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Tax Alert – Canada

Finance releases draft legislation for 2021 budget measures

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 4 February 2022, the Department of Finance released for public comment draft legislative proposals (and accompanying explanatory notes) to implement most of the remaining measures from the 2021 federal budget, postpone application of previously announced measures pertaining to new reporting requirements for trusts, introduce amendments relating to allocations to redeemers by mutual fund trusts (including extending the rules to mutual fund trusts that are exchange-traded funds), introduce rules respecting the application of GST/HST to crypto asset mining, and make certain other technical amendments.

Certain of the remaining 2021 federal budget proposals are not included, such as those concerning the hybrid mismatch rules; the tax incentive for carbon capture, utilization and storage; the GST/HST input tax credit information requirements; the rebate of excise tax for goods purchased by provinces; the excise duty on vaping products; the tax on select luxury goods; and the measures to improve duty and tax collection on imported goods. Interested parties are invited to provide comments on the proposed amendments by various dates specified below.

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The following is a summary of the income tax measures included in the package of draft legislative proposals.

Business income and international tax measures

- **Rate reduction for zero-emission technology manufacturers —** Temporary reduction in the corporate income tax rate for qualifying zero-emission technology manufacturers, applicable for taxation years beginning after 2021. Specifically, a reduced tax rate of 7.5% will apply to eligible zero-emission technology manufacturing and processing (M&P) income that would otherwise be subject to the 15% general corporate income tax rate, and a reduced tax rate of 4.5% will apply to eligible zero-emission technology M&P income that would otherwise be subject to the 9% small-business corporate income tax rate. The reduced tax rates will be gradually phased out for taxation years beginning in 2029 and fully phased out for taxation years beginning after 2031. For a taxpayer to qualify for the reduced rates, at least 10% of the taxpayer's gross revenue from all active businesses carried on in Canada must be derived from eligible zero-emission technology M&P activities. Eligible zero-emission technology M&P activities (from which eligible income must be derived) will include activities such as the manufacturing of energy conversion equipment (e.g., solar, wind, water and geothermal equipment), most manufacturing activities related to zero-emission vehicles (including batteries, fuel cells and charging stations), and activities in connection with the production of hydrogen by electrolysis of water, as well as of gaseous, liquid and solid biofuel. Income eligible for the reduced tax rates will be calculated based on the proportion of a taxpayer's total labour and capital costs that are used in eligible zero-emission technology M&P activities. (If that proportion is 90% or more, the proportion will be deemed to be 100%.)

- **Immediate expensing —** Temporary expansion of assets eligible for immediate expensing, of up to a maximum of $1.5 million per taxation year, for certain property that is acquired by a Canadian-controlled private corporation (CCPC) after 18 April 2021 and becomes available for use before 1 January 2024, or, as per new amendments, that is acquired by a Canadian-resident individual (other than a trust) or a Canadian partnership (all the members of which are CCPCs or Canadian-resident individuals (other than a trust)) after 31 December 2021 and becomes available for use before 1 January 2025 (or before 1 January 2024 for partnerships of which all the members are CCPCs). Assets eligible for immediate expensing include all assets subject to the capital cost allowance (CCA) rules, with the exception of property included in Classes 1 to 6 (e.g., buildings), 14.1 (e.g., goodwill), 17 (e.g., electrical generating equipment), 47 (e.g., transmission/distribution of electrical energy equipment), 49 (e.g., oil and gas pipelines), and 51 (e.g., pipelines). Immediate expensing is available in the year in which eligible property becomes available for use. The $1.5 million limit per taxation year must be shared among members of a group of associated CCPCs and prorated for short taxation years. No carryforward will be available if the full $1.5 million amount is not used in a particular taxation year. Taxpayers will be able to choose whether particular eligible assets are immediately expensed under this new measure or subject to regular CCA rates, and other enhanced CCA rates will continue to apply (provided the total CCA deduction does not exceed the capital cost of the property). Certain restrictions that apply under CCA rules (such as for limited partners, specified leasing property, etc.) also apply for the purpose of immediate expensing. In addition, property that has been used, or acquired for use, for any purpose before being acquired by the taxpayer is eligible for the immediate expensing if conditions

similar to those currently enacted for accelerated investment incentive property under Regulation 1104(4)(b) are met. Finally, as per new amendments, a special rule (paralleling the special recapture rule introduced for zero-emission vehicles in 2019) is introduced for passenger vehicles that are included in Class 10.1 and designated for immediate expensing.

- **Accelerated CCA for clean energy equipment** — Expansion of CCA Classes 43.1 and 43.2 to include additional types of clean energy equipment, applicable to property that is acquired and becomes available for use on or after 19 April 2021, provided it has not been used or acquired for use before this date. In addition, certain property that becomes available for use after 2024 will be removed from Classes 43.1 and 43.2, and a heat rate threshold will be introduced in the classes' eligibility conditions for specified waste-fuelled electrical generation systems, to ensure the incentive provided by these two classes remains consistent with the government's environmental objectives.

- **Film or video production tax credits** — Temporary extension of certain time limits in respect of the Canadian film or video production tax credit (CPTC) and film or video production services tax credit (PSTC), applicable for productions for which eligible labour expenditures are incurred in taxation years ending in 2020 or 2021. Specifically, for the CPTC, a 12-month extension will be provided with respect to the periods within which qualifying expenditures may be incurred before principal photography begins, a certificate of completion must be submitted, and the production must be shown in Canada under a written agreement. For the PSTC, a 12-month extension will be provided for the period within which aggregate expenditure thresholds must be met. Taxpayers will be required to file a waiver of the assessment period for relevant taxation years to take advantage of these extensions.

- **Interest deductibility limit** — Introduction of a new earnings-stripping rule that will limit the amount of net interest expense that a corporation may deduct in computing taxable income to no more than a fixed ratio of tax EBITDA. In general terms, "tax EBITDA" is a corporation's taxable income before taking into account interest income and expenses, income tax, and deductions for depreciation and amortization, as determined for tax purposes; tax EBITDA would also exclude dividends that qualify for the intercorporate dividend deduction or the deduction for certain dividends received from foreign affiliates. Taxpayers subject to this new rule will generally include Canadian corporations, trusts, corporate or trust members of partnerships, and Canadian branches of non-resident corporations; however, it will not apply to CCPCs that, together with any associated corporations, have taxable capital employed in Canada of less than $15 million or to groups of corporations or trusts that have aggregate net interest expense among Canadian members of $250,000 or less. Interest expense and interest income for the purposes of this new rule will include certain payments that are economically equivalent to interest, as well as certain financing-related amounts, but will generally exclude amounts relating to debts owing between Canadian members of a corporate group and interest expense amounts that are not deductible under existing income tax rules (such as the thin capitalization rules). To provide for a transitional period, the new earnings-stripping rule will be phased in with a fixed ratio of 40% of tax EBITDA for taxation years beginning on or after 1 January 2023, but before 2024, and a fixed ratio of 30% for taxation years beginning on or after 1 January 2024. In addition, a "group ratio" will allow a taxpayer to deduct interest in excess of the fixed ratio where the taxpayer is able to demonstrate that

the ratio of net third-party interest expense to book EBITDA of its consolidated group supports a higher deduction limit. For this purpose, a consolidated group will include a parent company and all its subsidiaries that are fully consolidated into the parent's audited consolidated financial statements. In broad terms, the amount of any interest expense that is denied under the new earnings-stripping rule will be able to be carried forward for up to 20 years or carried back for up to three years (including to taxation years prior to the rule becoming effective). Conversely, Canadian members of a group that have a ratio of net interest expense to tax EBITDA below the fixed ratio will generally (with the exception of relevant financial institutions) be able to transfer the interest deduction unused capacity to other Canadian members of the group whose net interest expense deductions would otherwise be limited by the new rule. This new rule will apply for taxation years beginning on or after 1 January 2023 (subject to anti-avoidance rules), with respect to both new and existing borrowings.

- **Mandatory disclosure rules** — Introduction of new rules to enhance Canada's mandatory disclosure requirements and give the Canada Revenue Agency (CRA) earlier access to relevant information on aggressive tax planning or transactions, including the following changes, which are also described in the Department of Finance Backgrounder – Mandatory disclosure rules:

  - **Reportable transactions** — Amendments to the existing rules regarding reportable transactions to increase the effectiveness of these rules and make them consistent with international leading practices. Specifically, the definition of "avoidance transaction" for the purposes of these rules will be amended so that a transaction will be considered an avoidance transaction if it can reasonably be concluded that one of the main purposes of entering into the transaction was to obtain a tax benefit. Amendments will also be made so that only one of the additional conditions (or hallmarks) for reportable transactions will need to be met for a transaction to be reportable (instead of two conditions under the existing rules). Further amendments will require a taxpayer who enters into a reportable transaction, or another person who enters into a reportable transaction in order to obtain a tax benefit for the taxpayer, to report the transaction within 45 days of the earlier of the day that the taxpayer or other person becomes contractually obligated to enter into the transaction and the day the taxpayer or other person enters into the transaction. Reporting within the same time limits will also be required by a promoter or advisor of a scheme (or other person who does not deal at arm's length with a promoter or advisor and who receives a fee with respect to the scheme) that would be a reportable transaction if it were implemented; an exception to this rule is provided for advisors to the extent of solicitor-client privilege.

  - **Notifiable transactions** — Amendments to provide the Minister of National Revenue with the authority to designate "notifiable transactions," which would include types of transactions that the CRA has found to be abusive, as well as transactions of interest. Taxpayers who enter into a notifiable transaction (or other persons who enter into notifiable transactions for the benefit of a taxpayer), as well as promoters or advisors of a scheme (or other non-arm's length persons who receive a fee with respect to the scheme) that would be a notifiable transaction if implemented, will be required to report the transaction (or series of transactions) within the same time limits listed above for reportable transactions (an exception will be provided for advisors to the

extent of solicitor-client privilege). Samples of notifiable transactions that fall into the following six categories of transactions have been provided for consultation in the Department of Finance Backgrounder - Income tax mandatory disclosure rules consultation: Sample notifiable transactions:

1. Manipulating CCPC status to avoid anti-deferral rules applicable to investment income (e.g., avoiding "Canadian corporation" status through foreign continuance)
2. Straddle loss creation transactions using a partnership
3. Avoidance of deemed disposal of trust property (e.g., indirect transfer of trust property to another trust)
4. Manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation
5. Reliance on purpose tests in section 256.1[1] to avoid a deemed acquisition of control
6. Back-to-back arrangements intended to circumvent the application of the thin capitalization rules or Part XIII withholding tax

A notifiable transaction will be a transaction that is the same as, or substantially similar to, a designated transaction in the Backgrounder, or a transaction in a series of transactions that is the same as, or substantially similar to, a designated series of transactions in the Backgrounder. Moreover, for these purposes, any transaction or series of transactions that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or a similar tax strategy will be considered to be substantially similar, which is to be interpreted broadly in favour of disclosure.

- **Uncertain tax treatments** – Introduction of a requirement for specified corporate taxpayers to report particular uncertain tax treatments to the CRA. In general terms, an uncertain tax treatment is a tax treatment used, or planned to be used, in an entity's income tax filings for which there is uncertainty over whether the tax treatment will be accepted as being in accordance with tax law. Under the proposed new rules, a corporation will generally be required to report an uncertain tax treatment if the corporation is required to file a Canadian income tax return for the taxation year, the corporation has at least $50 million in assets at the end of the last financial year (that ends before the end of the taxation year or that coincides with the taxation year), and the corporation or a related corporation has audited financial statements (prepared in accordance with International Financial Reporting Standards or other country-specific generally accepted accounting principles relevant for domestic public companies) in which uncertainty in respect of the corporation's Canadian income tax for the taxation year is reflected. Prescribed information in respect of uncertain tax treatments (e.g., quantum of taxes at issue) will be required to be reported at the time that a corporation's Canadian income tax return is due.

- **Reassessment periods** – Amendments to provide that where a taxpayer has a mandatory disclosure requirement in respect of a transaction relevant to the taxpayer's income tax return for a taxation year, the taxpayer's normal reassessment

[1] Unless otherwise specified, references are to provisions of the *Income Tax Act.*

period will not commence in respect of the transaction until the taxpayer has complied with the reporting requirement.

- **Penalties** — Introduction of penalties for non-compliance with mandatory disclosure requirements. For reportable or notifiable transactions, a penalty of $500 per week, up to a maximum of the greater of $25,000 and 25% of the tax benefit, will apply for the failure to report a transaction by a taxpayer who enters into the transaction or who receives a tax benefit as a result of the transaction. For corporations that have assets with a total carrying value of $50 million or more, this penalty is increased to $2,000 per week, up to a maximum of the greater of $100,000 and 25% of the tax benefit. For promoters or advisors of reportable or notifiable transactions (or other persons who do not deal at arm's length with promoters or advisors and who receive a fee in respect of the transaction), the penalty for each failure to report a transaction will be equal to the total of $10,000, 100% of the fees charged by the promoter or advisor (or other person), and $1,000 per day, up to a maximum of $100,000, for each day the failure continues. For corporations required to report uncertain tax treatments, the penalty for each failure to report a particular treatment will be $2,000 per week, up to a maximum of $100,000.

These new rules on mandatory disclosures are intended to be effective in 2022 (i.e., either for taxation years beginning after 2021 or for transactions entered into after 2021); penalties will not apply, however, to transactions that occur before Royal Assent of the enacting legislation.

- **Avoidance of tax debts** — Introduction of new rules to address abusive arrangements designed to avoid joint and several liability for tax on non-arm's length transfers of property for insufficient consideration, as well as implement a penalty for planners and promoters of such schemes. Specifically, new anti-avoidance rules will be introduced to deem a tax debt to have arisen before the end of the taxation year in which property is transferred (if certain conditions are met), deem a transferor and transferee not to be dealing at arm's length (if certain conditions are met), and require the overall result of a series of transactions to be considered in determining the value of the property transferred and the consideration given for the property. In addition, a new penalty will be introduced for planners and promoters of tax debt avoidance schemes, equal to the lesser of 50% of the tax that is attempted to be avoided and $100,000 plus compensation received for the scheme. These new rules, which are also similarly introduced to comparable provisions in the *Excise Tax Act*, the *Excise Act, 2001*, and Part 1 of the *Greenhouse Gas Pollution Pricing Act,* will apply in respect of transfers of property that occur on or after 19 April 2021.

- **Electronic filing, payment, signature and correspondence requirements** — Changes to electronic filing, payment, signature and correspondence requirements, including the following:

  - **Electronic correspondence** — Change in the default method of correspondence to electronic only for businesses that use the CRA My Business Account online portal, effective on Royal Assent of the enacting legislation. However, businesses will still be able to choose to receive paper correspondence (provided the request is made with 30 days notice and in the prescribed manner). Similar changes will apply for the purposes

of the *Excise Tax Act*, the *Excise Act, 2001*, the *Air Travellers Security Charge Act*, and Part 1 of the *Greenhouse Gas Pollution Pricing Act*. Minor amendments are also made in respect of electronic notices sent to individuals to take into account changes to an individual's email address, effective on Royal Assent of the enacting legislation.

- **Electronic filing thresholds for income tax returns** — Elimination of the mandatory electronic filing threshold for corporate income tax returns for taxation years beginning after 2021, so that most corporations will be required to file returns electronically and not just those with gross revenue in excess of $1 million. Tax preparers will also be required to file returns electronically if, for a calendar year, they prepare more than five corporate income tax returns (reduced from 10 returns per year), more than five personal income tax returns (reduced from 10 returns per year), or more than five estate or trust income tax returns (new requirement), effective for calendar years after 2021. Mandatory electronic filing thresholds for GST/HST registrants (other than charities or selected listed financial institutions) are also eliminated for reporting periods beginning after 2021.

- **Electronic notice of assessment** – New rules that allow the Minister of National Revenue to provide a notice of assessment electronically to either an individual who filed their personal income tax return electronically or a tax preparer that filed the individual's personal income tax return electronically on behalf of the individual. The notice of assessment is presumed to have been sent to the individual and received by the individual on the day that it is made available, using electronic means, to the individual or the tax preparer. This measure is effective on 1 January 2023.

- **Electronic filing and issuance requirements for information returns** — Reduction in the mandatory electronic filing threshold for income tax information returns, from 50 to five returns of a particular type for a calendar year, applicable for information returns filed after 2021. Consequential amendments are made to the applicable penalty for failure to file information returns in the appropriate manner. In addition, issuers of T4A, *Statement of Pension, Retirement, Annuity, and Other Income*, and T5, *Statement of Investment Income*, information returns will be able to provide them to taxpayers electronically, without having to also prepare a paper copy or obtain taxpayer authorization, for information returns issued after 2021.

- **Electronic payments** — Amendments to require electronic payments for remittances made under the *Income Tax Act* that are over $10,000 (unless the payer or remitter cannot reasonably satisfy this requirement), applicable to payments made on or after 1 January 2022. Failure to comply with this requirement will result in a penalty of $100 for each such failure. In addition, the threshold for mandatory remittances to be made at a financial institution under the GST/HST portion of the *Excise Tax Act*, the *Excise Act, 2001*, the *Air Travellers Security Charge Act*, and Part 1 of the *Greenhouse Gas Pollution Pricing Act* is lowered from $50,000 to $10,000 (unless the payer or remitter cannot reasonably satisfy this requirement). As well, other amendments clarify that payments required to be made at a financial institution include online payments made through a financial institution, applicable to payments made on or after 1 January 2022.

- **Electronic signatures** — Elimination of the requirement for handwritten signatures on the following forms that are prescribed under the *Income Tax Act*: Form T183CORP, *Information Return for Corporations Filing Electronically* (as well as Form T183 for individuals), and Form T2200, *Declaration of Conditions of Employment*, effective on Royal Assent of the enacting legislation.

- **Audit authorities** — Amendments to ensure that the CRA has the authority to require persons to answer all proper questions (orally or in writing) and provide all reasonable assistance to CRA officials for any purpose related to the administration or enforcement of the *Income Tax Act*. These amendments, which will also similarly apply to the *Excise Tax Act*, the *Excise Act, 2001*, the *Air Travellers Security Charge Act*, and Part 1 of the *Greenhouse Gas Pollution Pricing Act*, apply on Royal Assent of the enacting legislation.

Measures concerning trusts

- **Mutual funds: allocation to redeemers methodology** — Amendments relating to previously enacted rules that ensure that any capital gains realized by a mutual fund trust in a taxation year in excess of the capital gains realized by redeeming unitholders in that year are taxed in that year either at the mutual fund trust level or in the hands of the remaining unitholders. These rules deny a mutual fund trust a deduction in respect of the portion of an allocation made to a unitholder on a redemption of a unit of the mutual fund trust that is greater than the capital gain that would otherwise have been realized by the unitholder on the redemption, if the allocated amount is a capital gain and the unitholder's redemption proceeds are reduced by the allocation. Specifically, the amendments expand application of the rules to deny the deduction of certain amounts allocated to beneficiaries that have redeemed units of a mutual fund trust that is an exchange-traded fund or a fund that offers both listed and unlisted units (a "combined fund"), including consequential amendments to the qualifying exchange rules in section 132.2, as well as prevent unintended consequences (relating to a mutual fund trust's capital gains refund mechanism and the new rules for exchange-traded funds and combined funds) that may result from the application of existing rules in paragraph 107(2.1)(c). These measures apply to taxation years of mutual fund trusts that begin after 15 December 2021.

- **Trust reporting requirements** — Updated measures requiring the filing of a trust return as well as the provision of additional beneficial ownership information for express trusts, with some exceptions, and to impose new penalties for failing to file a trust return (including any required beneficial ownership information) in these circumstances or making a false statement or omission in a return. New amendments extend these reporting requirements to bare trusts, expand the list of trusts excluded from application of the new reporting requirements to include a trust for which all the units are listed on a designated stock exchange, and clarify that the disclosure of information that is subject to solicitor-client privilege is excluded from the new reporting requirements. In addition, the application date has been updated to postpone implementation of the new reporting rules; the new requirements will now apply to taxation years ending after 30 December 2022. As a result, for trusts with a calendar year-end, these rules will apply beginning with their 2022 taxation year instead of with their 2021 taxation year as previously proposed.

Personal and other income tax measures

- **Disability tax credit** — Various amendments to improve access to the disability tax credit (DTC) and other tax-related measures that require a DTC certificate. Specifically, the amendments expand the list of "mental functions necessary for everyday life", reduce the requirement for therapy to be administered at least three times each week to two times each week, expand and clarify the list of activities allowed to be counted as time spent receiving "life-sustaining therapy" to recognize certain components of therapy that are excluded under current rules, and allow time required by another person to assist in the therapy to be counted where an individual is incapable of performing therapy on their own. These amendments apply to the 2021 and subsequent taxation years in respect of DTC certificates (described in paragraphs 118.3(1)(a.2) or (a.3)) that are filed with the Minister of National Revenue after the enacting legislation receives Royal Assent.

- **Post-doctoral fellowship income: earned income** — Inclusion of postdoctoral fellowship income in "earned income" for the purpose of determining an individual's contribution limit for a registered retirement savings plan (RRSP). This change applies in respect of postdoctoral fellowship income received in 2021 and subsequent years, and a taxpayer may also request (by filing an election before 2026) an adjustment to their RRSP contribution room in respect of postdoctoral fellowship income received from 2011 to 2020.

- **Taxes applicable to registered investments** — Amendments to provide for a more equitable method of applying the Part X.2 penalty tax to trusts or corporations that are registered investments. The tax is currently applied without consideration to the extent registered plans are invested in units or shares of the registered investment. The amendments will prorate any Part X.2 tax, limiting it to the proportion of the registered investment held by registered accounts. This amendment generally applies after 2020. However, it may also apply retroactively to any month prior to 2021, provided that before 20 April 2021 no notice of assessment for Part X.2 tax had been sent to the taxpayer for the pre-2021 months, or the taxpayer had rights of objection or appeal on 20 April 2021 in respect of an assessment issued for the pre-2021 months.

- **April 2020 one-time additional GST/HST credit payment** — Retroactive technical amendment to correct the formula relating to the one-time COVID-19 relief provided through a special one-time additional payment under the GST/HST credit rules (effective retroactive from 25 March 2020).

- **Defined contribution pension plans** — Amendments to permit plan administrators of defined contribution pension plans to correct certain contribution errors, applicable in respect of additional contributions made, and amounts of overcontributions refunded, in 2021 and later years.

- **Revocation tax rules applicable to charities** — Amendments to ensure that rules that are relevant to the calculation of tax payable as a result of the revocation of a charity's registration, specifically the determination of the charity's winding-up period, apply when an entity becomes a listed terrorist entity. These amendments apply as of 29 June 2021.

Deadlines for public comments

The comment period for the draft legislative proposals varies depending on the measures. Specifically, submissions on the income tax draft legislative proposals must be made by the following dates:

- 7 March 2022 for measures pertaining to the rate reduction for zero-emission technology manufacturers; immediate expensing; accelerated CCA for clean energy equipment; film or video production tax credits; electronic filing, payment, signature and correspondence requirements; the DTC; the treatment of post-doctoral fellowship income as earned income; the one-time additional GST/HST credit payment; contribution errors for defined contribution pension plans; and the revocation tax rules applicable to charities;
- 5 April 2022 for measures pertaining to taxes applicable to registered investments; the mandatory disclosure rules (including the samples of notifiable transactions); the avoidance of tax debts; audit authorities; reporting requirements for trusts; and the allocation to redeemers rules for mutual fund trusts; and
- 5 May 2022 for the interest deductibility measures.

Learn more

For more information on the 2021 federal budget measures, refer to EY Tax Alert 2021 Issue No. 19, *Federal budget 2021-22: A recovery plan for jobs, growth and resilience*, and for more information on any of the other measures, contact your EY or EY Law tax advisor.

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