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# Tax Alert – Canada

Federal budget 2023-24: highlights

“With these strong economic fundamentals, Budget 2023 comes at an important moment for our country—and at an important moment for the world. In the near-term, we must contend with a slowing global economy, elevated interest rates around the world, and inflation that is still too high. In the months and years to come, we must seize the remarkable opportunities for Canada that are presented by two fundamental shifts in the global economy: the race to build the clean economies of the 21<sup>st</sup> century, and our allies’ accelerating efforts to friendshore their economies by building their critical supply chains through democracies like our own.”

*Deputy Prime Minister and Federal Finance Minister Chrystia Freeland  
2023-24 Budget, Deputy Prime Minister’s Foreword*



On 28 March 2023, Deputy Prime Minister and Federal Finance Minister, Chrystia Freeland, tabled the federal budget 2023-24. The budget contains tax measures affecting individuals and corporations, but no change to the general corporate tax rate or the general personal income tax rates.

The Deputy Prime Minister and Federal Finance Minister anticipates deficits of \$43 billion for fiscal 2022-23 and \$40.1 billion for fiscal 2023-24, with reduced deficits for each of the next four years.

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 2023 Issue No. 20 – Federal budget 2023-24:

## Proposed measures

### Business income tax measures

- ▶ **Investment tax credit for clean hydrogen:** Following on the government's announcement in the 2022 Fall Economic Statement, introduction of a refundable clean hydrogen investment tax credit in respect of the cost of purchasing and installing eligible equipment for projects that produce hydrogen from electrolysis or from natural gas, so long as emissions are abated using carbon capture, utilization, and storage ("CCUS"). The tax credit rate will be 40%, 25%, or 15%, based on assessed carbon intensity ("CI") of the hydrogen that is produced (i.e., kilogram ("kg") of carbon dioxide equivalent ("CO<sub>2</sub>e") per kg of hydrogen), to eligible property that becomes for use before 2034 (e.g., the rate will be 40% for a CI of less than 0.75 kg). The credit will be phased out by 50% for property that becomes available for use in 2034 and will be fully phased out for property that becomes available for use after 2034.
- ▶ **Clean technology investment tax credit - geothermal energy:** Expansion of the eligibility of the 30% refundable clean technology investment tax credit announced in the 2022 Fall Economic Statement to include geothermal energy systems that are eligible for Class 43.1 capital cost allowance. The phase-out schedule of the credit will rather start in 2034 instead of 2032 - the credit will be phased out by 50% for property that becomes available for use in 2034 and will be unavailable after 2034.
- ▶ **Clean electricity investment tax credit:** Introduction of a 15% refundable tax credit for eligible investments in non-emitting electricity generation systems, abated natural gas-fired electricity generation, stationary electricity storage systems, and equipment for the transmission of electricity between provinces and territories. The credit will be available as of the day of the budget 2024 for projects that did not begin construction before 28 March 2023 - the tax credit will not be available after 2034.
- ▶ **Labour requirements related to certain investment tax credits:** Extended application of the labour requirements that were announced in the 2022 Fall Economic Statement to the clean technology investment tax credit, the clean hydrogen tax credit and the clean electricity investment tax credit - a 5% rate will be applicable for the latter credit (instead of 15%) if the labour requirements are not met. It is intended that the labour requirements be applied to the investment tax credit for carbon capture, utilization, and storage (details will be announced at a later date).

Additional details were also provided on the labour requirements (e.g., at least 10% of the tradesperson hours worked must be performed by registered apprentices in the Red Seal trades to meet the apprenticeship requirement).

- ▶ **Investment tax credit for clean technology manufacturing:** Introduction of a refundable investment tax credit for clean technology manufacturing and processing, and critical mineral extraction and processing, equal to 30% of the capital cost of new machinery and equipment used to manufacture or process key clean technologies (e.g., manufacturing of nuclear energy equipment), and extract, process, or recycle key critical minerals (lithium, cobalt, nickel, graphite, copper, and rare earth elements). The credit will apply to property that is acquired and becomes available for use on or after 1 January 2024 and will be gradually phased out starting with property that becomes available for use in 2032 and would no longer be in effect for property that becomes available for use after 2034.
- ▶ **Zero-emission technology manufacturers:** Income from the following nuclear manufacturing and processing activities would qualify for the reduced tax rates for zero-emission technology manufacturers: (i) manufacturing of nuclear energy equipment, (ii) processing or recycling of nuclear fuels and heavy water, and (iii) manufacturing of nuclear rods. Also, extension of the availability of the reduced tax rates for zero-emission technology manufacturers by three years, such that the planned phase-out would start in taxation years that begin in 2032. The measure would be fully phased out for taxation years that begin after 2034.
- ▶ **Investment tax credit for carbon capture, utilization, and storage (“CCUS”):** Additional design details are provided in respect of the CCUS tax credit. Further details will be included in legislative proposals to be released in the coming months. In general terms, amendments are proposed so that (i) dual use equipment that produces heat and/or power or uses water, that is used for CCUS as well as another process, be eligible for the CCUS tax credit on a pro-rated basis and provided certain conditions are met; (ii) British Columbia be added to the list of eligible jurisdictions for dedicated geological storage, applicable to expenses incurred on or after 1 January 2022; (iii) the process for validating the concrete storage requirement is modified; (iv) interaction with other federal tax credits is modified to avoid duplication; and (v) complex measures related to eligible refurbishment costs (Refurbishment ITCs) as well as complex measures related to the recovery of Refurbishment ITCs are included. Draft legislative proposals related to knowledge sharing and climate risk disclosure are included in the accompanying *Notice of Ways and Means Motion*.
- ▶ **Flow-through shares and critical mineral exploration tax credit (“CMETC”) - Lithium from brines:** Amendments to the *Income Tax Act* to include lithium from brines as a mineral resource. This will allow relevant principal-business corporations that undertake certain exploration and development activities to issue flow-through shares and renounce expenses to their investors. Also, proposal to expand the eligibility of the CMETC to lithium from brines. Eligible expenses would qualify as Canadian exploration expenses and Canadian development expenses. The expansion of the eligibility for the CMETC to lithium from brines would apply to flow-through share agreements entered into after 28 March 2023 and before April 2027.

- ▶ **Tax on repurchases of equity:** Design and implementation details of the proposed tax that would apply to Canadian-resident public corporations but excludes mutual fund corporations; and to real estate investment trusts, specified investment flow-through (“SIFT”) trusts, and SIFT partnerships, that have units listed on a designated stock exchange.

The tax would be equal to 2% of the net value of an entity’s repurchase of equity, defined as the fair market value of equity repurchased less the fair market value of equity issued from treasury on an annual basis (with certain exceptions for debt-like preferred shares/ units and certain corporate reorganizations).

The tax would not apply to an entity in a taxation year if it repurchased less than \$1 million of equity during that taxation year, as determined on a gross basis.

The tax would apply in respect of repurchases and issuances of equity that occur on or after 1 January 2024.

- ▶ **General anti-avoidance rule (“GAAR”):** Further to the consultation on various approaches to modernizing and strengthening the GAAR that has recently been conducted, the GAAR will be amended as follows by:
  - ▶ (i) **Preamble** - A preamble would be added to the GAAR in order to help address interpretive issues and ensure that the GAAR applies as intended.
  - ▶ (ii) **Avoidance transaction** - The threshold for the avoidance transaction test would be reduced from a “primary purpose” test to a “one of the main purposes” test.
  - ▶ (iii) **Economic substance** - The economic substance is to be considered at the ‘misuse or abuse’ stage of the GAAR analysis and that a lack of economic substance tends to indicate abusive tax avoidance.
  - ▶ (iv) **Penalty** - Transactions subject to the GAAR will be subject to a penalty equal to 25% of the amount of the tax benefit. The penalty could be avoided if the transaction is disclosed to the CRA, under the proposed mandatory disclosure rules or voluntarily.
  - ▶ (v) **Reassessment period** - A three-year extension to the normal reassessment period would be provided for GAAR assessments unless the transaction had been disclosed to the Canada Revenue Agency (“CRA”).

Interested parties are invited to send written representations to the Department of Finance Canada by 31 May 2023. Following this consultation, the government intends to publish revised legislative proposals and announce the application date of the amendments.

- ▶ **Dividend received deduction by financial institutions:** To align the treatment of dividends and gains on portfolio shares under the mark-to-market rules, the deduction in respect of dividends received on shares of other corporations resident in Canada received after 2023 by financial institutions on shares that are mark-to-market property will be denied.

- ▶ **Income tax and GST/HST treatment of credit unions:** Elimination of the revenue test from the definition of “credit union” included in the *Income Tax Act* and used in the *Excise Tax Act* and amendment of this definition to accommodate how credit unions currently operate. The amendment would apply in respect of taxation years of a credit union ending after 2016.

## International tax measures

As part of Budget 2023, Finance provided an update on the most recent developments and upcoming implementation steps regarding the OECD recommendations on Pillar One and Pillar Two.

- ▶ **Pillar One - reallocation of taxing rights:** Further to the OECD draft rules consolidated in two major progress reports released in July and October of 2022, countries are working toward completing multilateral negotiations so that the convention to implement Pillar One can be signed by mid-2023, with a view to it entering into force in 2024. Budget 2023 announced that the Digital Services Tax (“DST”) could be imposed as of 1 January 2024, but only if the multilateral convention implementing the Pillar One framework has not come into force. In that event, the DST would be payable as of 2024 in respect of revenues earned as of 1 January 2022.
- ▶ **Pillar Two - global minimum tax:** Consistent with the announcement in Budget 2022, Budget 2023 announces the government’s intention to introduce legislation implementing the Income Inclusion Rule (“IIR”) and a domestic minimum top-up tax applicable to Canadian entities of Multinational Enterprises (“MNEs”) that are within the scope of Pillar Two, with effect for fiscal years of MNEs that begin on or after 31 December 2023. The government also intends to implement the Undertaxed Profits Rule (“UTPR”) with effect for fiscal years of MNEs that begin on or after 31 December 2024. The government intends to release draft legislative proposals for the IIR and domestic minimum top-up tax for public consultation in the coming months, with draft legislative proposals for the UTPR to follow at a later time. Budget 2023 also announces the government’s intention to share with provinces and territories a portion of the revenues from the international tax reform.

## Personal income tax measures

- ▶ **Strengthening the intergenerational business transfer framework:** Bill C-208 introduced an exception to section 84.1 of the *Income Tax Act* to facilitate intergenerational business transfers but contained insufficient safeguards. The rules will now only apply where a genuine intergenerational business transfer takes place, which includes one of two transfer options: (i) an immediate intergenerational business transfer (three-year test based on arm’s length sale terms) or (ii) a gradual intergenerational business transfer (five-to-ten-year test based on traditional estate freeze characteristics). There are several proposed conditions that will need to be met in respect of either transfer option.

A joint election will be required and the limitation period for reassessing the transferor’s liability under section 84.1 is proposed to be extended by three years for an immediate business transfer and by ten years for a gradual business transfer.

A ten-year capital gains reserve will also be available for intergenerational share transfers that satisfy the conditions. These measures would apply to transactions that occur on or after 1 January 2024.

- ▶ **Employee ownership trusts:** New rules to facilitate the use of Employee Ownership Trusts (“EOTs”) to acquire and hold shares of a business. The proposed changes to tax rules would extend the capital gains reserve to ten years for qualifying sales to an EOT, create an exception to the current shareholder loan rule, and exempt EOTs from the 21 year deemed disposition rule that applies to certain trusts. A trust would be considered an EOT if it is a Canadian-resident trust (excluding deemed resident trusts) and has only two purposes: (i) hold shares of qualifying businesses for the benefit of the employee beneficiaries of the trust, and (ii) make distributions to employee beneficiaries under a distribution formula that could only consider an employee’s length of service, remuneration, and hours worked. Otherwise, all beneficiaries must generally be treated in a similar manner. Various other conditions (e.g., EOT’s assets) would apply.
- ▶ **Registered education savings plans (“RESP”):** Amendments such that the terms of an RESP may permit educational assistance payment (“EAP”) withdrawals of up to \$8,000 in respect of the first 13 consecutive weeks of enrollment for beneficiaries enrolled in full-time programs, and up to \$4,000 per 13-week period for beneficiaries enrolled in part-time programs. Also, an amendment to enable divorced or separated parents to open joint RESPs for one or more of their children, or to move an existing joint RESP to another promoter.
- ▶ **Retirement compensation arrangements (“RCA”):** Amendment so that fees or premiums paid for the purposes of securing or renewing a letter of credit (or a surety bond) for an RCA that is supplemental to a registered pension plan will not be subject to the refundable tax. Also, amendment to allow employers to request a refund of previously remitted refundable taxes in respect of fees or premiums paid for letters of credit (or surety bonds) by RCA trusts, based on the retirement benefits that are paid out of the employer’s corporate revenues to employees that had RCA benefits secured by letters of credit (or surety bonds). Employers would be eligible for a refund of 50% of the retirement benefits paid, up to the amount of refundable tax previously paid.
- ▶ **Registered disability savings plan (“RDSP”):** A temporary measure, which is legislated to expire on 31 December 2023 allows a qualifying family member to open an RDSP and be the plan holder for an adult whose capacity to enter into an RDSP contract is in doubt, and who does not have a legal representative. An extension of the qualifying family member measure by three years, to 31 December 2026 is proposed. A qualifying family member who becomes a plan holder before the end of 2026 could remain the plan holder after 2026. Also proposed, a broadening of the definition of “qualifying family member” to include a brother or sister of the beneficiary who is 18 years of age or older.
- ▶ **Alternative minimum tax (“AMT”) for high-income individuals:** Changes are proposed to broaden the AMT base by further limiting tax preferences, namely (i) increasing the AMT capital gains inclusion rate from 80% to 100%, (ii) including 100% of the benefit associated with employee stock options in the AMT base, (iii) continuing to include 30% of capital gains eligible for the lifetime capital gains exemption in the AMT base, (iv) including 30% of capital gains on donations of publicly listed securities in the AMT base, and (v) disallowing 50% of certain deductions. In addition, only 50% of non-refundable tax credits would be allowed to reduce the AMT, subject to certain exceptions and the exemption amount would increase to approximately \$173,000, which would be

indexed annually to inflation. Also, the AMT rate would increase from 15% to 20.5%. The length of the carry forward would be maintained at seven years and trusts that are currently exempt from the AMT would continue to be exempt.

- ▶ **Deduction for tradespeople's tools expenses:** Doubling of the maximum employment deduction for tradespeople's tools from \$500 to \$1,000, effective for 2023 and subsequent taxation years.
- ▶ **Grocery rebate:** Introduction of an increase to the maximum Goods and Services Tax Credit ("GSTC") amount for January 2023 that would be known as the Grocery Rebate. Eligible individuals would receive an additional GSTC amount equivalent to twice the amount received for January. The Grocery Rebate would be paid as soon as possible following the passage of the legislation, through the GSTC system.
- ▶ **Taxpayer information sharing for the Canadian dental care plan:** Amendment to provide legislative authority for the Canada Revenue Agency to share taxpayer information with:
  - (i) an official of Employment and Social Development Canada or Health Canada solely for the purposes of the administration or enforcement of the Canadian Dental Care Plan; and
  - (ii) an official of Health Canada solely for the evaluation or formulation of policy for that plan.

## Sales and excise tax measures

- ▶ **GST/HST treatment of payment card clearing services:** Amendment of the GST/HST definition of "financial service" to clarify that payment card clearing services rendered by a payment card network operator are excluded from the definition to ensure that such services generally continue to be subject to GST/HST (addition of new paragraph (r.6) in the definition of "financial service"). This measure would apply to a service rendered under an agreement for a supply if any consideration for the supply becomes due, or is paid without becoming due, after 28 March 2023. This measure would also apply to a service rendered under an agreement for a supply if all of the consideration for the supply became due, or was paid, on or before 28 March 2023, except in certain situations, generally being where the following conditions were both met:
  - ▶ The supplier did not, on or before 28 March 2023, charge, collect or remit any amount as or on account of tax in respect of the supply; and
  - ▶ The supplier did not, on or before 28 March 2023, charge, collect or remit any amount as or on account of tax in respect of any other supply that is made under the agreement and that includes the provision of a payment card clearing service.
- ▶ **Alcohol excise duty:** Temporary cap on the inflation adjustment for excise duties on beer, spirits and wine at 2%, for one year only, as of 1 April 2023. The proposed measure would come into force on 1 April 2023.
- ▶ **Cannabis taxation - quarterly duty remittances:** Amendment of the *Excise Act, 2001* to allow all licensed cannabis producers (and not only certain smaller producers) to remit excise duties on a quarterly rather than monthly basis, starting from the quarter beginning on 1 April 2023.

- ▶ **Air travellers security charge:** Increase of the Air Travellers Security Charge (“ATSC”) rates by 32.85% to maintain and increase the Canadian Air Transport Security Authority's level of service, improve screening wait times, and strengthen security measures at airports. The proposed new ATSC rates will apply to air transportation services that include a chargeable emplanement on or after 1 May 2024, for which any payment is made on or after that date.

### Custom tariffs measures

- ▶ **Tariff support for developing countries:** Renewal, until the end of 2034, and update of the General Preferential Tariff (“GPT”) and of the Least Developed Country Tariff (“LDCT”), two non-reciprocal tariff preference programs to developing countries, under the *Customs Tariff*. Updates would include creating a GPT+ program, in alignment with Canada’s progressive trade agenda, as well as expanding benefits for certain import categories, and simplifying administrative requirements for Canadian importers.

### 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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