be relevant services and sales of goods. Relevant services would be:

  - personal services for example, transportation and delivery services, manual labour, tutoring, data manipulation and clerical, legal or accounting tasks;
  - rental of immovable property (residential or commercial property, as well as parking spaces); and
  - rental of means of transportation.

  This measure would apply to calendar years beginning after 2023. This would allow the first reporting and exchange of information to take place in early 2025 with respect to the 2024 calendar year.

- **Interest Coupon stripping:** Budget 2022 proposes modifications to the interest withholding tax rules to ensure that the total interest withholding tax paid under an interest coupon stripping arrangement is the same as if the arrangement had not been undertaken and instead the interest had been paid to the non-resident lender.

  In general terms, an interest coupon stripping arrangement would be considered to exist where the following conditions are met: (i) a Canadian-resident borrower pays or credits a particular amount to a person or partnership (interest coupon holder) as interest on a debt (other than a publicly offered debt obligation) owed to a non-resident person with whom the Canadian-resident borrower is not dealing at arm's length (non-resident lender); and (ii) the tax that would be payable under Part XIII in respect of the particular amount, if the particular amount were paid or credited to the non-resident lender, is greater than the tax payable under Part XIII on the particular amount paid or credited to the interest coupon holder.

Where an interest coupon stripping arrangement exists, the Canadian-resident borrower would be deemed, for the purposes of the interest withholding tax rules, to pay an amount of interest to the non-resident lender such that the Part XIII tax on the deemed interest payment equals the Part XIII tax otherwise avoided as a result of the interest coupon stripping arrangement.

Charities tax measures

- **Annual Disbursement Quota for Registered Charities:** Introduction of a number of changes to increase expenditures by larger charities, and to improve the enforcement and operation of the disbursement quota ("DQ") rules, including the following: (i) Increase the DQ rate from 3.5% to 5% for the portion of property not used in charitable activities or administration that exceeds $1 million, (ii) Amendment to clarify that expenditures for administration and management are not considered qualifying expenditures for the purpose of satisfying a charity's DQ and (iii) amendment of the existing rule such that the CRA will have the discretion to grant a reduction in a charity's DQ obligation for any particular tax year and allow the CRA to publicly disclose information relating to such a decision. Finally, Budget 2022 proposes to remove the accumulation of property rule.
- Budget 2022 proposes a number of changes allowing charities to make qualified disbursements to organizations that are not qualified donees, provided that they meet certain accountability requirements under the Income Tax Act. Additional measures designed to ensure compliance by charities with these new rules are forthcoming.

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.

For up-to-date information on the federal, provincial and territorial budgets, visit ey.com/ca/budget

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