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2022 FEDERAL BUDGET NEWSLETTER

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BUDGET 2022: A PLAN TO GROW OUR ECONOMY AND MAKE LIFE MORE AFFORDABLE

By Ryan Keey, MAcc, CPA, CA and Paula Ideias, BA, LLB, LLM (Tax) (Thomson Reuters)

Overview

This Newsletter provides a summary of key income tax measures contained in Budget 2022, which was tabled on April 7, 2022, by Deputy Prime Minister and Finance Minister Chrystia Freeland. For a summary table outlining the anticipated "cost" (or "revenue") for each of the proposed tax measures, see the Annex 1 Table.

In the first five years of implementation, the business tax measures anticipated to gross the most tax "revenue" include: applying the refundable tax rules to "substantive CCPCs" (certain private corporations that fall outside the CCPC definition – e.g., because they are incorporated in a foreign jurisdiction) ($4.235B); the Canada Recovery Dividend (a one-time 15% tax on bank and life insurer groups) ($4.05B); Additional Tax on Banks and Life Insurers ($2.055B); amendments related the adoption of IFRS 17 for insurance contracts ($2.35B); and amendments to address hedging and short selling strategies implemented by certain Canadian Financial Institutions ($635M). Taxpayer-friendly business measures with the largest anticipated "cost" to the government include: increasing the small business deduction taxable capital phase-out threshold ($660M); the introduction of new investment tax credits ("ITCs") for qualifying carbon capture; utilization and storage expenditures ($2.6B); and the introduction of a critical mineral exploration tax credit ($400M). Other business measures include the introduction of clean technology tax incentives related to air-source heat pumps; the elimination of flow-through share benefits in respect of oil, gas, and coal activities; and amendments to the definition of a "tax benefit" for the purposes of applying the general anti-avoidance rule ("GAAR"). From an international perspective, the government reaffirms its commitment to implement certain BEPS Pillar One and Two proposals. Also, Budget 2022 proposes to raise tax revenues of $640M by amending the interest withholding tax rules with the intention of ensuring that the total interest withholding tax paid under an interest coupon stripping arrangement is the same as if the arrangement had not been undertaken and instead the interest had been paid to the non-resident lender.

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Business Tax Measures — Private Corporations

Small Business Deduction

Budget 2022 proposes to extend the range over which the small business limit is reduced based on the combined taxable capital employed in Canada of a Canadian-controlled private corporation ("CCPC") and its associated corporations. The new phase out range will be $10M to $50M (increased from the current dollar amount of $15M).[1] This amendment will allow more medium-sized CCPCs to benefit from the small business deduction ("SBD") and will increase the amount of qualifying active business income that can be eligible for the SBD. The amendment will apply to taxation years that begin after April 6, 2022.

Substantive CCPCs

Background

At the 2021 APFF Conference Roundtable (q. 4), the CRA stated that, depending upon the circumstances, it may seek to apply the GAAR if an investment company were to incorporate in a foreign jurisdiction (i.e., such that the corporation was not a "Canadian corporation" (ITA 89(1)) with the central management and control (CMC) of the company residing in Canada if the purpose of incorporating in a foreign jurisdiction was to avoid the additional refundable tax under ITA 123.3. In the situation considered, ITA 250(5) (treaty tie-breaker deeming rule) did not apply. In particular, the CRA stated (unofficial translation):

> In the circumstances, the incorporation of the Company under the corporate laws of a foreign jurisdiction is a transaction that would provide a tax benefit consisting of the avoidance of the refundable tax on the investment income of a CCPC under [ITA] 123.3 and the general tax deduction under [ITA 123.4(2)]. However, without further details, it is difficult to determine whether such a transaction constitutes an avoidance transaction. If the purpose of such a transaction were to avoid CCPC status in order to defeat the purpose and intent of various anti-avoidance rules applicable to investment income, including ITA 123.3 and ITA 123.4(2), the CRA would consider, depending on the circumstances, the use of the GAAR under ITA 245(2).

Under proposed ITA 237.4 (Notifiable Transactions), the CRA has the authority to designate, with the concurrence of the Minister of Finance, transactions and series of transactions that require disclosure by taxpayers, advisers, promoters, and certain other persons. In Backgrounder 2022-02-04: Income Tax Mandatory Disclosure Rules Consultation: Sample Notifiable Transactions, Finance identified several series of transactions that would be designated for the purposes of ITA 237.4, including the following:

> *1. Manipulating CCPC status to avoid anti-deferral rules applicable to investment income*
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> Introduction
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> The *Income Tax Act* contains anti-deferral rules the purpose of which is to ensure that individual taxpayers cannot gain a tax advantage by earning investment income through a corporation they control. More specifically: i) portfolio dividends earned

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by all private corporations are subject to a special refundable tax under Part IV of the Income Tax Act; and ii) “other investment income” (e.g., capital gains, interest, rent and royalties) earned by Canadian-controlled private corporations (CCPCs) is generally subject to a special refundable tax mechanism under Part I of the Income Tax Act, which includes a special tax of 10 2/3 per cent under section 123.3, and is also denied the 13 per cent general rate reduction provided for under section 123.4. The special refundable taxes under Parts I and IV are meant to ensure that immediate taxation of income earned in these corporations is roughly equal to the tax that would be paid if the income were earned directly by the individual. The special taxes are fully or partially refundable to the corporations to the extent that they distribute their investment income in the form of taxable dividends.

Some taxpayers are engaging in transactions or arrangements regarding private corporations they control, directly or indirectly. These transactions seek to avoid CCPC status of such corporations – in circumstances where such corporations are or continue to be controlled (directly or indirectly) by Canadian residents (other than a public corporation) – in order to achieve a tax deferral advantage in respect of other investment income. The transactions generally involve avoiding “Canadian corporation” or “Canadian-controlled” status, either of which could make it such that the corporation would not be a CCPC. The tax consequences sought in these transactions and circumstances are inconsistent with the purpose of the anti-deferral rules.

Designated transactions

The following transactions and series of transactions are hereby designated by the [CRA] for the purposes of [ITA 237.4].

Avoiding “Canadian corporation” status

Foreign continuance: A taxpayer’s corporation that holds investment assets, or assets that subsequently become investment assets, and that is initially incorporated in Canada is later continued under the laws of a foreign jurisdiction. As a result, it ceases to be a CCPC by virtue of it no longer being a “Canadian corporation”. However, by ensuring that the central management and control of the corporation are exercised in Canada and that subsection 250(5) does not apply, the corporation remains resident in Canada and, as a result, it is not considered to have emigrated and it is not subject to the foreign accrual property income regime.

Avoiding “Canadian-controlled” status

“Skinny” voting shares: On or after incorporation, a corporation that holds or is capitalized with investment assets, or assets that subsequently become investment assets, issues a majority of special voting shares, redeemable for a nominal amount (also known as “skinny” voting shares), to a non-resident person in order to cause the corporation to not be “Canadian-controlled” and, as such, to not be a CCPC. The non-resident person who owns the voting shares is often (but not necessarily) an entity owned and controlled by Canadian residents. Alternatively, the skinny voting shares could be issued to a public corporation instead of a non-resident person.

Option to acquire control: A corporation that holds investment assets, or assets that subsequently become investment assets issues an option to a non-resident person for the acquisition of a majority of the voting shares of a corporation in order to cause the corporation to not be “Canadian-controlled” and, as such, to not be a CCPC. This right to acquire control through the majority of the voting shares is often (but not necessarily) held by a non-resident entity that is owned by Canadian residents or accommodating non-resident persons. Alternatively, the option to acquire control could be issued to a public corporation instead of a non-resident person.

It is interesting to note that public and foreign controlled Canadian corporations are not subject to the investment income refundable tax rules that apply to CCPCs, arguably providing such entities with an advantage over CCPCs (even though the additional taxes payable by a CCPC on investment income are eventually refunded when a dividend is paid to an individual, public and foreign controlled Canadian corporations have a tax deferral advantage in respect of investment income).[2]

Budget 2022 Proposal

With the above context in mind:

> Budget 2022 proposes targeted amendments to the [ITA] to align the taxation of investment income earned and distributed by "substantive CCPCs" with the rules that currently apply to CCPCs. Substantive CCPCs would be private corporations resident in Canada (other than CCPCs) that are ultimately controlled (in law or in fact) by Canadian-resident individuals. Similar to the CCPC definition, the test would contain an extended definition of control [i.e., a hypothetical shareholder test will apply – ed.] that would aggregate the shares owned, directly or indirectly, by Canadian resident individuals, and would therefore deem a corporation to be controlled by a Canadian resident individual where Canadian individuals own, in aggregate, sufficient shares to control the corporation. This measure would address tax planning that manipulates CCPC status without affecting genuine non-CCPCs (e.g., private corporations that are ultimately controlled by non-resident persons and subsidiaries of public corporations). It would also cause a corporation to be a substantive CCPC in circumstances where the corporation would have been a CCPC but for the fact that a non-resident or public corporation has a right to acquire its shares.

Under the proposed rules, so-called "substantive CCPCs" earning and distributing investment income will be subject to the same anti-deferral and integration mechanisms as CCPCs, with respect to such income (i.e., substantive CCPCs will be treated as CCPCs with respect to the taxation of investment income). In particular, investment income of a substantive CCPC will be subject to a federal tax rate of 38.67%, of which 30.67% will be refundable upon distribution (i.e., when a dividend is paid to an individual shareholder). The investment income earned by substantive CCPCs will be added to their "low rate income pool" (ITA 89(1)) such that distributions of such income will not entitle the shareholders to the enhanced dividend tax credit available in respect of eligible dividends. Substantive CCPCs will continue to be treated as non-CCPCs for all other purposes of the ITA. Per Budget 2022, these rules are intended to "ensure that private corporations cannot effectively opt out of CCPC status and inappropriately circumvent the existing anti-deferral rules applicable to CCPCs".

The Budget 2022 Paper further state that the proposed rules will be supported by:

- a targeted anti-avoidance rule to address particular arrangements or transactions where it is reasonable to consider that the particular arrangement, transaction, or series of transactions was undertaken to avoid the anti-deferral rules applicable to investment income; and
- targeted amendments to facilitate administration of the rules applicable to investment income earned and distributed by substantive CCPCs, including a one year extension of the normal reassessment period for any consequential assessment of Part IV tax that arises from a corporation being assessed or reassessed a dividend refund.

This proposal will apply taxation years that end after April 6, 2022. However, "to provide certainty for genuine commercial transactions" entered into before April 7, 2022, an exception will be provided where the taxation year of the corporation ends because of an acquisition of control caused by the sale of all or substantially all of the shares of a corporation to an arm's length purchaser. The purchase and sale agreement pursuant to which the acquisition of control occurs must have been entered into before April 7, 2022 and the share sale must occur before the end of 2022.

Presumably, the transactions targeted by the above rules will no longer be "notifiable transactions" for the purposes of proposed ITA 237.4.

Per the *Notice of Ways and Means Motion to amend the Income Tax Act and Other Related Legislation* (NWMM) that accompanied the Budget 2022 Papers:

Substantive CCPCs

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(1) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

Substantive CCPC means a private corporation (other than a Canadian-controlled private corporation) that at any time in a taxation year (a) is controlled, directly or indirectly in any manner whatever, by one or more Canadian resident individuals, or (b) would, if each share of the capital stock of a corporation that is owned by a Canadian resident individual were owned by a particular individual, be controlled by the particular individual.

(2) Section 248 of the Act is amended by adding the following after subsection (42):

Substantive CCPC — anti-avoidance

(43) For the purposes of this Act, a corporation (other than a Canadian-controlled private corporation) that is resident in Canada and would not, in the absence of this subsection, be a substantive CCPC, is deemed to be a substantive CCPC if it is reasonable to consider that one of the purposes of any transaction (as defined in subsection 245(1)), or series of transactions, was to cause the corporation not to qualify as a substantive CCPC.

(3) Subsections (1) and (2) apply to

(a) taxation years of a corporation that begin on or after Budget Day, if (i) the corporation's first taxation year that ends on or after Budget Day ends due to a loss restriction event caused by a sale of all or substantially all of the shares of a corporation to a purchaser before 2023, (ii) the purchaser deals at arm's length (determined without reference to a right referred to in paragraph 251(5)(b)) with the corporation immediately prior to the loss restriction event, and (iii) the sale occurs pursuant to a written purchase and sale agreement entered into before Budget Day; and (b) in any other case, taxation years that end on or after Budget Day.

37 The Act is further modified to give effect to the proposals relating to Substantive CCPCs as described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Deferring Tax Using Foreign Resident Corporations

The FAPI rules (see ITA 90–95) are intended to prevent Canadian taxpayers from gaining a tax deferral advantage by earning certain types of mobile income (including investment income) through controlled foreign affiliates (CFAs). To achieve this objective, the rules generally tax a Canadian shareholder's participating share of a CFA's FAPI in the Canadian shareholder's income in the year it is earned. If the Canadian shareholder is a CCPC, this amount is subject to the same additional refundable tax rules described above (i.e. the FAPI regime seeks to address any deferral advantage by subjecting FAPI earned in a CFA to tax on a current basis and at the same level as if it was earned in Canada). To prevent double taxation, such income inclusions in respect of FAPI are subject to a deduction in respect of foreign tax paid in respect of the FAPI (referred to as "foreign accrual tax" (FAT)). The FAT deduction is a proxy for a foreign tax credit on the FAPI amount included in the Canadian resident taxpayer's income. The proxy is computed based on the amount of foreign income that was subject to a sufficient level of foreign tax, determined based on the "relevant tax factor" (RTF), which is defined in ITA 95(1). The RTF is intended to be calibrated to the tax rate to

which the taxpayer would have been subject had the income been earned in Canada. To account for the fact that different types of taxpayers are generally subject to different tax rates in Canada, there are two RTFs: 1) the RTF applicable to corporations (and partnerships all the members of which, other than non-resident persons, are corporations), which is 4 (thus, the corporate RTF, when multiplied by the FAT, provides for a deduction that fully offsets FAPI income inclusions where the foreign tax rate equals or exceeds 25%; and 2) the RTF applicable to all other taxpayers, including individuals, which is 1.9 (such that a foreign tax rate lower than 52.63% will result in net FAPI income inclusions for other taxpayers). The FAPI rules (and more specifically the RTF) do not differentiate between different tax rates applicable to different types of Canadian corporations. Consequently, there can be a tax-deferral advantage for CCPCs and their individual shareholders earning passive investment income through CFAs. Also, the inclusion of certain amounts in respect of FAPI in a CCPC's "general rate income pool" (i.e. GRIP, as defined in ITA 89(1)) entitles the CCPC to distribute FAPI in the form of lower-taxed "eligible dividends" (as defined in ITA 89(1)), providing a further advantage on a fully distributed basis (i.e. compared to investment income earned by a CCPC in Canada and distributed as higher-taxed ineligible dividends).

Budget 2022 proposes targeted amendments to the ITA to eliminate the above noted tax-deferral advantage available to CCPCs and their shareholders earning investment income through CFAs. The deferral advantage will be addressed by applying the same RTF to individuals, CCPCs and substantive CCPCs (i.e., the RTF – 1.9 – currently applicable to individuals). This RTF is calibrated based on the highest combined federal and provincial or territorial personal income tax rate and will therefore eliminate any tax incentive for CCPCs and their shareholders to earn investment income in a controlled foreign affiliate. Per the Supplementary Information to Budget 2022:

> This rule would be accompanied by amendments to address the integration of FAPI as it is repatriated to and distributed by CCPCs and substantive CCPCs to their individual shareholders. Under the current rules, amounts repatriated from foreign affiliates to CCPCs and distributed to individual shareholders are generally integrated through the system of deductions available for dividends received from foreign affiliates and the enhanced gross-up and dividend tax credit. However, due to the new relevant tax factor for CCPCs and substantive CCPCs, the current rules would not effectively integrate such amounts.
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> Integration would be addressed by adding an amount to the capital dividend account (from which amounts may be received tax-free by Canadian resident individual shareholders) of a CCPC or a substantive CCPC. The amount added would approximate the portion of the after-tax earnings repatriated to the corporation from its foreign affiliate to the extent such earnings had been subject to a notional tax rate of 52.63 per cent. This addition to the capital dividend account would represent after-tax income that was subject to tax at the highest combined personal income tax rate and therefore, to achieve integration, should not be subject to additional Canadian income tax upon its distribution to the corporation's Canadian resident individual shareholders.
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> In addition, other dividend income from foreign affiliates for which a foreign tax credit is effectively provided through the relevant tax factor mechanism (dividends paid out of hybrid surplus and taxable surplus other than FAPI) would be treated in the same manner. All such dividends, to the extent not deductible in computing taxable income, will continue to be subject to the refundable tax system. The treatment of dividends paid out of exempt surplus and pre-acquisition surplus would be unaffected.

More specifically, Budget 2022 proposes to:

1) remove from the general rate income pool of a CCPC an amount equal to the deductions claimed in respect of repatriations of a foreign affiliate's hybrid surplus (representing certain capital gains) and taxable surplus (generally representing FAPI and active business income earned in a country with which Canada does not have a tax treaty or tax information exchange agreement), and in respect of the payment of withholding tax to a foreign government on inter-corporate dividends received from a foreign affiliate prescribed to be paid out of taxable surplus; and

2) include in the capital dividend account of a CCPC (and a substantive CCPC) upon repatriation:

i) the amount of an inter-corporate dividend deduction claimed with respect to a dividend paid out of hybrid surplus less the amount of withholding tax paid with respect to the dividend (representing the non-taxable half of hybrid surplus plus the after-tax portion of the taxable half of hybrid surplus that was subject to sufficient foreign tax, as determined based on the new relevant tax factor less any withholding tax paid in respect of the dividend prescribed to have been paid out of hybrid surplus);

ii) the amount of an inter-corporate dividend deduction claimed with respect to a dividend paid out of taxable surplus (representing the after-tax amount of the foreign accrual tax-sheltered FAPI (i.e., the amount of foreign accrual tax-sheltered FAPI less foreign accrual tax) repatriated to Canada as well as other non-FAPI amounts included in taxable surplus that were subject to sufficient foreign tax, as determined based on the new relevant tax factor); and

iii) the amount of a withholding tax deduction claimed less the withholding tax paid in respect of repatriations of taxable surplus (representing the after-tax amount of withholding tax sheltered amounts, i.e., the amount of the deduction for withholding tax paid on dividends prescribed to have been paid out of taxable surplus less the withholding tax paid).

These proposed measures will to taxation years that begin after April 6, 2022.

Genuine Intergenerational Share Transfers

Bill C-208, a Private Member's Bill that received Royal Assent on June 29, 2021, amended ITA 84.1 with the intention of permitting intergenerational business transfer in a tax-efficient manner (i.e., comparable to the manner in which such transactions can be structured with third-party purchasers). Bill C-208 was not subject to normal quality control procedures and the amendments have several technical deficiencies. Additionally, Finance did not support the passage of the Bill due to concerns that the amendments facilitated abusive surplus stripping transactions. Consequently, Finance News Release 2021-07-19: *Government of Canada clarifies taxation for intergenerational transfers of small business shares*, announced that the rules would be revised.[3] The following update was provided in the Supplementary Information to Budget 2022:

> The *Income Tax Act* contains a rule to prevent people from converting dividends into lower-taxed capital gains using certain self-dealing transactions—a practice referred to as "surplus stripping." Private Member's Bill C-208, which received Royal Assent on June 29, 2021, introduced an exception to this rule in order to facilitate intergenerational business transfers.

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> However, the exception may unintentionally permit surplus stripping without requiring that a genuine intergenerational business transfer takes place. Budget 2022 announces a consultation process for Canadians to share views as to how the existing rules could be modified to protect the integrity of the tax system while continuing to facilitate genuine intergenerational business transfers. The government is committed to bringing forward legislation to address these issues, which would be included in a bill to be tabled in the fall after the conclusion of the consultation process. The Department of Finance is interested to hear from all stakeholders, and will engage directly with key affected sectors, in particular the agriculture industry. Please send your comments. Comments should be received by June 17, 2022.

As announced in the July 19, 2021 News Release, in a Virtual Legal Publishers' Technical Briefing (held shortly after Budget 2022 was tabled), Finance once again confirmed that pending revisions to ITA 84.1 will not apply until the date of publication of final draft legislation.

Business Tax Measures — Other

Application of the General Anti-Avoidance Rule to Tax Attributes

A 2018 Federal Court of Appeal decision[4] held that the GAAR did not apply to a transaction that resulted in an increase in a tax attribute that had not yet been utilized to reduce taxes. The reasoning behind this decision has also been applied in subsequent cases.[5] According to Budget 2022, "[t]he limitation of the GAAR to circumstances where a tax attribute has been utilized runs counter to the policy underlying the GAAR and the determination rules. This limitation also reduces certainty for both taxpayers and the CRA, as they could have to wait several additional years to confirm the tax consequences of a transaction". To address the latter concerns, Budget 2022 proposes to amend the ITA to provide that the GAAR can apply to transactions that affect tax attributes that have not yet become relevant to the computation of tax. The proposed measure will apply to notices of determination issued after April 6, 2022. Per the Supplementary Information to Budget 2022, "[f]or greater certainty", determinations made before April 7, 2022, where the rights of objection and appeal in respect of the determination were exhausted before April 7, 2022, will remain binding on taxpayers and the CRA.

Per the Budget 2022 NWMM:

> *Application of the General Anti-Avoidance Rule to Tax Attributes*
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> 34(1) Subsection 152(1.11) of the Act is replaced by the following:
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> Determination under subsection 245(2)
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> (1.11) If at any time the Minister ascertains the tax consequences to a taxpayer because of subsection 245(2) with respect to a transaction, the Minister (a) shall, in the case of a determination under subsection 245(8), determine any amount that is, or could at a subsequent time be, relevant for the purposes of computing the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or amount refundable to, the taxpayer under this Act; (b) may, in any case not described in paragraph (a), determine any amount referred to in paragraph (a); and (c) shall, if a determination is made under this subsection, send to the taxpayer, with all due dispatch, a notice of determination stating the amount so determined.
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> (2) Subsection (1) applies in respect of determinations made on or after Budget Day. For greater certainty, determinations made under subsection 152(1.11) of the Act prior to Budget Day continue to be binding, to the extent provided under subsection 152(1.3) of the Act.

35(1) The definitions tax benefit and tax consequences in subsection 245(1) of the Act are replaced by the following:

“tax benefit” means (a) a reduction, avoidance or deferral of tax or other amount payable under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty, (b) an increase in a refund of tax or other amount under this Act, and includes an increase in a refund of tax or other amount under this Act as a result of a tax treaty, or (c) a reduction, increase or preservation of an amount that could at a subsequent time (i) be relevant for the purpose of computing an amount referred to in paragraph (a) or (b), and (ii) result in any of the effects described in paragraph (a) or (b);

“tax consequences”, to a person, means (a) the amount of income, taxable income or taxable income earned in Canada of the person under this Act, (b) the tax or other amount payable by, or refundable to, the person under this Act, or (c) any other amount that is, or could at a subsequent time be, relevant for the purpose of computing an amount referred to in paragraph (a) or (b);

(2) Subsection (1) applies in respect of transactions that occur
(a) on or after Budget Day; or
(b) before Budget Day if a determination is made under subsection 152(1.11) of the Act on or after Budget Day in respect of the transaction.

Investment Tax Credit for Carbon Capture, Utilization, and Storage

Budget 2022 proposes to introduce an investment tax credit for carbon capture, utilization, and storage (the CCUS Tax Credit). The refundable CCUS Tax Credit will be available to businesses that incur eligible expenses starting on January 1, 2022. The CCUS Tax Credit will be available in respect of the cost of purchasing and installing eligible equipment (see “Eligible Equipment” section under the above link) used in an eligible CCUS project (see “Eligible Project” section under the above link), so long as the equipment was part of a project where the captured CO2 was used for an eligible use (see “Eligible CO2 Uses” section under the above link). For the CCUS Tax Credit to be claimed, a project will also be subject to a validation and verification process (see “Validation and Verification” section under the above link), would need to meet certain storage requirements (see “Storage Requirements” section under the above link), and a climate-related financial disclosure report would need to be produced (see “Climate Risk Disclosure” section under the above link). The following rates will apply to eligible expenses incurred after 2021 through 2030: 60% for eligible capture equipment used in a direct air capture project; 50% for all other eligible capture equipment; and 37.5% for eligible transportation, storage, and use equipment. Eligible expenses that are incurred after 2030 through 2040 would be subject to lower credit rates. The proposed measures will apply to eligible expenses incurred after 2021 and before 2041.

Clean Technology Tax Incentives – Air-Source Heat Pumps

Budget 2022 proposes to expand eligibility under Classes 43.1 and 43.2 to include air-source heat pumps primarily used for space or water heating. Eligible property will include equipment that is part of an air-source heat pump system that transfers heat from the outside air, including 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. Eligible property 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 apply in respect of new property that is acquired and that becomes available for use after April 6, 2022.

Flow-Through Shares for Oil, Gas, and Coal Activities

Budget 2022 proposes to eliminate the flow-through share regime for oil, gas, and coal activities by no longer permitting oil, gas and coal exploration or development expenditures to be renounced to a flow-through share investor. The amendments will apply to expenditures renounced under flow-through share agreements entered into after March 31, 2023. In the Virtual Legal Publishers' Technical Briefing (held shortly after Budget 2022 was tabled), Finance indicated that there will be no exceptions.

Critical Mineral Exploration Tax Credit

Budget 2022 proposes to introduce a new 30% Critical Mineral Exploration Tax Credit ("CMETC") for specified minerals. The specified minerals that would be eligible for the CMETC are copper, nickel, lithium, cobalt, graphite, rare earth elements, scandium, titanium, gallium, vanadium, tellurium, magnesium, zinc, platinum group metals and uranium.[6]

Eligible expenditures cannot benefit from both the proposed CMETC and the mineral expense tax credit. The administration of the CMETC will generally follow the rules in place for the mineral expense tax credit; however, the CMETC will only apply in relation to exploration expenditures for the minerals listed above. In order for exploration expenses to be eligible for the CMETC, a qualified person (as defined under National Instrument 43-101 published by the Canadian Securities Administrators as of April 7, 2022) will need to certify that the expenditures that will be renounced will be incurred as part of an exploration project that targets the specified minerals. The CMETC will apply to expenditures renounced under eligible flow-through share agreements entered into after April 7, 2022 and on or before March 31, 2027.

Canada Recovery Dividend and Additional Tax on Banks and Life Insurers

Budget 2022 proposes to introduce the Canada Recovery Dividend ("CRD") in the form of a one-time 15% tax on "bank and life insurer groups". Per the Supplementary Information to Budget 2022:

> A group would include a bank or life insurer and any other financial institution (for the purposes of Part VI of the Income Tax Act) that is related to the bank or life insurer. The CRD would be determined based on a corporation's taxable income for taxation years ending in 2021. A proration rule would be provided for short taxation years. Bank and life insurer groups subject to the CRD would be permitted to allocate a $1 billion taxable income exemption by agreement amongst group members. The CRD liability would be imposed for the 2022 taxation year and would be payable in equal amounts over five years.

International Financial Reporting Standards for Insurance Contracts (IFRS 17)

In News Release 2021-05-28: *Department of Finance Launches Consultations on Tax Implications of International Accounting Rules for Insurance Contracts (IFRS 17)*, the Government announced that it intends to generally support the use of IFRS 17 accounting for income tax purposes.[7] However, adjustments would be made to recognize underwriting profits as taxable income so that it remains aligned with economic activities.

More specifically, the contract service margin ("CSM") would not be considered a deductible reserve for tax purposes. Per the Supplementary Information to Budget 2022:

> The Government's overall objective is to recognize income for tax purposes when the key economic activities occur. Following extensive consultations with the insurance industry, Budget 2022 proposes to maintain the policy intent described in the May 2021 Release, but proposes to make certain relieving modifications, as well as consequential changes to protect the minimum tax base for life insurers. … Budget 2022 proposes that the CSM associated with segregated funds be fully deductible on the basis that this income will continue to be recognized as the relevant economic activities occur. …
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> Consistent with the May 2021 Release, the CSM would not be deductible for tax purposes (with the exception of the CSM for segregated funds). However, in recognition of future so-called non-attributable expenses that are included in deductible reserves at the inception of the contract under current rules, Budget 2022 proposes that ten per cent of the CSM associated with life insurance contracts (other than segregated funds) be deductible for tax purposes. The ten-per-cent deductible portion of the CSM will be included in income for tax purposes when the non-attributable expenses are incurred in the future.
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> *Transition*
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> Budget 2022 proposes transitional rules in the following circumstances: 1) A transition period of five years to smooth out the tax impact of converting insurance reserves from IFRS 4 to IFRS 17, including the non-deductible portion of the CSM on transition; 2) A transition period of five years for the mark-to-market gains or losses on certain fixed-income assets on the effective date, since insurers will also be required to adopt IFRS 9 effective January 1, 2023; and 3) Certain reserves will be reclassified from insurance contracts under IFRS 4 to investment contracts under IFRS 17. A deduction for the investment contract amount will be allowed on transition since the premiums for these contracts have been included in income for accounting and tax purposes.
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> *Adjustments to Maintain Minimum Tax*
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> The Part VI federal tax is a capital-based tax on large financial institutions, which ensures that they pay a minimum amount of tax to the federal government each year. The Part VI tax base is partly comprised of surplus which includes after-tax retained earnings. The Part VI tax base for life insurers will decrease as a consequence of IFRS 17. This is attributable primarily to the increase in total reserves, including the CSM, and the reclassification of gains and losses on certain fixed income assets from retained earnings to accumulated other comprehensive income (AOCI). Deferred tax assets are income taxes anticipated to be recovered in future periods when temporary differences between income for accounting and tax purposes reverse. Deferred tax assets often arise because insurance contract liabilities recognized for accounting purposes exceed the amount of insurance reserves claimed for tax purposes. Deferred tax assets are currently deducted from the Part VI minimum tax base. In order to avoid the erosion of the Part VI tax base due to IFRS 17, Budget 2022 proposes to include the non-deductible CSM and AOCI in the tax base. In addition, deferred tax assets will not be deducted from the minimum tax base for life insurers.
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> *Mortgage and Title Insurance*
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> Consistent with the changes for long-term insurance contracts, Budget 2022 proposes a deduction of ten per cent of the CSM for mortgage and title insurance contracts. The deductible portion of the CSM will be included in income when the non-attributable expenses are incurred in the future in the same manner described above in the context of life insurers. Budget 2022 also proposes a transition period of five years to smooth out the tax impact of the non-deductible portion of the CSM.
>
> *Property and Casualty (P&C) Insurance*
>
> Budget 2022 proposes to maintain the current tax treatment for P&C insurance contracts (other than title and mortgage insurance contracts) on the basis that the CSM reserve is largely insignificant for these short-term contracts that are typically not longer than a year. Budget 2022 also proposes a transition period of five years to smooth out the tax impact of converting P&C insurance reserves from IFRS 4 to IFRS 17.

Coming into Force

Budget 2022 proposes that all of these measures, including the transitional rules discussed above, would apply as of January 1, 2023.

Hedging and Short Selling by Canadian Financial Institutions

The ITA generally allows a Canadian corporation, in computing its taxable income, to claim a deduction (the "dividend received deduction") under ITA 112 in respect of the amount of a taxable dividend received on a share (a "Canadian share") that it holds in another Canadian corporation. This dividend received deduction avoids the imposition of multiple levels of corporate taxation on earnings distributed from one corporation to another. The deduction is not available in certain circumstances, however, such as where the economic exposure (i.e., the risk of loss or opportunity for gain or profit) with respect to the share accrues to someone other than the taxpayer.[8] Also, under the securities lending arrangement ("SLA") rules, registered securities dealers are allowed to claim a deduction for two-thirds of a dividend compensation payment (this is an exception to the general rule whereby dividend compensation payments are not deductible). According to the Supplementary Information to Budget 2022:

> The Government is concerned that certain taxpayers in financial institution groups are engaging in aggressive tax planning arrangements whereby a dividend received deduction is claimed in circumstances giving rise to an unintended tax benefit. For example, where a Canadian bank owns Canadian shares, a registered securities dealer in the Canadian bank's corporate group will borrow identical shares under a securities lending arrangement and sell the borrowed shares short. The corporate group thereby eliminates its economic exposure to the Canadian shares. The registered securities dealer will generally hold the short position during the entire period that the Canadian bank owns the Canadian shares. In this scenario, the Canadian bank claims a dividend received deduction for the dividends received on the Canadian shares, resulting in tax-free dividend income. The registered securities dealer deducts two-thirds of the amount of the dividend compensation payments made to the lender that reflect the same dividends paid on the shares. In sum, the Canadian banking group generates an artificial tax deduction under the arrangement equal to two-thirds of the amount of dividend compensation payments made to the lender over the term of the arrangement. A registered securities dealer could carry out a similar transaction on its own with respect to Canadian shares owned by it. That is, it could borrow and sell short identical shares, claiming both the dividend received deduction for dividends received on its shares and a two-thirds deduction for dividend compensation payments made to the lender. Although these arrangements can be challenged by the Government based on existing rules in the Income Tax Act, these challenges could be both time-consuming and costly. Accordingly, the Government is introducing specific legislation to prevent taxpayers from realizing artificial tax deductions through the use of these hedging and short selling arrangements.

To address the above concerns, Budget 2022 proposes amendments to the ITA to: 1) deny the dividend received deduction for dividends received by a taxpayer on Canadian shares if a registered securities dealer that does not deal at arm's length with the taxpayer enters into transactions that hedge the taxpayer's economic exposure to the Canadian shares, where the registered securities dealer knew or ought to have known that these transactions would have such an effect; 2) deny the dividend received deduction for dividends received by a registered securities dealer on Canadian shares that it holds if it eliminates all or substantially all of its economic exposure to the Canadian shares by entering into certain hedging transactions; and 3) provide that in the above situations, the registered securities dealer will be permitted to claim a full, rather than a two-thirds, deduction for a dividend compensation payment it makes under a securities lending arrangement entered into in connection with the above hedging transactions.

The proposed amendments will apply to dividends and related dividend compensation payments that are paid, or become payable, after April 6, 2022, unless the relevant hedging transactions or related securities lending arrangement were in place before April 7, 2022, in which case the amendments will apply to dividends and related dividend compensation payments that are paid after September 2022.

The proposed amendments are contained in sections 32 and 33 of the Budget 2022 NWMM.

International Tax Measures

Interest Coupon Stripping

Part XIII generally imposes a 25% withholding tax on interest paid or credited by a Canadian resident to a non-arm's length non-resident. The 25% rate is generally reduced for interest paid to a resident in a country with which Canada has a tax treaty, normally to 10% or 15%. As an exception, for interest paid to U.S. residents, the Canada-U.S. Tax Treaty generally reduces the withholding tax rate to nil. According to the Supplementary Information to Budget 2022:

> Some taxpayers have sought to avoid Part XIII interest withholding tax on non-arm's length debt using so-called interest coupon stripping arrangements. These arrangements generally involve a non-resident lender selling its right to receive future interest payments (interest coupons) in respect of a loan made to a non-arm's length Canadian-resident borrower to a party that is not subject to withholding tax. The non-resident lender generally retains its right to the principal amount under the loan. While an amendment was made in 2011 to address a particular interest coupon stripping arrangement that was the subject of a court decision[9], it did not deal with two other variations of the arrangement.
>
> The first variation generally involves a non-resident lender, not resident in the U.S., selling the interest coupons in respect of a loan made to a non-arm's length Canadian-resident borrower to another person who is resident in the U.S. This U.S.-resident interest coupon holder could be either arm's length or non-arm's length with the Canadian-resident borrower. To the extent that the interest paid by the Canadian-resident borrower to the U.S. interest coupon holder under this arrangement is eligible for benefits under the Canada-U.S. tax treaty, the withholding tax rate to which it is subject would be reduced from 25 per cent to nil. This variation could also involve a lender resident in a non-treaty country - or in a treaty country where the treaty provides for a relatively high rate of withholding tax on interest - selling interest coupons to a purchaser in any country with a lower treaty rate. The second variation involves a non-resident lender, not resident in the U.S., selling the interest coupons in respect of a loan made to a non-arm's length Canadian-resident borrower to a person resident in Canada. Under this variation, interest paid by the Canadian-resident borrower to the Canadian-resident interest coupon holder is not subject to withholding tax since it is not paid to a non-resident. In these circumstances, taxpayers take the position that certain potentially applicable provisions in the *Income Tax Act* do not apply to deem an interest payment to be made by the Canadian-resident interest coupon holder to the non-resident lender. Depending on the particular facts, these two variations of interest coupon stripping arrangements could be challenged by the Government based on existing rules in the *Income Tax Act*. However, to avoid the uncertainty and costs associated with such challenges, the Government is proposing a specific legislative measure to ensure that the appropriate tax consequences apply to these arrangements.

To address the above concerns, Budget 2022 proposes to amend the interest withholding tax rules "to ensure that the total interest withholding tax paid under an interest coupon stripping arrangement is the same as if the arrangement had not been undertaken and instead the interest had been paid to the non-resident lender". Generally, an interest coupon stripping arrangement will be considered to exist where the following conditions are met: 1) a Canadian-resident borrower pays or credits a particular amount to a person or partnership (interest coupon holder) as interest on a debt (other than a publicly offered debt obligation) owed

to a non-resident person with whom the Canadian-resident borrower is not dealing at arm's length (non-resident lender); and 2) the tax that would be payable under Part XIII in respect of the particular amount, if the particular amount were paid or credited to the non-resident lender, is greater than the tax payable under Part XIII on the particular amount paid or credited to the interest coupon holder. Where an interest coupon stripping arrangement exists, the Canadian-resident borrower will be deemed, for the purposes of the interest withholding tax rules, to pay an amount of interest to the non-resident lender such that the Part XIII tax on the deemed interest payment will equal the Part XIII tax otherwise avoided as a result of the interest coupon stripping arrangement.

This proposed measure will apply to interest paid or payable by a Canadian-resident borrower to an interest coupon holder to the extent that such interest accrued after April 6, 2022, unless the interest payment meets the following conditions: i) it is in respect of a debt or other obligation incurred by the Canadian-resident borrower before April 7, 2022; and ii) it is made to an interest coupon holder that deals at arm's length with the non-resident lender and that acquired the interest coupon as a consequence of an agreement or other arrangement entered into by the interest coupon holder, and evidenced in writing, before April 7, 2022. For cases falling within the latter exception, the proposed measure will apply to interest paid or payable by a Canadian-resident borrower to an interest coupon holder to the extent that such interest accrued on or after the day that is one year after April 7, 2022.

Per the NWMM that accompanied Budget 2022:

> Interest Coupon Stripping
>
> 39
>
> (1) Section 212 of the Act is amended by adding the following after subsection (20):
> Interest coupon stripping arrangement – conditions
>
> (21) Subsection (22) applies at any time in respect of a taxpayer if (a) the taxpayer pays or credits a particular amount at that time as, on account or in lieu of payment of, or in satisfaction of, interest to a person or partnership (in this subsection and subsection (22) referred to as the "interest coupon holder") in respect of a debt or other obligation, other than a specified publicly offered debt obligation, owed to another person or partnership (in this subsection and subsection (22) referred to as the "non-arm's length creditor") that is (i) a non-resident person with whom the taxpayer is not dealing at arm's length, or (ii) a partnership other than a Canadian partnership; and (b) the tax that would be payable under this Part in respect of the particular amount, if the particular amount were paid or credited to the non-arm's length creditor rather than the interest coupon holder, is greater than the tax payable under this Part (determined without reference to subsection (22)) in respect of the particular amount.
>
> Interest coupon stripping arrangement – application
>
> (22) If this subsection applies at any time in respect of a taxpayer, then for the purpose of paragraph (1)(b), the taxpayer is deemed, at that time, to pay interest to the non-arm's length creditor, the amount of which is determined by the formula $A \times (B - C)/B$ where A is the particular amount referred to in paragraph (21)(a); B is the rate of tax that would be imposed under this Part in respect of the particular amount if the particular amount were paid by the taxpayer to the non-arm's length creditor rather than the interest coupon holder at that time; and C is the rate of tax imposed under this Part in respect of the particular amount paid or credited to the interest coupon holder at that time.
>
> Specified publicly offered debt obligation

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> (23) For the purposes of subsection (21), specified publicly offered debt obligation means a debt or other obligation that meets the following conditions: (a) 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 (b) 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 by a non-resident person or partnership to whom the debt or other obligation is owed.
>
> (2) Subsection (1) applies in respect of interest that accrues on or after Budget Day and is paid or payable by a taxpayer to an interest coupon holder in respect of a debt or other obligation owed to a non-arm's length creditor. However, subsection (1) does not apply to interest that accrues before April 7, 2023, if the interest is paid or payable
> (a) in respect of a debt or other obligation incurred by the taxpayer before Budget Day; and
> (b) to an interest coupon holder that deals at arm's length with the non-arm's length creditor and that acquired the entitlement to the interest as a consequence of an agreement or other arrangement entered into by the interest coupon holder, and evidenced in writing, before Budget Day.

Pillar One – Reallocation of Taxing Rights

The Canadian government is actively working with its international partners to develop the model rules and the multilateral convention needed to establish the new multilateral tax framework and bring it into effect. With respect to the status of the related proposed Digital Services Tax, the Supplementary Information to Budget 2022 states:

> To ensure that Canadians' interests are protected, as a back-up plan the government released draft legislative proposals for a Digital Services Tax (DST) in December 2021. A period for public input on the proposals closed in February and the government is reviewing the feedback received. Consistent with the October Statement, the DST could be imposed as of January 1, 2024, but only if the multilateral convention implementing the Amount A tax framework has not come into force. (In that event, the DST would be payable as of 2024 in respect of revenues earned as of January 1, 2022.) It remains the government's hope and underlying assumption that the timely implementation of the new international tax framework will make this unnecessary.

Pillar Two – Global Minimum Tax

The Pillar Two project has entered the implementation phase. The "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" ("the October Statement") provides that countries should implement Pillar Two effective in 2023, with the Undertaxed Profits Rule ("UTPR") coming into effect in 2024. In light of international developments, and in accordance with the timeline and parameters set out in the October Statement, Budget 2022 proposes to implement Pillar Two, along with a domestic minimum top-up tax that would apply to Canadian entities of multinational enterprises that are within the scope of Pillar Two. Per the Budget Papers, "[t]he government anticipates that draft implementing legislation would be publicly released for consultation and the IIR [Income Inclusion Rule] and domestic minimum top-up tax would come into effect in 2023 as of a date to be fixed. The UTPR [Undertaxed Profits Rule] would come into effect no earlier than 2024".

Personal Income Tax Measures

Tax-Free First Home Savings Account

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Budget 2022 proposes to create a new registered account, called the tax-free first home savings account ("FHSA"), to help individuals save for their first home. To open an FHSA, an individual must be at least 18 years old, a resident of Canada, and cannot have lived in a home that they owned either at any time in the year the account is opened or during the preceding four calendar years. The lifetime limit on contributions will be $40,000, subject to an annual contribution limit of $8,000. The full annual contribution limit will be available starting in 2023. Contributions to an FHSA will be deductible, income earned in an FHSA will not be subject to tax, and qualifying withdrawals from an FHSA made to purchase a first home will be non-taxable. Individuals will be limited to making non-taxable withdrawals in respect of a single property in their lifetime, and once an individual has made a non-taxable withdrawal to purchase a home, they will be required to close their FHSA and will not be eligible to open another FHSA. Unlike RRSPs, unused annual contribution room cannot be carried forward, meaning an individual contributing less than $8,000 in a given year would still face an annual limit of $8,000 in subsequent years. An individual will be permitted to hold more than one FHSA, but the total amount that an individual contributes to all of their FHSAs cannot exceed their annual and lifetime FHSA contribution limits.

An individual can transfer funds from an FHSA to an RRSP and the transfers will not reduce, or be limited by, the individual's available RRSP room; however, withdrawals and transfers would not replenish FHSA contribution limits. Individuals would also be allowed to transfer funds from an RRSP to an FHSA on a tax-free basis, subject to the $40,000 lifetime and $8,000 annual contribution limits; however, these transfers would not restore an individual's RRSP contribution room.

The home buyers' plan ("HBP") will continue to be available as under existing rules. However, an individual will not be permitted to make both an FHSA withdrawal and an HBP withdrawal in respect of the same qualifying home purchase.

Home Buyers' Tax Credit

Applicable to acquisitions of a qualifying home made on or after January 1, 2022, Budget 2022 proposes to double the existing first-time home buyers' tax credit amount to $10,000, which will provide up to $1,500 in tax relief to eligible home buyers. An individual is a "first-time home buyer" if neither the individual nor the individual's spouse or common-law partner owned and lived in another home in the calendar year of the home purchase or in any of the four preceding calendar years. For purposes of this credit, a qualifying home is one that the individual or individual's spouse or common-law partner intends to occupy as their principal residence no later than one year after its acquisition. This credit is also available for certain acquisitions of a home by, or for the benefit of, an individual who is eligible for the disability tax credit, even if the first-time home buyer condition is not met.

Multigenerational Home Renovation Tax Credit

Applicable for 2023 and subsequent taxation years, in respect of work performed and paid for and/or goods acquired on or after January 1, 2023, Budget 2022 proposes to introduce a new multigenerational home

renovation tax credit. The proposed measure will allow a refundable credit for eligible expenses for a qualifying renovation, which is a renovation that creates a secondary dwelling unit to permit an “eligible person” (i.e., a senior or a person with a disability) to live with a “qualifying relation”. For these purposes, a qualifying relation, in respect of an eligible person, is an individual who is 18 years of age or older at the end of the taxation year, and is a parent, grandparent, child, grandchild, brother, sister, aunt, uncle, niece or nephew of the eligible person (including the spouse or common-law partner of one of those individuals). The maximum credit will be 15% of the lesser of: 1) eligible expenses; and 2) $50,000.

Generally, for the purposes of this credit, a qualifying renovation is one of an enduring nature and integral to the eligible dwelling; and undertaken to enable an eligible person to reside in the dwelling with a qualifying relation, by establishing a “secondary unit” within the dwelling for occupancy by the eligible person or the qualifying relation. Generally, a secondary unit is a self-contained dwelling unit with a private entrance, kitchen, bathroom facilities and sleeping area. The secondary unit could be newly constructed or created from an existing living space that did not already meet the requirements to be a secondary unit. Relevant building permits for establishing a secondary unit must be obtained and renovations must be completed in accordance with the laws of the jurisdiction in which an eligible dwelling is located. Only one qualifying renovation will be permitted to be claimed in respect of an eligible person over their lifetime.

Home Accessibility Tax Credit

Applicable to expenses incurred in 2022 and subsequent taxation years, Budget 2022 proposes to double the annual expense limit of the home accessibility tax credit (“HATC”) to $20,000. Generally, the HATC is a non-refundable tax credit that provides recognition of eligible home renovation or alteration expenses in respect of an eligible dwelling of an individual who is either eligible to claim the disability tax credit in the year, or who is 65 years of age or older at the end of the year. Per the Supplementary Information to Budget 2022, “[t]his enhancement would provide additional tax support for more significant renovations undertaken to improve accessibility, such as building a bedroom and/or a bathroom to permit first-floor occupancy for a qualifying person who has difficulty accessing living spaces on other floors.”

Residential Property Flipping Rule

Per the Supplementary Information to Budget 2022, “the Government is concerned that certain individuals engaged in flipping residential real estate are not properly reporting their profits as business income. Instead, these individuals may be improperly reporting their profits as capital gains and, in some cases, claiming the Principal Residence Exemption.” To address these concerns, applicable in respect of residential properties sold on or after January 1, 2023, Budget 2022 proposes to introduce a new deeming rule to ensure profits from flipping residential real estate will be subject to full taxation. Specifically, profits arising from dispositions of residential property (including a rental property) that was owned for less than 12 months would be deemed to be business income. However, the proposed deeming rule will not apply if the disposition is made as a result of any of the following “life events”: the death of the taxpayer or a related person, in anticipation of a related person joining the taxpayer’s household or the taxpayer joining a related person’s household (e.g., birth of a child, adoption, care of an elderly parent), the breakdown of a marriage or common-law partnership, a threat to the personal safety of the taxpayer or a related person (e.g., the threat of domestic violence), a serious disability or illness of the taxpayer or a related person, certain employment changes, insolvency or to avoid

insolvency, or an involuntary disposition. Where the new deeming rule applies, the principal residence exemption will not be available. Where the proposed deeming rule does not apply because of a "life event" listed above or because the property was owned for 12 months or more, it would remain a question of fact whether profits from the disposition are taxed as business income.

Labour Mobility Deduction for Tradespeople

Applicable for 2022 and subsequent taxation years, Budget 2022 proposes to introduce a labour mobility deduction for tradespeople to recognize certain travel and relocation expenses of workers in the construction industry. This proposal will allow eligible workers to deduct up to $4,000 in eligible expenses per year. To qualify as an eligible temporary relocation, the work location must be in Canada but not in the locality in which the individual principally works, the temporary lodging must be at least 150 kilometres closer than the ordinary residence to the work location, and the temporary relocation must be for a minimum of 36 hours. Amounts that are eligible for the deduction are expenses incurred for temporary lodging, transportation and meals. The maximum amount of expenses that can be claimed in respect of a particular eligible temporary relocation will be capped at 50% of the worker's employment income from construction activities at the work location in the year.

Medical Expense Tax Credit for Surrogacy and Other Expenses

Expenses that are eligible for the medical expense tax credit ("METC") must generally be in respect of products and services received by the "patient", which is currently defined as the taxpayer, the taxpayer's spouse or common-law partner or certain dependants of the taxpayer. Since some approaches to building a family involve medical expenses for individuals other than the intended parents, Budget 2022 proposes to provide a broader definition of "patient" for purposes of the METC in cases where an individual relies on a surrogate or a donor in order to become a parent. In these cases, "patient" would be defined as: the taxpayer; the taxpayer's spouse or common-law partner; a surrogate mother; or a donor of sperm, ova or embryos. This broader definition will allow medical expenses paid by the taxpayer, or the taxpayer's spouse or common-law partner, with respect to a surrogate mother or donor to be eligible for the METC. Budget 2022 also proposes to allow reimbursements paid by the taxpayer to a "patient", under this expanded definition, to be eligible for the METC, provided that the reimbursement is made in respect of an expense that would generally qualify under the credit (e.g., the METC could be available for reimbursements paid by the taxpayer for expenses incurred by a surrogate mother with respect to an in vitro fertilization procedure or prescription medication related to their pregnancy). Budget 2022 also proposes to allow fees paid to fertility clinics and donor banks in order to obtain donor sperm or ova to be eligible under the METC where the sperm or ova are acquired for use by an individual in order to become a parent. All of these proposals would apply to expenses incurred in 2022 and subsequent taxation years.

Annual Disbursement Quota for Registered Charities

Registered charities are generally required to expend a minimum amount each year (called the "disbursement quota") equal to 3.5% of the registered charity's property not used directly in charitable activities or

administration. Budget 2022 proposes to increase the annual disbursement quota rate for registered charities from 3.5% to 5% for the portion of a charity's property not used in charitable activities or administration that exceeds $1 million. Budget 2022 also proposes to clarify that expenditures for administration and management are not considered qualifying expenditures for the purpose of satisfying a charity's disbursement quota. In addition, Budget 2022 proposes to provide the CRA with the discretion to grant a reduction in a charity's disbursement quota obligation for any particular tax year and to allow the CRA to publicly disclose information relating to such a decision. These measures would apply to charities in respect of their fiscal periods beginning on or after January 1, 2023.

Charitable Partnerships

Under the ITA, registered charities are limited to devoting their resources to charitable activities they carry on themselves or providing gifts to qualified donees. Where charities conduct activities through an intermediary organization (other than a qualified donee), they must maintain sufficient control and direction over the activity such that it can be considered their own. Budget 2022 proposes a number of changes to improve the operation of these rules, allowing charities to make qualified disbursements to organizations that are not qualified donees, provided that these disbursements are in furtherance of the charity's charitable purposes and the charity ensures that the funds are applied to charitable activities by the grantee. In addition, in order to be considered a qualifying disbursement, charities will be required to meet certain mandatory accountability requirements that are designed to ensure that their resources will be used for charitable purposes. Budget 2022 also proposes to require charities to take all reasonable steps to obtain receipts, invoices, or other documentary evidence from grantees to demonstrate amounts were spent appropriately, upon request by the CRA. Finally, Budget 2022 proposes to extend an existing provision in the ITA which would prohibit registered charities from accepting gifts, the granting of which was expressly or implicitly conditional on making a gift to a person other than a qualified donee. All of these proposals would apply as of the date of Royal Assent of the enacting legislation.

Borrowing by Defined Benefit Pension Plans

Currently, a registered pension plan can only borrow money in the following limited circumstances: 1) for the acquisition of income-producing real property where the borrowed amount does not exceed the cost of the property and only the property is used as security for the loan; and 2) where the term of the loan does not exceed 90 days and the property of the plan is not pledged as security for the loan. Budget 2022 proposes to provide more borrowing flexibility to administrators of defined benefit registered pension plans (other than individual pension plans) by maintaining the current borrowing rule for real property acquisitions and replacing the 90-day term limit with a limit on the total amount of additional borrowed money (for purposes other than acquiring real property), equal to the lesser of: 1) 20% of the value of the plan's assets (net of unpaid borrowed amounts); and 2) the amount, if any, by which 125% of the plan's actuarial liabilities exceeds the value of the plan's assets (net of unpaid borrowed amounts). This proposal will apply to amounts borrowed by defined benefit registered pension plans (other than individual pension plans) on or after April 7, 2022.

Reporting Requirements for RRSPs and RRIFs

Financial institutions are currently required to report annually to the CRA the payments out of, and contributions to, each RRSP and RRIF that they administer. By comparison, financial institutions file a comprehensive annual information return in respect of each TFSA that they administer, which includes the fair market value of property held in the account. Applicable to 2023 and subsequent taxation years, Budget 2022 proposes to require financial institutions to annually report to the CRA the total fair market value, determined at the end of the calendar year, of property held in each RRSP and RRIF that they administer. Per the Supplementary Information to Budget 2022, "[t]his information would assist the Canada Revenue Agency in its risk-assessment activities regarding qualified investments held by RRSPs and RRIFs."

Sales and Excise Tax Measures

See under the following links:

- Sales and Excise Tax Measures
  - GST/HST Health Care Rebate
  - GST/HST on Assignment Sales by Individuals
  - Taxation of Vaping Products
  - Cannabis Taxation Framework and General Administration under the *Excise Act, 2001*
  - WTO Settlement on the 100-per-cent Canadian Wine Exemption
  - Beer Taxation

Previously Announced Measures

[Per the Supplementary Information to Budget 2022]

Budget 2022 confirms the government's intention to proceed with the following previously announced tax and related measures, as modified to take into account consultations and deliberations since their release:

- Legislative proposals relating to the Select Luxury Items Tax Act released on March 11, 2022.
- Legislative proposals released on February 4, 2022 in respect of the following measures: i) electronic filing and certification of tax and information returns; ii) immediate expensing; iii) the Disability Tax Credit; iv) a technical fix related to the GST Credit top-up; v) the rate reduction for zero-emission technology manufacturers; vi) film or video production tax credits; vii) postdoctoral fellowship income; viii) fixing contribution errors in registered pension plans; ix) a technical fix related to the revocation tax applicable to charities; x) capital cost allowance for clean energy equipment; xi) enhanced reporting requirements for certain trusts; xii) allocation to redeemers methodology for mutual fund trusts; xiii) mandatory disclosure rules; xiv) avoidance of tax debts; xv) taxes applicable to registered investments; xvi) audit authorities; xvii) interest deductibility limits; and xviii) crypto asset mining.
- Legislative proposals tabled in a Notice of Ways and Means Motion on December 14, 2021 to introduce the *Digital Services Tax Act*.
- Legislative proposals released on December 3, 2021 with respect to Climate Action Incentive payments.
- The income tax measure announced in Budget 2021 with respect to Hybrid Mismatch Arrangements.
- The transfer pricing consultation announced in Budget 2021.
- The anti-avoidance rules consultation announced on November 30, 2020 in the Fall Economic Statement.

- The income tax measure announced on December 20, 2019 to extend the maturation period of amateur athletes trusts maturing in 2019 by one year, from eight years to nine years.
- Measures confirmed in Budget 2016 relating to the Goods and Services Tax/Harmonized Sales Tax joint venture election.
- Budget 2022 also reaffirms the government's commitment to move forward as required with technical amendments to improve the certainty and integrity of the tax system.

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[1] Under current rules, ITA 125(5.1)(a) phases out a CCPC's business limit if the "taxable capital employed in Canada" (ITA 181.2(1)) by the CCPC on an associated group basis in the immediately preceding taxation year exceeds $10M. In the latter case, the business limit is phased out on a straight-line basis, reducing to nil if taxable capital employed in Canada in the prior year exceeds $15M. The proposed amendment does not appear to provide for a pro-ration rule for taxation years that straddle April 7, 2022. Recent amendments to ITA 125(5.1)(b) also did not contain such a rule (see CRA Views Doc. 2018-0771871E5).

[2] See also Lanthier, "The latest Canadian tax scam has a Caribbean flavour," *Canadian Accountant*, January 21, 2022 and Goldberg et al., "Should Canadian Investors be able to Enjoy the Same Beneficial Tax Treatment as Public and Foreign Corporations?" mindengross.com/resources/publications/tax-newsletters/2022.

[3] See also Finance News Release 2021-07-19: *Government of Canada clarifies taxation for intergenerational transfers of small business shares*; Keey, "Wide Scope Intergenerational Business Transfer Rules Will Apply as Enacted Until At Least November 1, 2021", *Taxnet Pro*, July 21, 2021 and "Newly Enacted Intergeneration Business Transfer Rules Likely to be Revised Before Becoming Effective", *Taxnet Pro*, July 1, 2021; Wark, "Intergeneration Transfers of Shares—Where do Things Currently Stand?", *Insurance Planning* (Federated Press), Vol. XXVI-4, 2021; Sweeney et al., "Intergenerational Transfer of Family Businesses: Bill C-208 and the Path Forward", *Taxes & Wealth Management* (Taxnet Pro), Miller Thomson LLP, Issue 14-3, 2021; and Dolson et al., "The Continuing Saga of Bill C-208", *Corporate Structures & Groups* (Federated Press), Vol. XVII-3, 2021; Lanthier, "UPDATE: Surplus stripping and the new, costly tax loophole for intergenerational transfers", financesofthenation.ca, 2021; Quebec Information Bulletin 2021-6 (August 12, 2021); Mezzetta, "Will CRA challenge small biz transfers that use Bill C-208?", *Advisor's Edge*, 2021. Also, regarding the currently enacted rules, see recent CRA Release 2022-04-02: Affidavits and valuations for the transfer of a small business, family farm or fishing corporation (Bill C-208).

[4] The Budget Papers are presumably referring to *1245989 Alberta Ltd.* [(Wild)], 2018 CarswellNat 2778 (FCA), in which a series of transactions was undertaken to exploit the paid-up capital ("PUC") averaging rules to effectively transform soft-basis shares with nominal PUC to soft-basis shares with PUC equal to ACB, with the intention of subsequently distributing surplus in the form of tax-free returns of capital. Although the Court held that ITA 84.1 and 89(1)"PUC" had been abused by the series of transactions, the GAAR did not apply since a "tax benefit" had not yet arisen (i.e., since the surplus had not yet been removed at the time of the case). The Court did, however, note that the CRA could apply the GAAR at a future date if the surplus was distributed (paras. 97, 98). See also *Gladwin Realty Corporation*, 2020 CarswellNat 3733 (FCA), in which the GAAR was held to apply to a series of transactions that otherwise allowed for the full amount of a capital gain to be paid out as a capital dividend. In the case, the excessive capital dividend had not yet been paid to a non-corporate shareholder (i.e., the "tax benefit" had not yet been realized). In this respect, the FCA commented (paras. 47-49): "[I]t is now established that the modification of tax attributes, such as an increase in a taxpayer's CDA, does not give rise to a tax benefit unless and until a capital dividend is paid out of that account to a recipient capable of benefiting from its tax-free character" (see *Wild*, 2018 CarswellNat 2778 (FCA)). Faced with the parties' desire to obtain a resolution in this matter and the absence of a tax benefit, counsel for the appellant made the undertaking (now fulfilled) that a dividend be paid to non-corporate shareholders so as to allow the matter to be resolved at this juncture. With the agreement of the Crown, the Court agreed to conduct the abuse analysis on the basis that a tax benefit arose by reason of such a dividend having been paid". Similarly, see *Rogers Enterprises (2015) Inc.*, 2020 CarswellNat 3427 (TCC), discussed in *The Arnold Report* 185 (ctf.ca, 2020), "An Increase In A Tax Attribute Is Not A Tax Benefit".

[5] *Gladwin Realty Corporation*, 2020 CarswellNat 3733 (FCA) and *Rogers Enterprises (2015) Inc.*, 2020 CarswellNat 3427 (TCC).

[6] These minerals are used in the production of batteries and permanent magnets, both of which are used in zero-emission vehicles, or are necessary in the production and processing of advanced materials, clean technology, or semi-conductors.

[7] See also KPMG, "Insurers—Have Your Say on New Accounting Standards", *TaxNewsFlash-Canada* No. 2021-31 and PWC, "Department of Finance's policy direction on IFRS 17 for insurance contracts", *Tax Insights from Insurance*, 2021.

[8] See ITA 248(1)"synthetic equity arrangement".

[9] In *Lehigh Cement Ltd*, [2010] 5 C.T.C. 13 (FCA); rev'g 2009 CarswellNat 1048 (TCC), an interest-coupon stripping transaction was employed to access the withholding tax exemption under former ITA 212(1)(b) (see *Tax Times* 2010-11). In finding that the GAAR did not apply, the FCA emphasized that “the Crown cannot discharge the burden of establishing that a transaction results in the misuse of an exemption merely by asserting that the transaction was not foreseen or that it exploits a previously unnoticed legislative gap” (para. 37). The ITA was subsequently amended to prevent the type of planning at issue in the case.