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Audit | Tax | Advisory

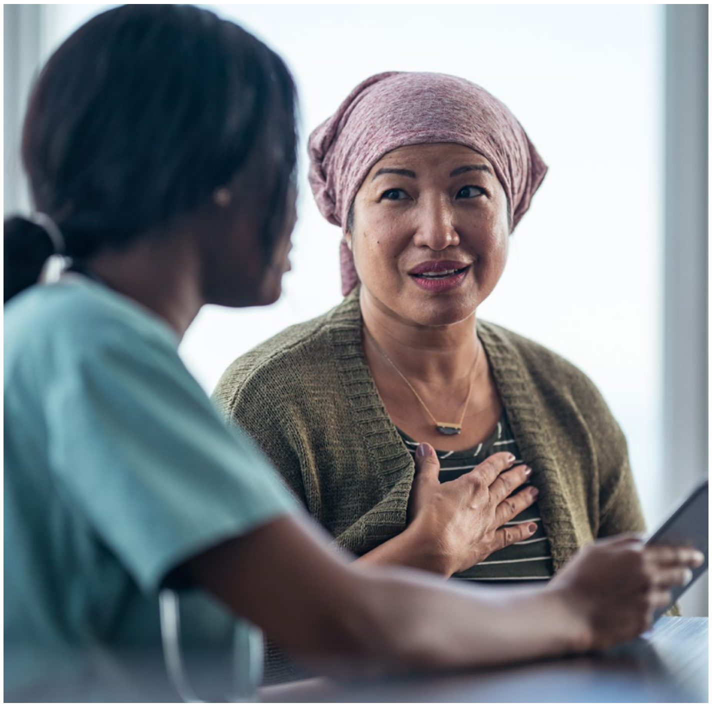
Budget 2022

Making sense of what's next.

April 08, 2022

About the budget

The Honourable Chrystia Freeland, Deputy Prime Minister and Minister of Finance, delivered *Budget 2022 - A Plan to Grow Our Economy and Make Life More Affordable* (Budget 2022) on April 7, 2022—the first federal budget since the 2021 federal election and the second since the Covid-19 pandemic began. Budget 2022 is influenced by a range of factors, including the Liberal government's spending promises from the election, new spending promises made through the supply-and-confidence agreement with the NDP, the need to balance pandemic relief spending, an affordable housing crisis, a redoubled focus on addressing climate change, and ongoing global economic uncertainty against the backdrop of the invasion of Ukraine.



Our analysis addresses the following areas:

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Economic recovery

Canada's economic recovery has certainly helped its forecasted deficit position, shifting the deficit for the 2021/22 fiscal year from a projected $144.5 billion to an actual shortfall of $113.8 billion, and a forecasted deficit of $52.8 billion for 2022/23. Federal debt is currently $1,160.8 billion and it is expected to grow to $1,308.4 billion by 2026/27.

Budget 2022 is centered around three pillars

The Canadian people

Budget 2022 proposes several measures designed to help stabilize the housing market, address housing supply, and make it easier to save and invest in housing. It also looks to build our workforce by making it easier to attract foreign skilled workers and making child care cheaper and more accessible.

Green transition

Budget 2022 builds on a pattern of past budget measures to make green investment more tax-efficient, to make pollution more costly, and to mandate minimum supply thresholds of zero-emission vehicles while reaffirming the government's commitment to achieving net-zero by 2050.

Productivity and innovation

Budget 2022 announces two significant new initiatives designed to drive economic growth and innovation.

1. The creation of a new Canada Growth Fund – a $15 billion arm's-length public investment fund designed to invest in Canadian business and industry, while attracting significant private sector investment.

2. The creation of a new Canadian Innovation and Investment Agency, an operationally independent agency whose mandate is to help Canadian businesses make investments in new technologies and innovations that will drive growth.

In addition, Budget 2022 provides significant new spending commitments to National Defense of $8 billion over five years, Indigenous reconciliation of $11 billion over six years, and $5.3 billion over five years for a national dental care program.

Personal measures

Tax-Free First Home Savings Account

Budget 2022 proposes a new Tax-Free First Home Savings Account (FHSA) to help first-time homebuyers save for a home. Similar to a registered retirement savings plan (RRSP), FHSA contributions would be deductible and income earned in the account will not be subject to tax, however qualifying withdrawals to purchase a first home would not be taxable while amounts withdrawn for other purposes will be subject to tax.

To be eligible to open an FHSA, an individual must:

- Be a resident of Canada;
- Be at least 18 years old; and
- Not have lived in a home they owned in the year the account is opened or during the preceding four calendar years.

Individuals will be required to close their FHSA within a year of making their first non-taxable withdrawal to purchase a home. They will not be eligible to open another FHSA.

FHSA contributions will have an annual limit of $8,000 and a lifetime limit of $40,000. The full annual limit would be available beginning in 2023.

Individuals would be permitted to transfer funds from an FHSA to an RRSP or registered retirement income fund (RRIF). These transfers would not be immediately taxable and would not impact an individual's available RRSP contribution room. Individuals would also be permitted to transfer funds from an RRSP to an FHSA on a tax-free basis subject to the annual and lifetime FHSA contribution limits.

While the existing Home Buyer's Plan (HBP) will continue to be available, an individual will not be permitted to make a withdrawal from an HBP and FHSA in respect to the same home purchase.

Home Buyers' Tax Credit

The first-time home buyers' tax credit (HBTC) is a non-refundable tax credit currently available to first-time home buyers purchasing a home that the taxpayer (or their spouse or common-law partner) intends to occupy as their principal residence within one year of acquisition. Unless qualifying for the disability tax credit, neither the taxpayer nor their spouse can have owned and lived in another home in the calendar year of the purchase or in any of the four preceding calendar years to qualify as a first-time home buyer.

Budget 2022 proposes to increase the HBTC amount from $5,000 to $10,000 which, at a rate of 15 per cent, increases the credit from $750 to $1,500. The credit can be split between spouses or common-law partners.

This increased credit would be effective for the purchase of a qualifying home on or after January 1, 2022.

Multigenerational Home Renovation Tax Credit

Budget 2022 proposes a new Multigenerational Home Renovation Tax Credit. This is a refundable tax credit applicable to eligible expenses incurred to create a secondary dwelling unit to allow a senior or a person over the age of 17 with a disability (eligible person) to live with a relative. The credit is applied at a rate of 15 per cent on eligible expenses up to $50,000.

This credit may be claimed by an individual who ordinarily resides or intends to ordinarily reside in the home within 12 months after the end of the renovation period and can be split among one or more eligible claimants, but the total of all amounts claimed must not exceed $50,000. The home must be owned (either jointly or otherwise) by the eligible person, the spouse or common-law partner or a qualifying relation of the eligible person.

The renovation must be of an enduring nature and integral to the eligible dwelling. Eligible expenses would include the cost of materials, labour, professional services, fixtures, equipment rentals and permits incurred in connection with the renovation. Individuals cannot claim expenses under the multigenerational home renovation tax credit if they are claimed under the medical expense tax credit or home accessibility tax credit.

The credit is effective for qualifying expenditures incurred and paid on or after January 1, 2023.

Home Accessibility Tax Credit

The Home Accessibility Tax Credit is an existing non-refundable tax credit for expenses incurred in connection with the renovation or alteration of a home to make it more accessible for a qualifying individual. Qualifying individuals include individuals who are 65 years of age or older at the end of a taxation year or individuals who are eligible for the Disability Tax Credit.

Budget 2022 proposes to double the annual expense limit on this tax credit from $10,000 to $20,000. This credit is applied at a rate of 15 per cent and provides up to $3,000 in tax relief.

The increased credit would be effective for expenses incurred in 2022 and subsequent years.

Residential Property Flipping Rule

Budget 2022 proposes a new deeming rule to characterize profits received from the disposition of residential property owned for less than 12 months as business income. The new deeming rule prevents taxpayers from characterizing profits from flipping real estate as capital gains or from claiming the Principal Residence Exemption.

The new deeming rule will not apply to residential property owned for a period of less than 12 months under the following special circumstances: death, addition to the household, separation, threats to personal safety, disability or illness, loss of employment, new location of employment, insolvency or involuntary disposition.

The measure would apply to residential properties sold on or after January 1, 2023.

Labour Mobility Deduction for tradespeople

Budget 2022 proposes a new Labour Mobility Deduction to allow tradespeople and apprentices in the construction industry to deduct certain travel and relocation expenses incurred in the course of employment for eligible temporary relocations. This measure would allow eligible employees to deduct eligible expenses equal to the lesser of $4,000 or 50 per cent of the worker's employment income from construction activities. The proposed measure would apply to 2022 onward.

To qualify for the proposed deduction, an individual must be a tradesperson or apprentice who makes an eligible temporary relocation within Canada to enable them to perform employment duties in a construction activity at a particular work location. The temporary relocation must be within Canada, last for a minimum duration of 36 hours, and be at least 150 kilometres closer to the work location than the taxpayer's ordinary residence. To claim the deduction, an individual must maintain an ordinary residence elsewhere that remains available to the individual or to their immediate family.

Eligible expenses would include amounts incurred in relation to the taxpayer's temporary lodging, transportation for one round trip from the taxpayer's ordinary residence to the temporary lodging, and the taxpayer's meals during the one round trip. Finally, the proposed measure would prohibit a taxpayer from claiming amounts in respect of which they received financial assistance from an employer that is not included in income, or where the taxpayer claims the amount under another deduction.

Medical Expense Tax Credit for surrogacy and other expenses

Budget 2022 proposes an extension of the Medical Expense Tax Credit to certain expenses incurred by individuals seeking to become parents through assisted reproductive technologies. Currently, an individual may only claim eligible medical expenses in respect of goods and services received by a patient where the patient includes either the taxpayer, the taxpayer's spouse or common-law partner, or certain dependants of the taxpayer. In circumstances where the individual relies on a surrogate or a donor to become a parent, Budget 2022 proposes a broadened definition of the term patient to include a surrogate mother or a donor of sperm, ova, or embryos. Further, the government proposes to include certain expenses not currently eligible for the tax credit, including:

- Reimbursements paid by the taxpayer in respect of eligible expenses incurred in Canada by a surrogate mother or a donor of sperm ova or embryos; and
- Fees paid by the taxpayer to a Canadian fertility clinic or donor bank in order to obtain donor sperm or ova.

The proposed measure would apply to eligible expenses incurred in 2022 onward.

Indigenous youth measures

Budget 2022 proposes to amend the Children's Special Allowances Act to extend eligibility for social assistance to include programs provided by an Indigenous governing body. These social assistance payments must be provided by an agency licenced under a federal, provincial or territorial law to be eligible currently. Budget 2022 also provides that a kinship care provider is considered a parent for purposes of the Canada Workers Benefit and Canada Child Benefit and that financial assistance received by kinship care providers from an Indigenous governing body is not taxable. Entitlement to income-tested benefit and credits will not be impacted by these financial assistance payments.

This measure is applicable retroactively to 2020 and subsequent taxation years.

New personal minimum tax regime

The government plans to revisit and replace or enhance the current Alternative Minimum Tax (AMT) rules, which are intended to impose a minimum tax on high income individuals who claim a large amount of deductions and tax credits. Details are to be announced in the 2022 fall economic and fiscal update.

Career Extension Tax Credit

In the interest of boosting Canada's productive workforce, Budget 2022 announces the government's intention to consult with experts on a new Career Extension Tax Credit designed to increase participation of seniors in the workforce.

Business measures

Small Business Deduction

The Small Business Deduction (SBD) currently provides Canadian controlled private corporations (CCPCs) with the benefit of a 9 per cent tax rate applied to its first $500,000 of qualifying active business income—subject to the sharing of this small business limit with associated CCPCs. The purpose of this deduction is to allow small businesses to retain more after-tax dollars which they can used to reinvest and grow the Canadian economy. Currently, the small business limit available is reduced where:

- The total Adjusted Aggregate Investment Income (AAII) of the associated group of companies exceeds $50,000, with the SBD eliminated when the total AAII reaches $150,000; or
- The aggregate taxable capital employed in Canada of the associated group of companies exceeds $10 million, with the SBD eliminated when taxable capital exceeds $15 million.

For tax years beginning on or after April 7, 2022, Budget 2022 proposes to extend the upper limit of taxable capital at which the SBD is fully ground down from the existing $15 million to $50 million. Under this expanded range, a greater number of medium-sized businesses would be eligible for some portion of the SBD.

Taxable capital	Current SBD	Proposed SBD
$10 million	$500,000	$500,000
$12 million	$300,000	$475,000
$30 million	-	$250,000
$50 million	-	-

Genuine intergenerational share transfers

Bill C-208, a private member's bill to facilitate the intergenerational transfer of a business, received Royal Assent on June 29, 2021. The legislative amendments in this Bill intend to equalize the income tax treatment between a sale of shares in a small business, family farm or fishing corporation to a corporation owned by the business owner's child or grandchild and a third-party sale. The government had previously expressed concerns that the new rules have unintended loopholes that may permit "surplus stripping" without any genuine transfer of business taking place. Budget 2022 confirms the government's intention to make amendments to the existing legislation to close any loopholes that might exist and announces a consultation process to gather public comments. Public consultation period will end on June 17, 2022. Visit our Bill C-208 Hub for more information.

Deferring tax using non-CCPCs - substantive CCPCs and changes to FAPI

Currently, a non-CCPC corporation enjoys a comparatively lower corporate tax rate on investment income than a CCPC, which is subject to refundable tax on that income. Budget 2022 proposes changes targeted at the avoidance of the anti-deferral rule applicable to investment income earned by a CCPC by manipulating the status of the corporation earning such income. The manipulation is often accomplished by an elected change in status, the interposing of a non-resident company in the corporate structure or some other means, while remaining under the control of Canadian resident individuals.

Substantive CCPCs

To address circumstances where a taxpayer may have manipulated the status of a corporation to reduce the income taxes on investment income, Budget 2022 introduces the concept of a "substantive CCPC". This new category of corporation is defined to be a private corporation resident in Canada (other than a CCPC) that is controlled (in law or in fact), directly or indirectly, by one or more Canadian-resident individuals, or would be controlled (in law) by a particular individual if that individual owned all of the shares of the corporation (or any other corporation) that are owned by Canadian resident individuals. Further, a corporation is a substantive CCPC if the only reason it would not be a CCPC is because a non-CCPC has a right to acquire its shares or it ceased to be a Canadian corporation (by legally continuing to a foreign jurisdiction while maintaining Canadian residence).

A proposed anti-avoidance rule may apply to deem a non-CCPC to be a substantive CCPC where it is reasonable to consider that one of the purposes of a transaction or series of transactions is to avoid the substantive CCPC status.

A substantive CCPC is to be taxable on its investment income in the same manner as a CCPC, including the refundable tax regime. Where currently investment income in a non-CCPC may add to the General Rate Income Pool of a corporation, which can be paid ultimately to individuals as eligible dividends, this would not be the case for a substantive CCPC. Rather, investment income would be added to their Low Rate Income Pool, paralleling treatment of a CCPC.

The proposed rules would generally apply to taxation years ending on or after April 7, 2022.

Changes to FAPI

Current anti-deferral rules prevent taxpayers from deferring taxes on property income earned through a controlled foreign affiliate (CFA). Property income earned by a CFA is generally considered foreign accrual property income (FAPI), which is included in the Canadian shareholder's income in the year it is earned by the CFA.

To prevent double taxation, a Canadian taxpayer is entitled to a gross-up deduction in respect of foreign tax paid on FAPI (referred to foreign accrual tax or FAT). The deduction for FAT is grossed-up by a relevant tax factor. There are currently two different relevant tax factors:

1. The relevant tax factor applicable to corporations is 4. As a result, if FAPI has already been subject to foreign tax at an effective rate of at least 25 per cent, the corporate taxpayer should be entitled to a full deduction in respect of the FAPI.
2. The relevant tax factor applicable to all other taxpayers is 1.9. As a result, a full deduction requires FAPI to be subject to foreign tax at a rate of at least 52.63 per cent.

The relevant tax factor of four is applicable to all corporations regardless of their status. The Government is concerned that this provides a tax-deferral opportunity for CCPCs to earn investment income through CFAs instead of directly.

Budget 2022 proposes to apply to CCPCs and substantive CCPCs the same relevant tax factor as individuals, reducing the FAT deduction and as a result the deferral of tax on investment income earned in jurisdictions with tax rates lower than Canada.

Budget 2022 also proposes new rules to address the integration of FAPI when repatriated and distributed by CCPCs and substantive CCPCs. The new rules add to a CCPC's capital dividend account (CDA) the after-tax earnings of a CFA that have been repatriated to the extent that such earnings have been subject to a notional tax rate of 52.63 per cent. The Government will propose similar rules for certain dividends paid out of a foreign affiliate's hybrid surplus or taxable surplus other than FAPI.

The proposed measures should not affect dividends paid out of exempt surplus or pre-acquisition surplus. The proposed rules apply to taxation years that begin on or after April 7, 2022.

Clean technology tax incentives – Air-source heat pumps

Budget 2022 proposes to expand the eligibility for classes 43.1 and 43.2 to include air-source heat pumps, including refrigerant piping, energy conversion equipment, thermal energy storage equipment, and control and interface equipment. Properties in these classes are eligible for accelerated tax write-off (immediate expensing rules). Parts of buildings, back-up system equipment, and air/water distribution equipment within a building are all exceptions and not eligible for the accelerated deduction.

Budget 2022 also proposes a temporary measure to reduce corporate income tax rates for manufacturers of air-source heat pumps used for space or water heating. This manufacturing will be included as eligible zero-emission technology manufacturing or processing activities, which qualify for income tax rate reductions of:

- 7.5 per cent, for income that would otherwise be taxed at the general corporate rate of 15 per cent; and
- 4.5 per cent, for income that would otherwise be taxed at the small business rate of 9 per cent.

These rate reductions would apply for tax years beginning in 2022 and would be phased out between 2029 and 2031.

Investment tax credit for carbon capture, utilization, and storage

Budget 2022 introduces a refundable investment tax credit for technologies that capture carbon dioxide emissions for storage or industrial use. The carbon capture, utilization, and storage (CCUS) tax credit is received in relation to costs incurred for the purchase and installation of eligible equipment used in a qualifying project, for eligible expenses incurred January 1, 2022 and onward.

Eligible expenses qualify for tax credits from 37.5 per cent to 60 per cent for years 2022 through 2030, and credits between 18.75 per cent and 30 per cent thereafter (up to 2040).

Two new capital cost allowance (CCA) classes will also be created for CCUS equipment, including the costs of converting existing equipment for use in a CCUS project, CO_2 monitoring and tracking equipment, and buildings dedicated entirely to a CCUS project:

- Equipment dedicated to capturing, processing, and compressing CO_2 will be eligible for a CCA class with an 8 per cent declining balance.
- Equipment using CO_2 in an eligible use, including dedicated geological storage and storage in concrete, will be eligible for a CCA class with a 20 per cent declining balance.

While exploration and development expenses related to a CCUS project will not qualify for the CCUS credit, two additional CCA classes are created for intangible exploration expenses (100 per cent declining-balance) and development expenses (30 per cent declining-balance) associated with the storage of CO_2.

Application of the general anti-avoidance rule to tax attributes

The general anti-avoidance rule (GAAR) is intended to prevent abusive tax avoidance transactions, typically on an assessment of tax. The Income Tax Act also allows the Canada Revenue Agency (CRA), through the use of the GAAR, to determine the amount of a tax attribute.

In 2018, the Federal Court of Appeal determined that the GAAR did not apply in a transaction where the adjustment to the tax attribute had not yet been utilized to reduce taxes. Budget 2022 proposes amendments to the Income Tax Act such that the GAAR could apply to a transaction irrespective of whether an adjusted tax attribute has yet become relevant to the computation of tax.

Critical Mineral Exploration Tax Credit

Currently, corporations engaged in certain exploration activities may renounce certain expenses to shareholders through flow-through share agreements, which permit investors to deduct these expenses against their own income. The Mineral Exploration Tax Credit (METC) is an additional benefit on top of these renounced expenses equal to 15 percent of the renounced specified mineral exploration expenses.

Budget 2022 introduces a new tax credit in lieu of the METC and in respect of specified minerals that are used in the production of batteries and permanent magnets for zero-emission vehicles. The Critical Mineral Exploration Tax Credit (CMETC) is a 30 per cent credit to the flow-through investor. Investors cannot benefit from both the METC and the CMETC.

In order for exploration expenses to qualify for the CMETC, a qualified person must certify that the expenditures to be renounced will be incurred as part of an exploration that targets the specified minerals. The CMETC would apply to expenditures renounced under eligible flow-through share agreements entered into after April 7, 2022 and before April 1, 2027.

Flow-through shares for oil, gas, and coal activities

Currently, flow-through share agreements allow certain expenditures relating to oil, gas, and coal exploration or development to be renounced by corporations and deducted by shareholders against their own taxable income. Investors can deduct exploration expenses at a rate of 100 per cent and development expenses at a rate of 30 per cent on a declining balance basis.

Budget 2022 proposes to eliminate this flow-through regime for oil, gas and coal activities effective for flow-through share agreements entered into after March 31, 2023.

Canada Recovery Dividend and additional tax on banks and life insurers

Budget 2022 proposes a one-time 15 per cent tax, the Canada Recovery Dividend (CRD), on banks, life insurers and any other financial institutions (for the purpose of Part VI tax) that are related to those banks or life insurers. The CRD would be calculated based on taxable income for taxation years ending in 2021 (prorated for short taxation years) and payable in equal amounts over five years. The proposals include a $1 billion taxable income exemption that can be allocated amongst group members.

Budget 2022 also proposes to permanently increase the federal income tax for members of bank and life insurer groups (determined in the same way as the CRD) from 15 per cent to 16.5 per cent. A related group can allocate a $100 million taxable income exemption by agreement amongst group members. The proposed rules apply to taxation years that end after April 7, 2022 (the 1.5 per cent increase would be prorated for taxation years that includes April 7, 2022).

International Financial Reporting Standards for Insurance Contracts (IFRS 17)

Under the new IFRS 17 contract service margin (CSM) rule, Canadian insurers will defer for accounting purposes a large portion of the profits earned on underwritten insurance contracts beginning in 2023. These amounts will be gradually brought into accounting income over the estimated life of the insurance contracts. Budget 2022 proposes to treat the CSM as a non-deductible reserve for tax purposes, absent certain key economic activities. Specifically, Budget 2022 proposes a different tax treatment of CSM for different products as follows:

- Segregated funds: The CSM would be fully deductible for tax purposes since the income-earning activities for segregated funds are primarily investment management activities. The income will continue to be recognized as the relevant economic activities occur.
- All other life insurance contracts: Only ten percent of the CSM would be deductible with transitional relief in certain cases to smooth the impact of this change over five years.
- Mortgage and title insurance: A ten percent CSM deduction. Similar to life insurance, a five-year transitional period will exist and the deducted CSM amounts will be taken into income as the non-attributable expenses arise.

Budget 2022 proposes no changes to the CSM for Property and Casualty (P&C) insurance contracts. A five-year transitional period is proposed to relieve the tax impact of converting P&C insurance reserves from IFRS 4 to IFRS 17.

Hedging and Short Selling by Canadian Financial Institutions

Budget 2022 proposes rules applicable to registered securities dealers to prevent a double-deduction in situations where taxpayers within a financial institution group take advantage of offsetting short and long securities positions to obtain multiple tax deductions. In such situations, the economic exposure of the holding is effectively hedged while the holder of the security receives a dividend received deduction at the same time the short-seller of the security receives a deduction for two-thirds of a dividend compensation payment. The proposed measures will deny the dividend received deduction and allow a complete deduction of the dividend compensation payment deduction, thereby eliminating the duplicated tax benefit.

The proposed rules apply to dividends and related dividend compensation payments paid or payable on or after April 7, 2022 (or September 2022 if the hedging or related securities lending arrangement was in place before April 7, 2022).

Sales and excise tax measures

Goods and Services Tax (GST)/ Harmonized Sales Tax (HST) on assignment sales

Budget 2022 proposes new legislation to tax all assignment sales of single unit residential complexes and condos. The tax applies regardless of the original intention of the purchaser, and regardless if the purchaser had any intention to make their unit their residence or use it for any other non-business purpose. These measures are to come into effect one month after April 7, 2022, or May 7, 2022.

GST/HST health care rebate

Qualifying non-profit organizations, public institutions, and charities making facility supplies and home medical supplies are eligible for an increased rebate of 83 per cent of the GST and federal portion of the HST, provided they meet certain criteria for operation. One of these criteria required that the health supplies be provided under the direction of a physician.

Budget 2022 proposes that “nurse practitioner” be added to the definition in order to respond to their increased involvement in the Canadian health care system.

Excise taxes

Vaping

Budget 2022 expands the tobacco and cannabis duty rules to include all vaping products. These changes effectively treat any vaping product the same as tobacco and cannabis products. This includes the introduction of vaping excise stamps on vaping substances and vaping devices that are sold containing a vaping substance. All manufacturers in Canada must now be licensed to manufacture vaping products. Furthermore, all vaping products manufactured must be stamped to indicate that the additional duty has been paid on these products, similar to tobacco and cannabis rules. Duty is also payable on import of vaping substances. The duty rate is $1 per 2mL for the first 10mL of vaping substance, and $1 per 10mL for volume in excess of 10mL.

Further, the government has indicated willingness to work with any province that wishes to harmonize their taxation of vaping with the federal system.

Cannabis

Budget 2022 makes various administrative amendments to the cannabis filing and duty and administration. Some licensed cannabis producers may move to a quarterly filing and remittance frequency rather than monthly. Further, the CRA will now be able to approve certain contracts for services to allow for stamping and duty activities to be performed between licensed producers.

Wine and beer

Canadian wine with ingredients grown in Canada and further produced in Canada currently enjoy a 100 per cent exemption from duties. This exemption is not available for wines from other jurisdictions that are imported and sold in Canada. In response to a World Trade Organization objection from Australia, Canada promised to repeal this exemption no later than June 30, 2022. Budget 2022 proposes a repeal of the wine duty exemption for Canadian-produced wines. As a result, the excise tax will now apply when Canadian wine is packaged or consumed in bulk. The current duty rates translate to an additional 52 cents for a 750mL bottle or $0.688 per litre.

Beer with an alcohol by volume content of 0.5 per cent is no longer subject to excise duty.

International tax measures

International Tax Reform

Budget 2022 reaffirms the Government's commitment to the OECD's Pillar One and Pillar Two approach to international tax reform impacting large multinational enterprises (MNEs).

Pillar One

Pillar One reassigns the rate of tax to a certain MNEs profits to market jurisdictions in which the customers are located. Impacted MNEs are those with global revenues above €20 billion and a profit margin above 10 per cent.

The Pillar One taxing right is allocated based on MNE revenues to the countries in which their customers are found, and not necessarily to the countries in which MNEs have a physical presence (permanent establishment), as has historically been the case. The Pillar One framework allocates allocates a rate of 25 per cent of an MNE's. The residual profit is profit in excess of 10 per cent of revenues determined in accordance with accepted rules of financial accounting.

The Government noted that it will continue to work with its OECD/G20 partners in further developing the Pillar One rules and dispute resolution mechanisms so that the tax is allocated justly amongst countries while not exposing MNEs to double tax.

Canada's expectation is that Pillar One will soon progress to the point of a multilateral agreement amongst the participating countries and come into force for international tax treaty purposes; but if that does not occur by January 1, 2024, the proposed draft Digital Services Tax (DST) legislation (released December 2021 for public consultation that ended in February 2022) may be brought into effect in respect of revenues earned as of January 1, 2022. The details of the proposed DST can be found in our Economic and Fiscal Update 2021.

Pillar Two – global minimum tax

Pillar Two introduces a minimum 15 per cent rate of tax to MNEs with annual revenues of €750 million or more. Where a MNE's effective rate of tax falls below 15 per cent in a given jurisdiction, an Income Inclusion Rule imposes top-up tax to make up the difference, subject to a substance-based income exclusion based on a percentage of the MNE's tangible assets and labour expenditures in the country.

The right to impose the top-up tax is given to the country of the MNE's ultimate parent or of its other intermediary parents, depending on whether they have adopted Pillar Two. Failing that, an Undertaxed Profits Rule acts as a back-up in which the jurisdictions where the MNE operates are then given the taxing rights, based on a formulaic allocation. Pillar Two allows for a country to enact a domestic minimum tax on its MNEs, creditable against the top-up tax imposed upon the MNE's parent by its host country.

Pillar Two detailed rules and commentary are still in development by the OECD/G20 but are intended to be ultimately implemented in the domestic tax laws of each participating country. Budget 2022 notes that this process is occurring in various partner countries and proposes to introduce legislation implementing both the income inclusion Rule (applicable in 2023) and the Undertaxed Profits Rule (applicable no earlier than 2024).

Budget 2022 announces a public consultation to seek feedback on how the OECD model rules should apply for Canadian legal and income tax purposes, but not on their overall design or policy consideration. Written representations to the Department of Finance Canada, Tax Policy Branch are invited until July 7, 2022.

Exchange of tax information on digital economy platform sellers

The digital economy makes it possible for more business to be conducted online, whether it is the provision of services or sale of goods. Online sellers are responsible for reporting any income they earn from online platforms, but the Government is concerned that not all online sellers are aware of the tax implications of their online activities.

Budget 2022 proposes to address this concern by introducing new reporting rules, which align with the OECD's model, for certain digital platform operators. The rules would apply to reporting platform operators, which are entities that (i) provide sellers with a platform to connect with other users, or (ii) collect compensation for the activities that are facilitated through the platform.

The new rules require Canadian resident digital platform operators to complete certain due diligence procedures and collect and report relevant information in respect of certain defined reportable sellers (including their place of residence for tax purposes). The rules may also impose reporting obligations upon certain non-Canadian digital platform operators who facilitate activities by Canadian sellers or the rental of immovable property located in Canada.

Certain exemptions from the new reporting obligations are contemplated:

- activities that merely involve payment processing, advertising or the transferring of users to other platforms
- certain digital platform operations that do not allow sellers to profit from compensation received or that do not have reportable sellers
- digital platform operators that facilitate the provision of certain defined ‘relevant activities’ with total compensation under €1 million in the prior year and who elect to be excluded

Reporting platform operators must file their reports with the CRA by January 31 of the year following the calendar year for which a reportable seller is identified and are required to provide the filed information concerning each reportable seller to them by the same date. A first-time platform operator is required to complete its due diligence obligations by December 31 of the second calendar year in which it is subject to the reporting rules.

Under Canada’s bi-lateral exchange of information and tax treaty agreements, the CRA will automatically provide its partner jurisdictions the information it receives on sellers resident in, and on rental property located, in the partner’s country. The partners will in turn automatically provide such relevant information to the CRA concerning Canadian resident sellers and rental property.

The new reporting rule would apply to calendar years beginning after 2023, with the initial reporting and bi-lateral information exchange occurring in early 2025 with respect to the 2024 calendar year.

Interest coupon stripping

Interest paid or credited to non-arm’s length non-residents is subject to 25 per cent withholding tax under domestic rules. Canada’s treaties generally reduce the withholding tax to 10 per cent or 15 per cent, with Canada’s treaty with the United States being the only treaty to eliminate such withholding tax (with certain exceptions).

The Government is concerned with taxpayers avoiding interest withholding tax on non-arm’s length debt through “interest coupon stripping arrangements”. Generally, this involves a non-resident lender that is related to a Canadian borrower selling its rights to receive the interest payments to a person that would not be subject to withholding tax on the interest payments.

Budget 2022 proposes new rules to deem the Canadian resident borrower to pay the interest to the non-resident lender for withholding tax purposes, attracting the same withholding tax that would apply absent the interest coupon stripping transaction. The new rules would apply where:

- a Canadian resident borrower pays or credits an amount to a person or partnership (interest coupon holder) that is interest on a debt owed to a non-arm’s length non-resident; and
- the amount of withholding tax payable if the amount was paid to the non-resident lender is greater than the actual amount of withholding tax on the amount paid to the interest coupon holder.

The new measure applies to interest paid or payable to an interest coupon holder to the extent that such interest accrued on or after April 7, 2022. If the following conditions are satisfied, the new measure would apply to interest accrued on or after the day that is one year after April 7, 2022:

- the interest is paid on debt incurred by a Canadian resident borrower before April 7, 2022, and
- the interest is paid or payable to an interest coupon holder that deals at arm’s length with the non-resident lender and the interest coupon was acquired as a consequence of an agreement or arrangement entered into before April 7, 2022.

Other tax measures

Tax administration

Budget 2022 proposes $1.2 billion in additional funding over the next five years for the CRA to increase:

- audits specifically targeting larger entities and non-residents engaged in aggressive tax planning
- tax evasion investigation and prosecution of taxpayers engaged in those schemes
- educational outreach

Annual disbursement quota for registered charities

Registered charities are required to meet an annual disbursement quota based on the amount of property not used directly in charitable activities or administration. Budget 2022 proposes increasing this annual disbursement quota from 3.5 per cent to 5 per cent for the portion of property in excess of $1 million.

Budget 2022 also proposes to amend the relief provisions for charities that are unable to meet the annual disbursement quota. The CRA will be permitted to grant a reduction in a charity's disbursement quota for a particular year. The CRA will be permitted to disclose information publicly in relation to this decision. This new relief provision would replace an existing rule that allows a charity to apply to the CRA for permission to exclude from the disbursement quota property they are accumulating for a specific purpose.

Both measures would apply to charities in respect of their fiscal periods beginning on or after January 1, 2023.

Charitable partnerships

Registered charities are currently subject to restrictions requiring their resources to be used for their own charitable activities or for gifts to other qualified donees. Budget 2022 proposes to extend these permissible disbursements to include organizations that are not qualified donees. The disbursements must still further the charity's charitable purpose and the charity will be required to meet several accountability requirements such are pre-grant screening, written agreements and detailed accounting of the use of funds.

This measure will apply upon the enacting legislation having received Royal Assent.

Review of SR&ED program

The government plans to review Canada's Scientific Research and Experimental Development (SR&ED) program to assess its effectiveness in promoting and supporting research and development activities and to modernize and simplify the program.

Review of rollover provisions for small business investments

The government intends to review the tax system as it relates to supporting investments in growing businesses. A review of the rollover rules applicable to small business investments will be part of this initiative.

Employee ownership trusts

After undertaking consultations in 2021 on employee ownership trusts and how they could be used to promote employee ownership and succession of small business, Budget 2022 proposes to create a new Employee Ownership Trust classification within the tax system to promote employee ownership and succession of small businesses. Further consultations with stakeholders will occur as these rules are developed.

Borrowing by defined benefit pension plans

Currently registered pension plans are not permitted to borrow money unless:

- the funds are being used to purchase income-producing real estate, only the real estate is used as security and the loan is not more than the cost of the property; or
- the term of the loan is less than 90 days and the plan assets are not used as security

Budget 2022 proposes to replace the 90-day term limit for defined benefit pension plans other than individual pension plans. The total amount of loans unrelated to real estate purchases will instead be limited to the lesser of 20 per cent of the value of the plan's assets and the amount by which 125 per cent of the plan's actuarial liabilities exceed the value of the plan's assets.

This measure would apply to borrowings on or after April 7, 2022.

Reporting requirements for RRSPs and RRIFs

Budget 2022 proposes to increase the required reporting to the CRA by financial institutions for RRSP and RRIF accounts. Beginning with the 2023 tax year, financial institutions will be required to annually report the total fair market value of RRSP and RRIF accounts as at December 31 in addition to the current reporting of contributions and withdrawals.

Other notable items

More affordable housing

In addition to the personal tax measures proposed to address Canada's housing crisis, the government proposes to provide funding in several affordable housing initiatives to boost housing supply. This includes:

- introducing a new Housing Accelerator Fund to help municipalities and communities create more affordable housing, with a target of 100,000 new units over the next five years
- extending the Rapid Housing Initiative to create at least 6,000 new units in the next two years
- supporting rent-to-own projects including funding to support companies to build new rent-to-own units

Ban on non-resident home purchases

Budget 2022 proposes a two-year ban on non-recreational, residential property purchases by foreign commercial enterprises and persons who are not Canadian citizens or permanent residents as part of the continued efforts to reduce the impact foreign buyers have on Canada's housing market. This ban excludes refugees and emergency relocation situations, certain international students, and individuals on work permits residing in Canada.

Review of corporate investment in residential housing

Budget 2022 announces a federal review of housing as an asset class to examine the possible impacts corporate investment may have on Canada's residential housing market. The review will consider potential tax changes as well as other options to mitigate the potential market impacts of large residential portfolio-holders. Additional details on the review will be provided later in 2022, with preliminary actions announced before the end of the year.

National dental care program

Budget 2022 proposes to provide a national dental care plan for families with less than $90,000 annual household income. The program would be rolled out as follows:

Eligible group	Proposed implementation
Under 12	2022
Age 12 – 17, seniors, and persons living with a disability	2023
Other individuals	2024

Families with annual household income under $70,000 do not need to pay for their dental coverage but those with annual household income between $70,000 and $90,000 would have co-pays.

Fast-tracking beneficial ownership registry for Canadian corporations

Budget 2022 announces a two-year acceleration of the previously announced beneficial ownership registry aimed at enhancing information around beneficial ownership of companies incorporated under the *Canada Business Corporations Act*, meaning it is to be implemented by the end of 2023. The registry is intended to make it more difficult to use shell companies to conceal ownership of assets, or even illegal activities such as money laundering and tax evasion.

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