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FEDERAL BUDGET 2022

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2022 Canadian Federal Budget Commentary – Tax Measures

INTRODUCTION

On April 7, 2022 (Budget Day), Canada's Finance Minister (and Deputy Prime Minister), Chrystia Freeland, delivered her second budget in the House of Commons (Budget 2022).

The stated focus of Budget 2022 is a growth agenda focusing on three "pillars" (presumably an expression borrowed from the OECD): (i) "modern" supply-side economics; (ii) the green transition; and (iii) tackling the "Achilles heel" of Canada's economy, productivity and innovation.

The good news for all individual taxpayers is no increase in tax rates and, for those whose beverage of choice is low-alcohol beer, the elimination of excise duty on that product! For some high-income Canadians, the bad news is that the Government is committed to changing the alternative minimum tax (AMT) so that "wealthy" Canadians pay their "fair" share. Details will be forthcoming in the fall 2022 economic and fiscal update. Measures are also proposed to address the manipulation of Canadian-controlled private corporation (CCPC) status to avoid additional refundable corporate income tax on investment income, as well as a residential property flipping rule.

Given pre-Budget speculation, banks, life insurers and other financial institutions are, not surprisingly, targets for rate increases and a number of specific anti-avoidance rules. Moreover, the Government "expects federally regulated financial institutions to demonstrate an exemplary level of corporate behaviour" and "proposes to examine potential changes to the financial transaction approval process to limit the ability of federally regulated financial institutions to use corporate structures in tax havens to engage in aggressive tax avoidance". No details are provided.

In fact, Budget 2022 is noteworthy for its lack of detail on a number of significant proposals. Unlike previous budgets, there is little in the way of proposed legislation. There will be consultations on a number of proposals including "modernizing" the general anti-avoidance rule.

On the compliance side, the Canada Revenue Agency (CRA) is to be provided with an additional $1.2 billion over five years to expand audits of larger entities and non-residents engaged in aggressive tax planning, increase the investigation and prosecution of those engaged in criminal tax evasion, and expand its educational outreach.

Our commentary, which focuses on the tax measures in Budget 2022 that are most relevant to businesses, is provided below.

Unless otherwise stated, all statutory references are to the *Income Tax Act* (Canada) (Tax Act).

BUSINESS INCOME TAX MEASURES

CANADA RECOVERY DIVIDEND AND ADDITIONAL TAX ON BANKS AND LIFE INSURERS

CANADA RECOVERY DIVIDEND (CRD)

No surprise here**.** Budget 2022 proposes to introduce a one-time 15% tax (CRD) on bank and life insurer groups.

No draft legislation accompanied the Budget proposal. Budget 2022 states that a group would include a bank or life insurer and any other financial institution (for the purposes of Part VI of the Tax Act) that is related to the bank or life insurer.

The term “financial institution” in Part VI refers to a corporation that: (i) is a bank; (ii) is authorized under the laws of Canada or a province to carry on the business of offering its services as a trustee to the public; (iii) is authorized under the laws of Canada or a province to accept deposits from the public and carries on the business of lending money on the security of real property or investing in mortgages on real property; or (iv) is a life insurance corporation that carries on business in Canada. It also includes a corporation all or substantially all of the assets of which are shares or indebtedness of such corporations to which the corporation is related.

The term “bank” is defined in the Tax Act to mean “a bank within the meaning assigned by section 2 of the *Bank Act* (other than a federal credit union) or an ‘authorized foreign bank’ ”. Thus, Canadian chartered banks, Canadian subsidiaries of foreign banks and Canadian branches of foreign banks would appear to be within the scope of the CRD.

Interestingly, a subsidiary of a “financial institution” that is not itself a financial institution (e.g., an investment dealer) would not be within the scope of the CRD.

The tax is to be imposed for a corporation’s 2022 taxation year but based on its taxable income for taxation years ending in 2021. It is proposed that there will be an exemption for $1 billion of taxable income that must be allocated by agreement amongst group members.

The tax will be payable in equal amounts over five years.

ADDITIONAL TAX ON BANK AND LIFE INSURERS

Budget 2022 proposes to introduce an additional tax of 1.5% of taxable income for members of bank and life insurer groups (determined in the same manner as the CRD). Again, no draft legislation accompanied this Budget proposal.

It is proposed that there will be an exemption for $100 million of taxable income that must be allocated by agreement amongst group members.

The proposed additional tax is to apply to taxation years that end after Budget Day. For a taxation year that includes Budget Day, the tax will be pro-rated based on the number of days in the taxation year after Budget Day.

The CRD and the additional 1.5% tax are expected to raise $6.1 billion over the next five years, with the 1.5% additional tax expected to raise $445 million ongoing.

SECURITIES LENDING ARRANGEMENTS AND THE DIVIDEND RECEIVED DEDUCTION

Budget 2022 proposes amendments to the definition of "dividend rental arrangement" in subsection 248(1) (relevant to the inter-corporate dividend deduction (DRD) under section 112) and the securities lending arrangement rules in section 260. The amendments target certain transactions undertaken by financial institution groups.

The particular types of transactions targeted are ones in which

- a Canadian taxpayer (generally a financial institution) (Can FI Taxpayer) owns shares of a Canadian public corporation that pays dividends (Can Pubco Shares);
- a registered securities dealer (Can Dealer) in Can FI Taxpayer's corporate group separately borrows Can Pubco Shares under a securities lending arrangement; and
- Can Dealer sells the borrowed Can Pubco Shares to another person (this is referred to as a short position because Can Dealer must return to the lender at a future date shares identical to the Can Pubco Shares borrowed under the securities lending arrangement).

Budget 2022 states that this arrangement results in Can FI Taxpayer's corporate group eliminating its economic exposure to the Can Pubco Shares, as Can FI Taxpayer would continue to hold the Can Pubco Shares but Can Dealer would be obligated to deliver Can Pubco Shares to the lender under the securities lending arrangement. The concern expressed by Budget 2022 is that Can FI Taxpayer's corporate group also creates an artificial tax deduction:

- Can FI Taxpayer would receive dividends on the Can Pubco Shares but would be entitled to the DRD under subsection 112(1) for the dividends received such that these dividends are received on a tax-free basis; and
- Can Dealer would be required to make dividend compensation payments in respect of dividends on the Can Pubco Shares to the lender under the securities lending arrangement and, as a result, Can Dealer would be entitled to deduct 2/3rds of such dividend compensation payments because of subsection 260(6).

The net effect, according to the Government, is an artificial tax deduction equal to 2/3rds of the dividend compensation payments.

Budget 2022 proposes to add a definition of "specified hedging transaction" to subsection 248(1) that is intended to capture the type of arrangement described above. If an arrangement is a specified hedging transaction, it will be a dividend rental arrangement, the DRD under subsection 112(1) will be denied, and the registered securities dealer will be permitted to deduct 100% of the dividend compensation payments.

In general terms, a specified hedging transaction is a transaction (including an arrangement or event) or series of transactions by a registered securities dealer in respect of a "DRA share" that is owned by it or by a person (Other NAL Owner) that does not deal at arm's length with, or is affiliated with, the registered securities dealer, where:

- the transaction or series has the effect, or would have the effect if the transaction or series were entered into by the Other NAL Owner instead of the registered securities dealer, of eliminating all or substantially all of the risk of loss and opportunity for gain or profit in respect of the DRA share; and
- if the DRA share is held by the Other NAL Owner, the transaction can reasonably be considered to have been entered into with the knowledge, or where there ought to have been the knowledge, that the effect described above would result.

In addition, the following amendments are proposed:

- an amendment to the definition of "dividend rental arrangement" in subsection 248(1) to include a specified hedging arrangement (the DRD under subsection 112(1) is denied for dividend rental arrangements); and
- amendments to paragraph 260(6)(a) and subsection 260(6.2) to permit Can Dealer (the registered securities dealer) to deduct the lesser of (i) 100% of the dividend compensation payment and (ii) the amount of the denied DRD.

Budget 2022 makes the comment that it is believed that these arrangements could be challenged under the existing legislation, but states that these challenges are time consuming.

The proposed amendments would apply to dividends and related dividend compensation payments that are paid, or become payable, on or after Budget Day, unless the relevant hedging transactions or related securities lending arrangements were in place before Budget Day, in which case the amendment would apply to dividends and related dividend compensation payments that are paid after September 2022.

The proposed amendments are expected to raise $635 million over the next five years.

INVESTMENT INCOME AND CANADIAN-CONTROLLED PRIVATE CORPORATIONS

Substantive CCPCs

Canadian-controlled private corporations (CCPCs) are subject to refundable tax on investment income that, generally, removes the incentive for a Canadian individual to earn investment income in a corporation rather than directly. In certain circumstances a private corporation controlled by Canadian residents may not qualify as a CCPC and, therefore, would not be subject to refundable tax on its investment income. The Government is of the view that certain taxpayers are purposefully taking steps to cause corporations not to be CCPCs for the purpose of avoiding the refundable tax. Budget 2022 describes examples of the steps a taxpayer may take to avoid CCPC status, including continuing a corporation so that it is governed under foreign corporate law while it continues to be resident in Canada (such a corporation would not be a CCPC because the definition of CCPC only includes corporations that are governed under Canadian corporate law) or allowing a non-resident to acquire options to acquire control of the corporation.

Budget 2022 introduces a new definition of a “substantive Canadian-controlled private corporation” (substantive CCPC) to counter this perceived manipulation of CCPC status. Private corporations that are resident in Canada will be substantive CCPCs if they are ultimately controlled, legally or factually, by Canadian resident individuals. A private corporation resident in Canada that would be a CCPC if a non-resident or public corporation did not own options or rights to acquire shares of such private corporation also will be a substantive CCPC.

Substantive CCPCs will be subject to the same refundable tax regime on their investment income as CCPCs. In addition, to ensure distributions from substantive CCPCs are taxed similarly to distributions from CCPCs, the investment income earned by a substantive CCPC will be added to the low rate income pool of the substantive CCPC. This will cause a dividend of such income to be a non-eligible dividend, as would a dividend of investment income from a CCPC (where the investment income is not added to the CCPC’s general rate income pool). While the objective of the rules is to place a substantive CCPC in the same position as a CCPC with respect to investment income, a substantive CCPC will not be treated as a CCPC for any other purpose. As a result, a substantive CCPC will not be entitled to any of the preferential measures available to CCPCs.

The new definition and related rules will be supported by: (i) a targeted anti-avoidance rule to deal with situations where it is reasonable to consider that particular arrangements, transactions or series of transactions were completed to avoid the anti-deferral rules for investment income, and (ii) certain amendments to assist in the administration of the rules that apply to substantive CCPCs.

The substantive CCPC rules apply to taxation years that end on or after Budget Day, with an exception for taxation years that end as the result of the sale of all or substantially all of the shares of the corporation to an arm’s-length purchaser if the purchase and sale agreement was entered into before Budget Day and the sale closes before the end of 2022.

Foreign Accrual Property Income (FAPI) by Controlled Foreign Affiliates of CCPCs

Budget 2022 proposes new rules to counter another situation where the Government perceives taxpayers may be inappropriately deferring tax on investment income, in this case by earning such income through a controlled foreign affiliate of a CCPC rather than directly as an individual or in Canada through a CCPC that is subject to the refundable tax regime.

A Canadian shareholder of a controlled foreign affiliate is, generally, required to include an amount in income in respect of the investment income earned by that controlled foreign affiliate in that year as foreign accrual property income (FAPI). If the shareholder is a CCPC, FAPI is included in its investment income and subject to the refundable tax mechanisms to prevent a deferral benefit from being achieved by earning the FAPI in a CCPC rather than directly by an individual. The FAPI rules provide a mechanism for avoiding double taxation when the investment income earned by the controlled foreign affiliate is subject to tax in the foreign country. This relieving mechanism works by providing a deduction from the Canadian shareholder's income. The amount of the deduction is computed by multiplying the tax payable in the foreign jurisdiction by a "relevant tax factor." If the shareholder is a corporation, including a CCPC, the relevant tax factor is 4, such that the deduction from income will fully offset the FAPI inclusion if the foreign tax rate is 25% or higher. For other shareholders, including individuals, the relevant tax factor is 1.9, such that if the foreign tax rate is less than 52.63%, the deduction from income will not fully offset the FAPI inclusion.

The Government believes there is a potential for an inappropriate tax deferral on investment income when a CCPC is the shareholder of the controlled foreign affiliate earning such income. That is, if the CCPC earned the investment income directly, the income would be subject to the refundable tax regime to prevent any deferral advantage. When the after-tax portion of the investment income was distributed to the shareholder as a dividend, it would be paid as a non-eligible dividend. By contrast, if the CCPC owned shares of a controlled foreign affiliate that earned the same investment income in a country with a 25% corporate tax rate, the FAPI inclusion would be offset by the deduction for foreign tax such that there would be no net income at the CCPC to be subject to the refundable tax regime. Further, certain amounts in respect of FAPI are added to a CCPC's general rate income pool which allows those amounts to be distributed to shareholders as eligible dividends.

Budget 2022 proposes amendments to eliminate this potential deferral advantage by changing the relevant tax factor for CCPCs and substantive CCPCs to be the same as that for individuals. Budget 2022 also proposes revisions to the rules that are intended to achieve integration when amounts are paid out to individual shareholders since the existing rules will not achieve integration with the new relevant tax factor. The proposed changes would reduce the CCPC's (and substantive CCPC's) general rate income pool by certain amounts and add certain amounts to the capital dividend account of the CCPC (or substantive CCPC) in an attempt to allow income that had been subjected to a tax rate of 52.63% or higher to flow tax free to an individual shareholder while ensuring income that has been subject to lower rates of tax is subject to the appropriate level of tax on an integrated basis.

These rules apply to taxation years that begin on or after Budget Day.

EXTENSION OF THE SMALL BUSINESS DEDUCTION

A CCPC may be entitled to claim a deduction, commonly known as the small business deduction, from Part I tax otherwise payable. The small business deduction effectively reduces the applicable federal corporate income tax rate from 15% to 9% on up to $500,000 of qualifying active business income per year. The $500,000 of qualifying active business income per year (the business limit) that is eligible for the small business deduction must be shared amongst associated corporations and is subject to reduction based on the CCPC's and any associated corporation's taxable capital employed in Canada and amount of certain investment income. Under the current rules, the business limit of a CCPC and any associated corporation is reduced on a straight-line basis when:

- the taxable capital employed in Canada by the CCPC and any associated corporation is between $10 million and $15 million; or
- the combined adjusted aggregate investment income of the CCPC and any associated corporation is between $50,000 and $150,000.

The business limit is the lesser of the two amounts determined by the foregoing reductions. A lower business limit reduces the available small business deduction and increases the CCPC's marginal federal income tax rate.

To encourage growth of small businesses, Budget 2022 proposes to extend the range over which the business limit is reduced based on taxable capital employed in Canada from between $10 million and $15 million to between $10 million

and $50 million. This amendment allows more medium-sized CCPCs to take advantage of the small business deduction and will also increase the extent to which a CCPC's qualifying active business income may be eligible for the small business deduction.

The proposed amendment would apply to taxation years that begin on or after Budget Day.

INTERGENERATIONAL SHARE TRANSFERS

Budget 2022 announces the launch of a consultation process regarding the rules applicable to the sale of shares of certain types of corporations (qualified small business corporations, family farm corporations and fishing corporations) to corporations controlled by the children or grandchildren of the shareholder. The Government states that the changes to these rules enacted by private member's Bill C-208, which received royal assent on June 29, 2021, may create opportunities for dividends to be converted to lower taxed capital gains in situations in which there has not been a "genuine intergenerational business transfer." The consultation process will seek stakeholder input on how to balance the objectives of allowing "genuine intergenerational business transfers" while "protect[ing] the integrity of the tax system." The Government invites comments by June 17, 2022, and intends to table a bill in the fall dealing with this matter.

FLOW-THROUGH SHARES — GOOD NEWS FOR SOME MINING COMPANIES AND BAD NEWS FOR OIL, GAS AND COAL EXPLORATION, OR DEVELOPMENT

The Tax Act permits a principal-business corporation to renounce expenses that the corporation would otherwise treat as Canadian exploration expense (CEE) or Canadian development expense (CDE) to purchasers of flow-through shares so that the purchasers can claim the relevant deductions instead of the corporation.

If the purchaser of the flow-through shares is an individual and the renounced expenses are CEE that qualify as specified mineral exploration expenses, the individual may claim a 15% non-refundable tax credit (METC) in respect of such expenses. The amount of the METC deducted from tax payable in a taxation year reduces the individual's cumulative CEE account in the following year, thereby potentially giving rise to an inclusion in the individual's income of that amount. (The METC rules also apply to specified mineral exploration expenses renounced to a partnership and allocated by the partnership to the individual.)

The good news is that Budget 2022 proposes a new 30% Critical Mineral Exploration Tax Credit (CMETC) for specified minerals.

- Budget 2022 states that "the administration of the CMETC would generally follow the rules in place for the METC." 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. There will be no double dipping — eligible expenditures would not benefit from both the proposed CMETC and the METC.
- The CMETC would apply to expenditures renounced under flow-through share agreements entered into after Budget Day and on or before March 31, 2027.
- To be eligible, a qualified person (as defined in National Instrument 43-101 published by the Canadian Securities Administrators as of Budget Day) must certify that the expenditures to be incurred by the corporation and renounced to the investor will be incurred as part of an exploration project that targets the specified minerals. Such expenditures will not be eligible for the CMETC if the qualified person is unable to "… demonstrate that there is a reasonable expectation that the minerals targeted by the exploration are primarily specified minerals."

The bad news is that Budget 2022 proposes to eliminate the flow-through share regime for oil, gas and coal activities such that CEE and/or CDE incurred in oil, gas and coal exploration or development cannot 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.

- In addition to transferring CEE and/or CDE to individual investors, flow-through shares are used to “move” expenditures within a corporate group. Finance officials have indicated that the change is to apply to all flow-through share agreements relating to oil, gas and coal exploration or development.

INVESTMENT TAX CREDIT FOR CARBON CAPTURE, UTILIZATION AND STORAGE

Budget 2022 introduces a new refundable investment tax credit (CCUS ITC) to encourage investment in carbon capture, utilization and storage (CCUS) project development. It applies to eligible expenses incurred after 2021 through 2040.

Eligible expenses are expenses incurred in the taxation year to acquire or install eligible equipment (Eligible Equipment) that will be used in an eligible CCUS project (Eligible Project) that results in CO_2 being used for an eligible use (Eligible Use). Each of these relevant concepts is discussed below. Expenses incurred in the development of a CCUS project that do not relate to the acquisition or installation of equipment do not qualify for the CCUS ITC (such as feasibility studies, front end engineering design studies, operating expenses, and exploration and development expenses).

Eligible Equipment

Eligible Equipment is equipment:

- the sole use of which is to capture, transport, store or use CO_2; and
- that is put to use in Canada in an Eligible Project.

Equipment that captures CO_2 in Canada, compresses it and transports it to another jurisdiction to be stored will be considered to be used in Canada.

Equipment that does not support CCUS and equipment required for the following purposes is not Eligible Equipment:

- hydrogen production;
- natural gas processing; and
- acid gas injection.

Eligible Project

Eligible Projects are new projects that:

- capture CO_2 directly from the ambient air (Direct Air Capture) or capture CO_2 that would otherwise be released into the atmosphere;
- prepare the CO_2 for compression;
- compress and transport the CO_2;
- store or use the captured CO_2 in a manner that satisfies the storage requirements; and
- are not connected with electricity generation facilities that are required to reduce emissions under *Reduction of Carbon Dioxide Emissions from Coal-fired Generation of Electricity Regulations* and the *Regulations Limiting Carbon Dioxide Emissions from Natural Gas-fired Generation of Electricity*.

It is not clear what constitutes a new project.

For geological CO_2 storage, the storage requirement is that the project must be located in a jurisdiction where there are sufficient regulations to ensure that CO_2 is, according to Environment and Climate Change Canada determinations, permanently stored (currently only Alberta and Saskatchewan qualify). For concrete storage projects, the storage requirement is that the process used by the project is approved by Environment and Climate Change Canada and 60% of the CO_2 injected into the concrete is successfully mineralized and locked into the resulting concrete.

Eligible Use

Eligible Uses are the storage of CO_2 in underground geological formations or the storage of CO_2 in concrete. The use of CO_2 to enhance oil and gas recovery is not an Eligible Use. If a portion of the eligible expense will not be utilized for an Eligible Use, the CCUS ITC is reduced by the percentage of CO_2 that will be put to the ineligible use.

ITC Rates

The rate of the CCUS ITC depends on the type of expense incurred and the period of time in which the expense is incurred.

Between January 1, 2022, and December 31, 2030, the following rates apply:

60%	expenses related to eligible capture equipment used in Direct Air Capture projects
50%	expenses related to eligible capture equipment used in projects other than Direct Air Capture projects
37.5%	expenses related to eligible transportation, storage and use equipment

Between January 1, 2031 and December 31, 2040 the rates are one-half of those rates described above.

Other Rules

The claim of the CCUS ITC in respect of a piece of equipment is not subject to any available for use rules.

The CCUS ITC may only be claimed by one owner of a piece of equipment (i.e., a subsequent owner may not claim the CCUS ITC if a previous owner has claimed CCUS ITC in respect of the same piece of equipment).

New Capital Cost Allowance (CCA) Classes

Budget 2022 proposes new depreciable property classes for certain expenses incurred in respect of a CCUS project:

- a new class with a CCA of 8% includes CO_2 capture equipment, CO_2 transportation equipment and CO_2 storage equipment, and is eligible for enhanced first year depreciation under the Accelerated Investment Incentive;
- a new class with a CCA rate of 20% includes equipment required for using CO_2 in an Eligible Use and is eligible for enhanced first year depreciation under the Accelerated Investment Incentive; and
- two new classes with CCA rates of 100% and 30% for intangible exploration expenses and development expenses, respectively, associated with storing CO_2.

Compliance Matters

Certain compliance matters are relevant to the claim of the CCUS ITC:

- CCUS projects are subject to a validation and verification process:
  - CCUS projects that expect to have eligible expenses of $100 million or greater are generally required to undergo an initial project tax assessment; and
  - eligible expenses must be verified by Natural Resources Canada, which occurs after the end of the taxpayer's tax year in which the expenses are incurred.
- CCUS projects will be assessed every five years (up to a maximum of 20 years) to determine if there should be a repayment by the taxpayer of the CCUS ITC based on the amount of CO_2 that ultimately is used for an ineligible use.
- CCUS projects that expect to have eligible expenses of $250 million or greater are required to contribute to public knowledge sharing in Canada (the specifics of what will be required will be provided at a later date).

- Taxpayers are required to prepare a climate-related financial disclosure report which details the taxpayer's plan to contribute to the Government's commitment to achieve net-zero emissions by 2050.
- Taxpayers are required to track the amount of CO_2 being captured by the CCUS project. Taxpayers must track the portion of CO_2 that is used for an eligible use and the portion of CO_2 that is used for an ineligible use. Where the portion of CO_2 being used for an ineligible use exceeds the amount set out in the initial project plan, a taxpayer may be required to repay CCUS ITC amounts.

CLEAN TECHNOLOGY TAX INCENTIVES – AIR-SOURCE HEAT

Capital Cost Allowance for Clean Energy Equipment

Certain investments in specified clean energy generation and energy conservation equipment are entitled to accelerated capital cost allowance (CCA) rates in Classes 43.1 and 43.2. Budget 2022 proposes to expand Classes 43.1 and 43.2 to include air-source heat pumps used primarily for interior space heating or cooling (e.g., refrigerant piping, energy conversion equipment, thermal energy storage equipment, control equipment and equipment designed to enable the system to interface with other heating and cooling equipment). Budget 2022 states that this expansion of Classes 43.1 and 43.2 will not include buildings or parts of buildings, energy equipment that backs up an air-source heat pump system, or equipment that distributes heated or cooled air or water within a building. The expansion of Classes 43.1 and 43.2 will generally apply in respect of eligible property that is acquired and becomes available for use on or after Budget Day.

Rate Reduction for Zero-Emission Technology Manufacturers

Budget 2021 proposed to reduce the applicable tax rates on certain eligible zero-emission technology manufacturing and processing income to:

- 7.5% (if that income would otherwise be taxed at the 15% general corporate rate); and
- 4.5% (if that income would otherwise be taxed at the 9% small business rate).

The reduced tax rates apply to taxation years that begin after 2021 but will be phased out beginning in 2029 and fully phased out for taxation years beginning in 2032.

Budget 2022 proposes to include the manufacturing of air-source heat pumps used for space or water heating as an eligible zero-emission technology manufacturing or processing activity.

REVIEW OF TAX SUPPORT TO R&D AND INTELLECTUAL PROPERTY

The Tax Act seeks to incent investment in innovative research and development in Canada through the scientific research and experimental development (SR&ED) program. To ensure that a taxpayer is entitled to such benefits, the Tax Act contains detailed rules in respect of these incentives. Unfortunately, eligible taxpayers often do not receive the intended incentives due to a narrow application of the rules by the CRA or an inadvertent failure to comply with the rules. Other taxpayers that undertake eligible activities do not apply for these incentives because the cost of properly doing so exceeds the potential benefits.

Budget 2022 proposes to review the Tax Act's SR&ED incentives to (i) ensure that they promote research and development activity that benefits Canada; (ii) "modernize and simplify" the incentives; and (iii) examine the possibility of making changes to the eligibility requirements to promote program efficiency while maintaining adequate proof of entitlement.

Budget 2022 states that "the government will also consider whether the tax system can play a role in encouraging the development and retention of intellectual property stemming from R&D conducted in Canada." More specifically, the Government will undertake a review and obtain stakeholder submissions on the possibility of Canada adopting a "patent box regime." In general, a patent box regime taxes income derived from intellectual property at a preferential rate in order to encourage research and development activities in the sponsoring jurisdiction and to encourage more mature

businesses that profit from their intellectual property to remain in the sponsoring jurisdiction, thereby providing spin-off benefits.

INTERNATIONAL TAX MEASURES

INTERNATIONAL TAX REFORM

UPDATE ON PILLAR ONE AND THE DIGITAL SERVICES TAX

Budget 2022 confirms the Government's intention to proceed with the implementation of the digital services tax (DST) if the multilateral approach (Pillar One) of the Organisation for Economic Co-operation and Development (OECD)/Group of 20 (G20) does not come into force by January 1, 2024.

Pillar One is one of two pillars developed by the OECD/G20 Inclusive Framework (Inclusive Framework) on base erosion and profit shifting (BEPS) that were originally intended to address the digitalization of the economy, but which have evolved into a much broader revision to the international tax system. Pillar One proposes to reallocate the right to tax a portion of the profits of large multinational enterprises (MNEs) to market jurisdictions (i.e., where consumers/users are located) regardless of the nature of the MNE's business (subject to some specific exclusions for regulated financial services and extractive industries)

In its 2020 Fall Economic Statement, the Government indicated that while it "strongly favour[ed]" a multilateral approach, it was prepared to act unilaterally to tax digital services if necessary. Further details regarding the DST were announced in Budget 2021.

An agreement on the broad parameters of Pillar One was reached by the majority of Inclusive Framework members (including Canada and the United States) in October 2021 (IF Statement), and the Inclusive Framework began releasing detailed draft rules for public consultation in February 2022, with a view to implementation (by way of a multilateral convention) in 2023. The IF Statement indicates that no new domestic digital services taxes will be imposed before the earlier of December 31, 2023, and the coming into force of Pillar One.

The Government introduced legislative proposals to implement the DST in December 2021 and is currently reviewing public comments on the proposals following a consultation period that ended in February 2022. Under the proposed legislation, the DST would impose a 3% tax on Canadian digital services revenues (generally, revenues from certain online marketplace and advertising services, social media services and the sale or licensing of user data) in excess of C$20 million earned in 2022 and later calendar years by an entity or consolidated group with at least €750 million total revenues. The DST would not be imposed before January 1, 2024 (and only if Pillar One does not come into force before then), but if the DST does come into force, it would apply retroactively to January 1, 2022. The United States has indicated that it opposes these measures.

In Budget 2022, the Government indicates that it is prepared to implement the DST, but that it "remains the [G]overnment's hope and underlying assumption that the timely implementation of the new international tax framework will make this unnecessary."

PILLAR TWO – GLOBAL MINIMUM TAX

IMPLEMENTATION OF PILLAR TWO

Budget 2022 confirms the Government's intention to proceed with the implementation of Pillar Two of the Inclusive Framework's BEPS project (Pillar Two). Pillar Two provides the architecture for imposing a global minimum tax of 15% on MNEs with annual revenues of €750 million or more.

Pillar Two contemplates that Inclusive Framework members will enact two domestic rules (collectively referred to as the Global Anti-Base Erosion Rules (GloBE)). Under the primary rule (Income Inclusion Rule), where an MNE has an effective tax rate below the global minimum tax rate in a jurisdiction in which it operates, the jurisdiction of the ultimate

parent entity (or, where such entity is not located in a jurisdiction that has implemented an Income Inclusion Rule, the jurisdiction of the next lower tier intermediate parent entity) will be entitled to impose a "top-up" tax. If neither the ultimate parent entity nor any intermediate parent entity is located in a jurisdiction that has implemented an Income Inclusion Rule, the Undertaxed Profits Rule permits other jurisdictions to impose a top-up tax on group entities located in their jurisdiction, with taxing rights allocated on a formulaic basis. A carve-out from these top-up taxes would be provided for certain "substance-based" income. In addition, Pillar Two allows a jurisdiction to introduce its own domestic minimum top-up tax, which may be credited against the top-up tax otherwise applicable under Pillar Two. This effectively permits a jurisdiction to collect the top-up tax on the low-taxed income of its domestic entities in priority over other jurisdictions. Finally, Pillar Two contemplates a potential treaty-based rule (Subject to Tax Rule) that may permit developing countries to impose higher withholding tax rates on certain related party payments that are not subject to a minimum rate of tax (9%) in the recipient's home jurisdiction. Budget 2022 states that Canada is not expected to be affected by this rule.

The IF Statement agreed to by the Inclusive Framework in October 2021 indicates that Pillar Two should be brought into members' domestic laws in 2022, with the Income Inclusion Rule coming into effect in 2023, and the Undertaxed Profits Rule in 2024. The Inclusive Framework has released model rules (Model Rules) and commentary to provide a template for a coordinated approach and has indicated that an implementation framework will be developed by the end of 2022. Some members (including the European Union and the United Kingdom) have already begun to take steps towards implementation. Budget 2022 notes that the U.S. global intangible low-taxed income (GILTI) regime is anticipated to be amended to align more closely with Pillar Two, and that conditions providing for the co-existence of the GILTI regime and Pillar Two "remain to be settled."

In accordance with the IF Statement, Budget 2022 states that the Government anticipates that the Income Inclusion Rule will come into effect in 2023, and the Undertaxed Profits Rule will come into effect no earlier than 2024. The domestic minimum top-up tax will also come into effect in 2023.

Budget 2022 launches a public consultation on the Model Rules and the domestic minimum top-up tax, and includes a series of specific questions to guide the consultation process. The Government indicates that "the principal purpose of consultation is to ensure that the draft legislation takes account of any necessary adaptations of the Model Rules to the Canadian legal and income tax context, rather than to seek views on the major design aspects of the Model Rules or broader policy considerations". The deadline to submit comments is July 7, 2022. Budget 2022 expects that additional public consultation will follow the release of draft legislation; however, no details on the timing of such release are provided.

EXCHANGE OF TAX INFORMATION ON DIGITAL ECONOMY PLATFORM SELLERS

Budget 2022 proposes to implement the OECD's model rules in respect of the collecting, reporting and sharing of information pertaining to sharing economy participants, gig economy participants and online sellers. The CRA will share the information collected with, and receive information from, partner jurisdictions that also implement the model rules. These rules are intended to ensure that revenues arising from these activities are properly taxed in the jurisdiction in which they are earned.

The rules apply to a digital platform operator (Reporting Platform Operator) that (i) is resident in Canada, or (ii) is not resident in Canada or a partner jurisdiction but facilitates reportable activities by Canadian resident sellers or the renting of immovable property located in Canada. A Reporting Platform Operator is obligated to collect and report specified information in respect of reportable sellers if the operator (i) directly or indirectly contracts with the seller to make the operator's platform software available to the seller so that the seller can connect with other platform users, or (ii) collects compensation for the reportable activities facilitated by the platform.

Reportable activities (Reportable Activities) include both the provision of services and the sale of goods. Reportable services are the provision of personal services, the rental of immovable property and the renting of the means of transportation.

Provided that the operator does not intervene further with the Reportable Activities, a Reporting Platform Operator does not include an operator whose software exclusively (i) facilitates the processing of compensation in relation to the Reportable Activities (e.g., a pure payment processor); (ii) lists or advertises the Reportable Activities (e.g., a classified ads board); or (iii) transfers sellers to other digital platforms (e.g., an online aggregator). In addition, a Reporting Platform Operator excludes an operator that can demonstrate to the CRA that (i) its business model does not allow sellers to profit from the compensation received, or (ii) its platform does not have any reportable sellers. Finally, there is also an optional reporting threshold: an operator may elect to be excluded from collecting and reporting information if it facilitated the provision of Reportable Activities for the previous year for which the total compensation is less than €1 million.

A reportable seller (Reportable Seller) is an active user who is registered on the operator’s platform to provide Reportable Activities. However, a Reportable Seller excludes certain entities that are considered a low compliance risk: governmental entities, certain publicly traded entities, certain large hotel accommodation providers and sellers of goods that do not exceed certain annual thresholds.

By conducting due diligence, a Reporting Platform Operator needs to identify Reportable Sellers and their jurisdiction of residence before December 31 of the second calendar year in which the operator becomes a Reporting Platform Operator. A Reporting Platform Operator may rely on the due diligence undertaken for a previous year if the operator (i) has verified the seller’s address within the last 36 months, and (ii) has no reason to believe that the seller’s information is unreliable or incorrect.

A Reporting Platform Operator is required to report a Reportable Seller’s specified information to the CRA by January 31 of the year following the calendar year for which the Reportable Seller is identified as a Reportable Seller. Similarly, the Reporting Platform Operator is required to provide the same information to the Reportable Seller by the same date. The proposed rules also contain provisions that prevent the duplicative reporting of a Reportable Seller’s specified information.

These proposed rules apply to calendar years beginning after 2023.

INTEREST COUPON STRIPPING

Generally, withholding tax under Part XIII of the Tax Act applies to interest paid or credited by a person resident in Canada to a non-arm’s length, non-resident person. The withholding tax rate is 25%, subject to reduction under an applicable income tax treaty between Canada and the jurisdiction in which the recipient is resident. The rate of withholding may be reduced under an applicable tax treaty to 10%, 15% or, in the case of the Canada-U.S. tax treaty, 0%.

Some taxpayers have sought to avoid (or reduce) Part XIII non-resident withholding tax on non-arm’s length interest by entering into interest coupon stripping arrangements. Under such an arrangement, a non-resident lender making an interest-bearing loan to a non-arm’s length Canadian-resident borrower sells the right to receive interest payments (interest coupons) in respect of such loan to a person who would not be subject to Part XIII withholding tax, or would be subject to a lower rate of withholding tax than would apply to a payment directly to the non-resident lender. The Tax Act already contains rules that are intended to prevent certain interest coupon stripping arrangements from achieving a reduction in the applicable withholding tax rate. In particular, subparagraph 212(1)(b)(i) was previously amended to override the Federal Court of Appeal decision in *Lehigh Cement Ltd v. R*, 2010 FCA 124, in which the Court found that the GAAR did not apply to the particular interest coupon stripping transaction at issue in that case. Subparagraph 212(1)(b)(i) generally provides that interest that is paid or payable “in respect of” a debt or other obligation to pay an amount to a non-arm’s-length person is subject to Part XIII withholding tax. As such, where a non-arm’s-length, non-resident lender makes an interest-bearing loan to a Canadian resident and sells the interest coupons to an arm’s-length person, subparagraph 212(1)(b)(i) causes the interest payment to remain subject to withholding tax because the interest is in respect of a debt owing to a non-arm’s-length non-resident. Subparagraph 212(1)(b)(i), however, does not apply to payments to a Canadian resident or override the Canada-U.S. tax treaty, such that an interest coupon stripping arrangement where a non-resident, non-U.S. lender sells the interest coupons to a U.S.-resident person entitled to the benefits of that treaty or to a Canadian resident may still be effective in reducing (or eliminating) the withholding tax applicable to the payment.

Budget 2022 proposes to address these variations of the interest coupon stripping arrangement by way of a new anti-avoidance rule. In general terms, the proposed rules will ensure that the Part XIII tax paid under an interest coupon stripping arrangement is the same as if the arrangement had not been undertaken and the interest had been paid to the non-resident lender.

Proposed subsection 212(21) sets out the conditions for the application of these rules. They will apply where

- a taxpayer pays or credits a particular amount as, on account or in lieu of payment of, or in satisfaction of, interest to a person or partnership (the interest coupon holder) in respect of a debt or other obligation (other than a specified publicly offered debt obligation) owed to a person or partnership (the non-arm's-length creditor) that is either a non-resident, non-arm's-length person or a partnership other than a Canadian partnership; and
- the Part XIII tax that would have been payable in respect of the particular amount, if paid or credited to the non-arm's-length creditor rather than the interest coupon holder, is greater than the Part XIII tax in respect of the particular amount otherwise determined.

Where the conditions in proposed subsection 212(21) are met, the operative rule in proposed subsection 212(22) applies to deem, for purposes of the interest withholding tax rules, the taxpayer to have paid interest to the non-arm's-length creditor the amount determined by the formula:

A x (B – C) / B

where

- **A** is the amount paid as, on account or in lieu of payment of, or in satisfaction of, interest;
- **B** is the rate of Part XIII tax that would be imposed in respect of the particular amount if such amount were paid to the non-arm's-length creditor rather than the interest coupon holder; and
- **C** is the rate of Part XIII tax imposed in respect of the particular amount paid or credited to the interest coupon holder at that time.

Budget 2022 proposes that a debt that is a "specified publicly offered debt obligation" will not be subject to the proposed rules. A "specified publicly offered debt obligation" is defined in proposed subsection 212(23) to mean a debt or other obligation that meets the following conditions:

- it was issued by the taxpayer as part of an offering that is lawfully distributed to the public in accordance with a prospectus, registration statement or similar document filed with and, where required by law, accepted for filing by a public authority; and
- it can reasonably be considered that none of the main purposes of a transaction or event, or series of transactions or events, as a part of which the taxpayer pays or credits an amount as, on account or in lieu of payment of, or in satisfaction of, interest to a person or partnership in respect of the debt or other obligation is to avoid or reduce tax that would otherwise be payable under this Part XIII by a non-resident person or partnership to whom the debt or other obligation is owed.

The proposed rules apply to a Canadian resident borrower in respect of interest that is paid or payable to an interest coupon holder if the interest accrues on or after Budget Day except in certain cases. The rules will not apply until April 7, 2023, if (i) the interest payment is in respect of a debt or other obligation incurred before Budget Day; (ii) the payment is made to an interest coupon holder with which the non-resident creditor deals at arm's length; and (iii) the interest coupon holder acquired the interest coupon under an agreement or arrangement that was evidenced in writing and entered into before Budget Day.

SELECT REGISTERED PLANS, TRUSTS, CHARITIES AND PERSONAL INCOME TAX MEASURES

MINIMUM TAX

Budget 2022 announces that the Government is examining a new “minimum tax regime.” Currently, the Tax Act provides for an “alternative minimum tax” (AMT), which was enacted in 1986. Budget 2022 states that the new regime would “go further towards ensuring that all wealthy Canadians pay their fair share of tax” and notes that high-earning Canadians “make significant use of deductions and tax credits.”

Budget 2022 refers specifically to Canadians who pay personal income tax at a rate of 15% (or less) of their “gross income” in excess of $400,000. “Gross income” is described as including realized capital gains at a 100% inclusion rate, rather than the 50% inclusion rate required under the Tax Act in respect of taxable capital gains; it also includes the cash value of dividend income. The statistics provided in Budget 2022 are based on personal T1 income tax returns filed for the 2019 taxation year and do not identify the nature of the deductions and tax credits claimed by individual filers.

Budget 2022 states that details regarding the new minimum tax regime will be released in the 2022 fall economic and fiscal update.

EMPLOYEE OWNERSHIP TRUSTS

In Budget 2021, the Government indicated its support for “employee ownership trusts” and stated that such trusts “encourage employee ownership of a business and facilitate the transition of privately owned businesses to employees.” Such trusts are available in the United Kingdom and the United States.

Following the Government’s consultations with stakeholders, Budget 2022 proposes to introduce a new special purpose trust, the “Employee Ownership Trust” under the Tax Act. No specific details are provided. Budget 2022 states that the Government will consider any remaining barriers to the creation of such trusts and will develop rules governing such trusts, with further consultation with stakeholders.

ENHANCED REPORTING REQUIREMENTS FOR RRSPS AND RRIFS

Currently, financial institutions that administer registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) are required to annually report to the CRA contributions to and payments from such plans.

Budget 2022 proposes to expand the current reporting requirements of financial institutions with respect to RRSPs and RRIFs they administer, applicable to 2023 and subsequent taxation years. Budget 2022 states that under the enhanced reporting requirements, a financial institution that administers an RRSP or a RRIF will be required to include the aggregate fair market value (determined at the end of the year) of all property held in the plan and that the new reporting requirements are intended to “assist the Canada Revenue Agency in its risk-assessment activities regarding qualified investments held by RRSPs and RRIFs.” No draft legislation is provided with respect to these measures.

BORROWING BY DEFINED BENEFIT PENSION PLANS

Canadian registered pension plans are currently prohibited from borrowing money, subject to two main exceptions.

The first exception (the real estate exception) requires that (i) the money be borrowed for the purpose of acquiring real property for the purpose of producing income from property; (ii) the aggregate borrowed amount (plus any indebtedness incurred as a consequence of the acquisition) does not exceed the cost of the property; and (iii) property held in connection with the plan (other than the real property) not be used as security for the borrowed money.

The second exception (the 90-day exception) requires that (i) the borrowing not exceed 90 days; (ii) the borrowing not be part of a series of loans or other transactions or repayments; and (iii) property held in connection with the plan not be used as security for the borrowed money(other than in certain limited circumstances).

A temporary exception is also available for a borrowing that exceeds 90 days or is part of a series of loans or other transactions or repayments, provided that the loan was entered into between May 2020 and January 2022 and is repaid by April 30, 2022, and provided that property held in connection with the plan is not used as security for the borrowed money (other than in certain limited circumstances).

Budget 2022 proposes to replace the 90-day exception for defined benefit pension plans (other than individual pension plans). The new borrowing restriction will apply to money borrowed on or after Budget Day, and would permit a defined benefit pension plan that is not an individual pension plan to borrow money subject to the following:

- at the time an amount is borrowed, the total of the borrowed amount plus any other outstanding borrowings (other than borrowings permitted under the real estate exception) cannot exceed the *lesser* of the following two amounts:
- 20% of the amount by which the value of the plan assets, measured on the first day of the plan's fiscal period that includes the borrowing, exceeds the aggregate outstanding borrowings on such day (Net Assets); and
- 125% of the plan's actuarial liabilities (determined on the effective date of its most recent actuarial report) minus its Net Assets.

Budget 2022 states that the above changes are intended "to provide more borrowing flexibility to administrators of defined benefit registered pension plans (other than individual pension plans)." Since the borrowing restriction is tested at the time of each new borrowing, subsequent changes to the borrowing limit should not impact prior borrowings.

Budget 2022 does not propose to extend the above amendment to money purchase pension plans or individual pension plans, to which the current 90-day exception would continue to apply; nor are similar amendments proposed for master trusts or other pension investment entities that are subject to similar borrowing restrictions. No substantive changes are proposed with respect to the real estate exception, which would continue to apply to all registered pension plans.

REGISTERED CHARITIES

Budget 2022 proposes various measures relating to registered charities, including (i) increasing the disbursement quota (DQ) from 3.5% to 5% for the portion of property not used in charitable activities or administration that exceeds $1 million; (ii) providing CRA with the discretion to reduce a registered charity's DQ obligation for any particular tax year; (iii) removing the accumulation of property rule; (iv) allowing registered charities, where certain accountability requirements are met, to provide their resources to organizations that are not qualified donees; and (v) prohibiting registered charities from accepting gifts that are conditional on making a gift to a person that is not a qualified donee.

The measures relating to the DQ are proposed to apply to fiscal periods beginning on or after January 1, 2023, and the amendment to remove the accumulation of property rule is proposed to apply to approved property accumulations resulting from applications submitted by a charity after December 31, 2022. The remaining measures would apply as of royal assent of the enacting legislation.

MISCELLANEOUS – TAX ENFORCEMENT, ADMINISTRATION AND OTHER MEASURES

CHANGES TO THE GENERAL ANTI-AVOIDANCE RULE

Budget 2022 proposes changes to the general anti-avoidance rule (GAAR) in section 245 to overturn the Federal Court of Appeal's decision in *Wild*, sub nom. *1245989 Alberta Ltd v Canada (Attorney General)* (2018 FCA 114).

The GAAR is intended to prevent abusive tax planning, and it applies only if three conditions are satisfied: (i) there is a "tax benefit"; (ii) the transaction or series of transactions giving rise to the tax benefit includes an avoidance transaction; and (iii) the avoidance transaction gives rise to a misuse or abuse of a provision of the Tax Act. If the GAAR applies, the "tax consequences" to the taxpayer will be determined as is reasonable in the circumstances to deny the tax benefit. In connection with determining the tax consequences upon the application of the GAAR to a particular transaction, the CRA

may determine the amount of any tax attribute, such as adjusted cost base of a property or the paid-up capital of a share, by issuing a notice of determination pursuant to subsection 152(1.11).

In *Wild*, the creation of a tax attribute (in that case, paid-up capital) that had not yet been utilized to reduce tax was held not to be a "tax benefit" and, as such, the GAAR could not apply. The reasoning in that case was subsequently followed in *Rogers Enterprises (2015) Inc v The Queen* (2020 TCC 92) and *Gladwin Realty Corporation v Canada* (2020 FCA 142). According to the Government, these decisions run counter to the policy underlying the GAAR and reduce certainty for taxpayers and the CRA since tax attributes at issue may not be utilized for several years in the future.

Budget 2022 proposes to amend the GAAR to allow it to apply to transactions even when the tax attributes have not yet become relevant in computing an item of tax. Specifically, Budget 2022 proposes to amend, *inter alia*:

- the definition of "tax benefit" to include a reduction, increase or preservation of an amount that could at a subsequent time be relevant for the purpose of computing a reduction, avoidance or deferral of tax or other amount payable under the Tax Act or an increase in a refund of tax or other amount under the Tax Act; and
- the definition of "tax consequences" to include an amount that is, or could, at a subsequent time be relevant for the purpose of computing an amount of income, taxable income or taxable income earned in Canada under the Tax Act, or the tax or other amount payable by, or refundable to, a person under the Tax Act.

The proposed amendments would apply to any transaction that occurs on or after Budget Day or before Budget Day if a determination under subsection 152(1.11) in respect of such transaction is made on or after Budget Day. Budget 2022 notes, for greater certainty, that notices of determinations made before Budget Day, where the rights of objection and appeal in respect of the determination where exhausted before Budget Day, would remain binding on taxpayers and the CRA.

More broadly, Budget 2022 announced that the Government intends to release a consultation paper on "modernization" of the GAAR. The consultation period is to run through the summer of 2022, and legislative proposals are to be tabled later this year.

BENEFICIAL OWNERSHIP REGISTRY

Budget 2021 announced the Government's intention to implement a publicly accessible corporate beneficial ownership registry by 2025. Budget 2022 accelerates that timeline and commits to amend the *Canada Business Corporations Act* by the end of 2023 to provide for a publicly searchable beneficial ownership registry. The registry is intended to be scalable so that it can be used to access data provided by provinces and territories that agree to participate in a national registry.

INCREASED FUNDING FOR THE CRA AND CAPACITY FOR THE SUPERIOR COURTS

Budget 2022 provides the CRA with an additional $1.2 billion over five years, in addition to the $2.2 billion in increased funding that has been announced since Budget 2016. The funds are to allow the CRA to increase its audits of "larger entities and non-residents engaged in aggressive tax planning; increase both the investigation and prosecution of those engaged in criminal tax evasion; and to expand its educational outreach."

Budget 2022 proposes to add 24 new positions for superior court judges across Canada to improve access to justice and timely resolution of legal disputes, and allocates ongoing funding for these new positions.

REVIEW OF HOUSING AS AN ASSET CLASS

Budget 2022 announces a "federal review of housing as an asset class". While limited details were included, Budget 2022 states that the review will consider the impact of large corporate players in the housing market on renters and homeowners and consider various options and tools, including potential tax measures. Additional details are to be released later this year.

GROWING BUSINESSES

The Government intends to complete a review of the tax system to determine if investments in growing business are sufficiently supported, including with respect to allowing investors to defer tax on capital gains on small business investments.

NISGA'A NATION TAXATION AGREEMENT

Budget 2022 proposes to amend the *Nisga'a Final Agreement Act* to grant all provisions of the Nisga'a Nation Taxation Agreement the force of law, including an amendment ensuring that pension benefits based on tax-exempt employment income will not give rise to taxation when received. Budget 2022 states that the proposed amendment would also enable future tax-related amendments to the Nisga'a Nation Taxation Agreement to have effect.

SALES AND EXCISE TAX MEASURES

EXPANDED ELIGIBILITY TO GST/HST HEALTH CARE REBATE FOR CHARITIES AND NON-PROFIT ORGANIZATIONS

The GST/HST system allows hospitals to claim an 83% rebate and charities and non-profit organizations (NPOs) to claim a 50% rebate of the GST and the federal component of the HST paid on property and services used in their exempt activities. To address the increased participation of charities and NPOs in the delivery of healthcare services, eligibility for the 83% hospital rebate was expanded in 2005 to include charities and NPOs that provide healthcare services similar to those historically provided by hospitals provided they satisfy certain conditions. One such condition is that the healthcare service must be delivered "with the active involvement of, or on the recommendation of a physician" or, if a physician is not readily accessible in a geographically remote area, a nurse practitioner.

In recognition of the greater role of nurse practitioners in the delivery of healthcare services, Budget 2022 proposes that eligibility for the hospital rebate be further expanded to include, without regard to location, healthcare services that are delivered with the active involvement of, or on the recommendation of, a nurse practitioner. Accordingly, the availability of the hospital rebate will no longer depend upon whether the healthcare services are performed by a physician or nurse practitioner.

The proposed rules apply to periods for claiming rebates that end after Budget Day in respect of tax that was paid or became payable after Budget Day.

GST/HST ON ASSIGNMENTS OF RESIDENTIAL REAL PROPERTY

Budget 2022 makes all assignment sales of new or substantially renovated residential housing taxable for GST/HST purposes pursuant to any assignment agreement entered into on or after May 7, 2022.

The proposed measures apply to assignments of the rights and obligations under a purchase agreement with a builder in respect of a new or substantially renovated single unit residential complex or condominium unit by the purchaser under the agreement with the builder (Assignor) to another person (Assignee). Under the existing GST/HST rules, such assignments would generally not be taxable if the Assignor had originally intended to occupy the real property as a place of residence.

Budget 2022 suggests that these measures are introduced to target speculators who are dishonest about their original intentions to occupy the real property in question. However, the proposals are broad and will apply to all assignment sales that satisfy the conditions, regardless of the Assignor's original intention.

As is normally the case, the GST/HST payable under the new measures is computed on the value of the consideration for the supply (i.e., for the assignment). However, the proposals provide for a reduction of the consideration and associated tax collectible on the assignment sale to account for the GST/HST that may have been due on a deposit paid under the purchase agreement. Importantly, this reduction is not available unless the assignment agreement indicates in writing that

a portion of the consideration paid under the assignment agreement is solely attributable to the reimbursement of the deposit paid under the purchase agreement. The remaining GST/HST for the purchase of the real property would still be payable on closing by the Assignee.

SIMPLIFIED COMPLIANCE WITH CANNABIS EXCISE DUTY REGIME

Budget 2022 proposes certain measures that will make it easier to conduct business for licensed cannabis producers. There is no draft legislation. The measures (discussed below) for “contracts-for-service” between licensees, penalties and licence exemptions are proposed to come into force upon receiving royal assent. The quarterly remitting proposals will take effect earlier.

QUARTERLY REMITTING FOR SMALLER LICENSED CANNABIS PRODUCERS

For fiscal quarters starting on or after April 1, 2022, licensed cannabis producers will be allowed to remit excise duties on a quarterly (rather than monthly) basis, provided the licensee was required to remit only $1,000,000 or less in excise duties in the four immediately preceding fiscal quarters.

NEWLY PERMITTED TRANSACTIONS BETWEEN LICENSEES

Budget 2022 also proposes to allow pairs of licensed producers to exchange product or stamps, or to pay duties in situations where doing so would not be permitted under existing legislation, which prohibits, for example, the transfer of packaged but unstamped cannabis products and excise duty stamps between licensed producers. To qualify for the relief, the two licensed producers must enter into a contract-for-service arrangement that is approved by the CRA. If their contract-for-service receives CRA approval, the pair of licensed producers could potentially be allowed to

- transfer stamps to each other;
- transfer packaged but unstamped product to each other;
- stamp product that has been packaged by the other producer;
- sell product that has been packaged by the other producer; or
- pay the excise duty owing on cannabis product that had been stamped by the other producer.

The proposals also include new penalties for illegally distributing cannabis product and amendments to the penalty provisions dealing with lost excise stamps.

LICENCE EXEMPTIONS

Finally, holders of a Health Canada–issued Research Licence or a Cannabis Drug Licence will be exempt from the excise duty licencing requirement under the Budget 2022 proposals.

PREVIOUSLY ANNOUNCED MEASURES

Budget 2022 confirms the Government’s intention to proceed with the following previously announced measures, as modified to take into account consultations and deliberations subsequent to their release:

- March 11, 2022, legislative proposals relating to the *Select Luxury Items Tax Act;*
- February 4, 2022, legislative proposals in respect of
  - the excessive interest and financing expenses limitation (EIFEL) regime;
  - mandatory disclosure rules;
  - avoidance of tax debts;

  - audit authorities;
  - clean energy incentives;
  - GST/HST treatment of cryptoasset mining;
  - electronic filing and certification of tax and information returns;
  - enhanced reporting requirements for certain trusts;
  - the Disability Tax Credit;
  - immediate expensing;
  - a technical fix to the GST Credit top-up;
  - film or video production tax credits;
  - postdoctoral fellowship income;
  - fixing contribution errors in registered pension plans;
  - a technical fix to the revocation tax applicable to charities;
  - allocation to redeemers methodology for mutual fund trusts; and
  - taxes applicable to registered investments;
- December 14, 2021 legislative proposals introducing the *Digital Services Tax Act;*
- December 3, 2021 legislative proposals with respect to Climate Action Incentive payments;
- Budget 2021 measure with respect to Hybrid Mismatch Arrangements;
- Budget 2021 announcement of the Government's transfer pricing consultation;
- November 30, 2020, Fall Economic Statement announcement of the Government's anti-avoidance rules consultation;
- December 20, 2019, measure to extend the maturation period for amateur athlete trusts by one year (from eight years to nine years); and
- Budget 2016 measures relating to the GST/HST joint-venture election.

Budget 2022 also reaffirms the Government's commitment to implement technical amendments to "improve the certainty and integrity of the tax system."