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Canadian Tax & Legal Alert

2021-2022 federal budget highlights

April 19, 2021

Deputy Prime Minister and Minister of Finance, the Honourable Chrystia Freeland, presented Budget 2021 in the House of Commons on April 19, 2021.

A summary of the tax highlights contained in the budget is provided below.

Deloitte professionals can help you understand how these measures may impact your business. If you have any questions, please reach out to your Deloitte advisor or any of the individuals noted in this alert.

I. C-suite briefing notes

What wasn't there

- Contrary to popular speculation, the Budget does not propose any increases in personal or corporate tax rates, no increases in GST or HST, and there are no new taxes on wealth, inheritances, or capital. There has been no proposed change to the capital gains inclusion rate (which remains at 50%), no change to the lifetime capital gains exemption, and no change to the taxation of the sale of principal residences.

COVID relief

- Extension of the Canada Emergency Wage Subsidy (CEWS) (with a claw-back for periods commencing after June 5, 2021 for certain public companies if there has been an increase in the compensation of certain executives in 2021 by comparison with 2019) and the Canada Emergency Rent Subsidy (CERS) and Lockdown Subsidy through September 25, 2021.

Taxation in the new economy

As signaled, the government has outlined measures to tax the digital economy and has also introduced measures supporting a "green agenda".

Digital

- For large digitally based companies (foreign or domestic), the cost of doing business with Canadian customers will increase as a result of the proposed introduction of a digital services tax (DST) effective for taxation years beginning on or after January 1, 2022. The measure, which is still subject to public consultation, is intended to be temporary pending global consensus on the Organization for Economic Cooperation and Development (OECD)'s Pillar I and Pillar II initiatives (which could be implemented in as few as 3-4 years), this new tax may be short-lived. The draft legislation is expected to be released in the summer of 2021. This measure is similar to steps taken by some other jurisdictions.
- As previously announced, an expanded scope of GST/HST to ensure foreign-based suppliers and digital platforms that supply goods and services register and collect the GST/HST. The effect of this will be to essentially increase the cost of these items to Canadian consumers.

Environment

- Temporarily reduced corporate income tax rates are available for qualifying zero-emission technology manufacturers. The rates are, in essence, half of the Federal rate normally applicable. Accelerated capital cost allowance for clean energy equipment will be available through the expansion of property qualifying for classes 43.1 and 43.2. Related to this, certain assets that use fossil fuels or waste fuels will be removed from these classes.

Other business incentives

Targeted measures have been introduced to stimulate hiring as well as capital investment by Canadian-controlled private corporations (CCPCs).

- As an alternative to the CEWS, additional funding is being made available via the Canada Recovery Hiring Program (CRHP) for privately-owned, Canadian-controlled organizations to help them cover the cost of incremental

remuneration paid from June 5, 2021 to November 20, 2021. Eligible remuneration is capped at $1,129 per employee per week.
- Immediate expensing of up to $1.5 million per year in respect of certain capital property (generally excluding longer life assets and goodwill), acquired by a CCPC, that becomes available for use prior to January 1, 2024.

Restrictions on deductions

As expected, the government introduced certain measures that are consistent with OECD's BEPS initiative recommendations which will, generally, have an impact on larger businesses.

- Interest deductions (not just interest paid to related parties) will be restricted to a fixed percentage of tax determined EBITDA for taxation years beginning on or after January 1, 2023. Generally speaking, this measure is impactful to larger multinational enterprises and may have an impact on capital structures. Importantly, there are no sector specific carve-outs although a group ratio concept may provide relief for sectors that ordinarily have higher leverage ratios. This measure is thematically consistent with provisions in a number of other significant jurisdictions (including the United States). Draft legislation was not provided but is expected to be released for comment this summer.
- New anti-hybrid measures may impact certain cross-border structures (including financing and IP-licensing). The earliest date that these measures will take effect is July 1, 2022. As with the limit on interest deductions, this measure is thematically consistent with provisions in a number of other significant jurisdictions – including the United States and draft legislation was not provided. Draft legislation is expected to be released in two tranches for comment with the first being released later in 2021.

Tax planning, anti-avoidance, and reporting

Continuing a multi-year trend of increasing Canada Revenue Agency (CRA) resources, the government has announced an additional $304.1 million over 5 years for the CRA to further enhance their audit resources, with a further $230 million over 5 years to improve their ability to collect outstanding taxes. A revisit of the general anti-avoidance rule and the transfer pricing provisions had been previously signaled and have the potential to significantly impact future tax planning activities. However, the consultation on mandatory disclosure measures is new and could also, if enacted, have a significant impact on tax planning and tax litigation.

- The government has signaled that the transfer pricing provisions and the general anti-avoidance rule (GAAR) will be revisited. The Budget indicates that the government will release a consultation paper on the transfer pricing rules for comment.
- The government is launching consultations on updated and increased mandatory disclosure rules with a focus on: a) changing the existing reportable transaction rules, b) introducing new disclosure on "notifiable transactions" (which are essentially transactions designated as such by the government), and c) introducing new rules to require certain corporations to report uncertain tax treatments (essentially a reporting requirement where a reserve for a tax position has been reflected in the financial statements).

II. Further Details on Tax Measures

Business income tax measures

- Immediate expensing of certain capital assets acquired by CCPCs (except long life assets included in classes 1 through 6, 14.1, 17, 47, 49, and 51), on up to $1.5 million of capital assets acquired on or after April 19, 2021 and that become available for use before 2024. This $1.5 million is an annual limit to be shared across an associated group of companies, with the limit being prorated for short taxation years.

- **Temporary reduction in the corporate tax rate for the manufacture of zero-emission technology** to 7.5% where the general corporate tax rate of 15% would otherwise have applied, and 4.5% where the small business tax rate would otherwise have applied. The reduced rates will be in place from 2022 through 2028, after which they will progressively increase to return to levels equal to the otherwise applicable rates in 2032 and later. Additional measures related to classes of clean energy equipment were also introduced, expanding the nature of assets eligible for inclusion in classes 43.1 and 43.2, and thereby eligible for accelerated capital cost allowance.

- **Proposed mandatory disclosure rules related to reportable transactions, notifiable transactions, and uncertain tax positions will be expanded and/or introduced**.

  In an effort to align to BEPS Action 12, this is expected to have the effect of increasing the number of transactions required to be reported and making those transactions reportable within 45 days by both the taxpayer and the promoter or advisor. Notifiable transactions would include both transactions that the CRA has found to be abusive and transactions identified as transactions of interest.

  There will be a requirement to report uncertain tax positions for certain corporations where there is a difference in tax position reported in the tax return of the corporation versus the audited financial statements (particularly situations where the corporation has concluded that it is not probable that a particular tax treatment is sustainable).

  The rules would also include an extension of the normal reassessment period, along with both taxpayer and promoter/advisor penalties for failures to report transactions.

  Public consultations will be undertaken in respect of these proposals.

- **Introduction of provisions to address the avoidance of tax debts**, including modifications to non-arm's length status for these purposes and the introduction of penalties for planners and promoters of tax debt avoidance strategies.

- **Modifications to the authority of CRA to compel persons to answer all proper questions raised**, including providing the authority to require them to respond to questions orally or in writing in any form specified by the CRA official. These changes are in response to certain court decisions that could otherwise have limited CRA's ability to require oral responses to questions.

- **Temporary extension for timelines associated with the Canadian Film or Video Production Tax Credit**, providing a 12-month extension to periods for requirements such as the period to incur qualifying expenditures and the deadline to submit a certificate of completion.

- **Reform of Canada's transfer pricing rules** to prevent the shifting of corporate income out of Canada. Although the budget indicates that Canada has accepted the new transfer pricing guidance developed by the OECD, recent court decisions have caused concerns with the application of the existing legislation. The budget indicates that a consultation paper outlining possible changes to existing transfer pricing rules will be released in the coming months.

- The **CEWS program** is extended for the period from June 6, 2021 to September 25, 2021 with the possibility to extend until November 20, 2021 if required by the circumstances. For this extension period, the subsidy rates will gradually decrease from July 4, 2021.

The budget also proposes to require a **publicly listed corporation to repay wage subsidy amounts received after June 5, 2021** if the total 2021 calendar compensation for specified executives exceeds the total compensation for specified executives during the 2019 calendar year. The amount of the subsidy to be reimbursed would be the lesser of the total of all CEWS received after June 5, 2021 or the amount of total compensation for specified executives for 2021 that exceeds the total compensation for specified employees for 2019. Compensation is as reflected in certain regulatory filings and caution should be exercised relative to the impact of stock options and other non-cash compensation including pension benefits.

- **Extension of the CERS program** for the period from June 6, 2021 to September 25, 2021 with the possibility to further extend until November 20, 2021 if required by the circumstances.

  For the extension period, the **subsidy rates will be gradually decreased with the base subsidy rate phased out as of July 4, 2021**. **Lockdown Support will remain at 25%**. Organizations will only be entitled to CERS and Lockdown Support if they have a revenue reduction of more than 10%.

- **Introduction of the Canada Recovery Hiring Program (CRHP)** to support Canadian businesses and provide a subsidy of up to 50% on the incremental remuneration paid to eligible employees between June 6, 2021 and November 20, 2021.

  Eligibility –CCPCs, non-profit organizations, registered charities, and certain partnerships who would otherwise be eligible to the CEWS will qualify. Eligible employees must be employed primarily in Canada through the qualifying period. The types of eligible remuneration will be the same as those for CEWS.

  Subsidy amount – For an eligibility period, the hiring subsidy will correspond to the additional remuneration of an eligible employer multiplied by the rate of the subsidy for that eligibility period, if its revenue reduction exceeds zero per cent for the period of June 6, 2021 to July 3, 2021, and 10%, for the period from July 4, 2021 to November 20, 2021.

- *Deadline* – As is the case for CEWS, claims for the hiring subsidy for an eligibility period must be submitted no later than 180 days after the end of the qualifying period. Finally, for a qualifying period, an eligible employer would be permitted to claim either the hiring subsidy or CEWS, but not both.

Indirect tax measures

- **Expand the scope of GST/HST** to ensure foreign-based suppliers and digital platforms that facilitate supplies of tangible personal property, services, intangible personal property or short-term accommodation register and collect the GST/HST. Budget 2021 proposes the following additional amendments to those proposed by the Department of Finance Canada on November 30, 2020 (as detailed here):

    - Where platform operators are required to collect GST/HST on supplies they facilitate for foreign suppliers not registered under the regular GST/HST regime, Budget 2021 imposes solidary liability on the platform operator and third-party supplier, should the third-party supplier provide false information to the platform operator. Further, the platform operator is limited in terms of liability for failure to collect and remit tax, if the platform operator reasonably relied on the information provided by a third-party supplier.
    - Suppliers registered under the specified GST/HST regime are eligible to deduct amounts for bad debts and certain HST point-of-sale rebates to purchasers. Further, certain institutions (such as public libraries) are eligible to claim a rebate for GST paid on audiobooks acquired from suppliers registered under the specified GST/HST regime.
    - The calculation of the $30,000 threshold over a 12-month period used to determine if a person is required to register under the specified GST/HST regime does not include GST/HST free (such as zero-rated) supplies.

- Requiring a platform operator that facilitates a supply of a short-term accommodation situated in Canada or a sale by a non-registered vendor of goods that are located in a fulfillment warehouse in Canada to file an annual information return, will only be applicable to platform operators registered or required to be registered for GST/HST purposes.
- Providing the Minister of National Revenue (Minister) the authority to register a person who should be under the specified GST/HST regime. This measure matches the existing authority given to the Minister under the general GST/HST regime.
- **The date of implementation of these measures remains July 1, 2021.** However, the CRA will work closely with businesses and platform operators subject to these rules to assist in meeting their obligations. Given this, where businesses and/or platform operators show that they have taken reasonable measures but are unable to meet their new obligations for operational reasons, the CRA commits to taking a practical approach to compliance and will exercise discretion in administering these measures during a 12-month transition from July 1, 2021. It is unclear at this time what "reasonable measures" are intended to cover.

- **Increasing the current input tax credit (ITC) information thresholds** to \$100 (from \$30) and \$500 (from \$150), to ease the burden of information required for claiming ITCs. This measure would come into force on April 20, 2021.

- **Allowing a recipient to claim an ITC**, provided it has the billing agent's GST/HST registration number and/or business name (same as the current rules for intermediaries), rather than requiring the recipient of the supply to obtain the business name and registration number of the underlying vendor. This measure would come into force on April 20, 2021.

- **Introduction of the GST New Housing Rebate,** which removes the condition that where two or more individuals buy a new home together, each of them must be acquiring the home for use as their primary place of residence or the primary place of residence of a relation. The rebate is proposed to be available as long as the new home is acquired for use as the primary place of residence of any one of the purchasers or a relation of any one of the purchasers.
    - Further, beyond the availability of the GST New Housing Rebate for new homes purchased from a builder, the rebate is proposed to be available in respect of owner-built homes, co-op housing shares and homes constructed on leased land. The proposed change would also apply to new housing rebates in respect of the provincial component of the HST.
    - This measure would apply to a supply made under an agreement of purchase and sale entered into after April 19, 2021. However, in the case of a rebate for owner-built homes, the measure would apply where construction or substantial renovation of the residential complex is substantially completed after April 19, 2021.

- **Creation of a new joint election mechanism for a province that does not have a Reciprocal Tax Agreement** (i.e., New Brunswick and Alberta) with the vendor to apply for the provincial-use rebate from the embedded federal excise tax on motive fuels, car air conditioners and fuel inefficient vehicles. If the election is not made, then only the province can apply for the rebate. This measure would apply in relation to these goods purchased or imported by a province on or after January 1, 2022.

- **Increasing various tobacco and tobacco product excise duty rates** effective April 20, 2021.

- **Introduce federally a vaping tax** similar to excise taxes imposed or proposed in a number of provinces across Canada including British Columbia, Nova Scotia, and Alberta. The proposed legislative changes are not yet in draft but are proposed to be introduced in 2022. The Government has requested input from stakeholders on these proposals by June 30, 2021.
    - The new excise duty is proposed to mirror the legislation already set out within the Excise Act, 2001 for duties applied on tobacco, wine, spirits, and cannabis products and would require manufacturers and importers to obtain an excise licence to sell these products in Canada. A stamp regime, as already in place in the tobacco, wine, spirits and cannabis industries, is proposed. The proposed framework considers

imposing a single flat rate duty of up to $1.00 per 10 millilitres of vaping liquid held in each pod or in each container.
    - The introduction of this vaping excise duty would put these products more in line with other products of the same nature. Further, there has been some confusion in the provinces as to whether vaping products would be classified as a vaping product or a heated tobacco product. In this case, taxing the vaping liquid as opposed to the pod/product in which the vaping liquid is used may help assist in defining where the product fits within these classifications and assist where provincial authorities have shown inconsistency.

- **Introduction of a tax on the retail sale of new luxury cars and personal aircraft priced over $100,000, and boats priced over $250,000.** For vehicles and aircraft priced over $100,000, the amount of the tax would be the lesser of 10% of the full value of the vehicle or the aircraft, or 20% of the value above $100,000. Further, for boats priced over $250,000, the amount of the tax would be the lesser of 10% of the full value of the boat or 20% of the value above $250,000. Upon purchase or lease, the seller or lessor would be responsible for remitting the full amount of the federal tax owing, regardless of whether the good was purchased outright, financed, or leased over a period. The GST/HST would apply to the final sale price, inclusive of the proposed tax. The effective date is proposed to be January 1, 2022. Further details will be announced in the coming months.

- **Amendments to the Customs Act and Regulations** that are intended to promote fairness and level the playing field with respect to the determination of the customs value of imported goods. The changes will reportedly be designed to ensure that importers value goods based on the "last" sale-for-export to a "purchaser-in-Canada". While the current regulations, and specifically the "purchaser-in-Canada" provisions, are structured to try and achieve such results currently, these rules have been the subject of significant audit activity and jurisprudence over the past several years and it is anticipated that the changes will be aimed at tightening the rules to align with the Canada Border Services Agency (CBSA) administrative policies and practices.

- **Regulatory amendments to support modernization efforts of the CBSA** to coincide with the implementation of key functionalities of the CBSA Assessment and Revenue Management (CARM) initiative. Under CARM, importers will face a number of changes related to the assessment and payment of duties and taxes to CBSA, including changes to security or bond requirements, billing and payment cycles, as well as correction and adjustment periods. Many of these changes are currently targeted to take effect in May 2022 and the proposed changes would seemingly seek to align the regulatory provisions to the modernization efforts to be implemented under CARM.

International tax measures

Consistent with the BEPS action plan recommendations drawn up by the OECD, the budget proposes certain measures related to the interest deductibility limits and to address hybrid mismatch arrangements.

- **New earnings-stripping rule** to limit the amount of net interest expense (or economically equivalent amounts) that may be deducted in computing taxable income to no more than a fixed ratio of tax EBITDA.
    - To be phased in, with a fixed ratio of 40% for taxation years beginning on or after January 1, 2023 and 30% for taxation years beginning on or after January 1, 2024.
    - Non-taxable dividend income to be excluded from the determination of tax EBITDA.
    - Existing interest deductibility restrictions continue to apply, including the thin capitalization rules.
    - Interest on debts between Canadian members of a corporate group is generally excluded from the new rule in order to facilitate loss consolidation transactions.
    - Exemption for certain taxpayers: in particular, CCPCs (and any associated corporations) with taxable capital employed in Canada of less than $15 million, and groups with total net interest expense of $250,000 or less.
    - Denied interest can be carried forward (20 years) or backward (3 years) under certain conditions.

- Possibility to transfer unused capacity between Canadian group members that have a net interest ratio lower than the fixed ratio.
- Inclusion of a "group ratio" rule to allow the deduction of interest in excess of the fixed ratio where the group has a ratio of net third party interest to accounting EBITDA that implies a higher deduction limit is appropriate. This is expected to provide relief for certain industries as well as for most purely domestic enterprises.
- Draft legislation to be released during the summer for comment.

- **New rules aimed at hybrid mismatch arrangements** to be modelled on Action 2 of the BEPS action plan.
  - Payments made under a hybrid mismatch arrangement would not be deductible for Canadian income tax purposes if the amounts are deductible in another country or are not included in the income of a non-resident recipient. Similarly, payments received under a hybrid mismatch arrangement would be included in income and, if the payment is a dividend, would not be eligible for the deduction otherwise available for certain dividends received from foreign affiliates.
  - Rules to implement other Action 2 recommendations – such as branch mismatch arrangements, imported mismatch arrangements, and reverse hybrids – may be introduced to the extent relevant and appropriate in the Canadian context.
  - To be implemented in two separate legislative packages. The first would address deduction/non-inclusion mismatches arising from payments in respect of financial instruments (to be released for comment during 2021 and would apply as of July 1, 2022). The second would address other Action 2 recommendations not addressed in the first package (to be released for comment after 2021 and would apply no earlier than 2023).

- **New digital services tax (DST)** of an interim nature until the entry into force of a multilateral approach.
  - Applies at a rate of 3% on revenues collected in connection with certain digital services which is dependent on participation, data and content contributions from Canadian users.
  - Applies to revenue from services provided through online marketplaces, social media, and online advertising.
  - Applies to an entity (or member of a business group) which meets both of the following two thresholds:
    - Global income of 750 million euros or more in the previous calendar year; and
    - In-scope revenue associated with Canadian users of $20 million or more in the given calendar year.
  - Effective date of January 1, 2022.
  - Draft legislation to be released during the summer for comment.

Personal tax measures

The budget does not contain significant measures impacting personal taxes. Highlights include:

- Improving access to the **Disability Tax Credit** and enhancing the **Canada Workers Benefit**.

- Expanding access to the **Northern Residents Deduction** to certain individuals who live in prescribed northern areas of Canada; this measure would take effect starting with the 2021 tax year.

- **Tax treatment of COVID-19 benefit amounts** to allow individuals the option to claim a deduction in respect of the repayment of a COVID-19 benefit amount in computing their income for the year in which the benefit amount was received rather than the year in which the repayment was made. This measure will minimize cash flow issues for individuals and would be available once they have repaid the benefit. For these purposes, COVID-19 benefits would include:

- Canada Emergency Response Benefits/Employment Insurance Emergency Response Benefits;
- Canada Emergency Students Benefits;
- Canada Recovery Benefits;
- Canada Recovery Sickness Benefits; and
- Canada Recovery Caregiving Benefits.

- **Creation of a 1% tax on the value of vacant or "underused" residential property owned by a non-resident non-Canadians**, taking effect in 2022. Disclosure requirements related to Canadian residential property will take effect in 2023, requiring non-resident non-Canadians to disclose the address, value, the owner's interest in the property, and other information. Additional details related to the parameters of the new tax and disclosure obligations, such as the definition of a residential property and implications of co-ownership, will be released at a later date.

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