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Tax Alert – Canada

Finance releases draft legislation for remaining 2022 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 9 August 2022, the Department of Finance released for public comment draft legislative proposals (and accompanying explanatory notes) to implement most of the remaining income tax measures from the 2022 federal budget, as well as various other measures (such as certain measures outstanding from the 2021 federal budget) that were previously included in the draft legislative proposals released on 4 February 2022, as amended (where applicable) to take into account comments received since their initial release.

The Department of Finance also released a separate package of draft technical amendments on 9 August 2022 relating to various previously enacted income tax measures, as well as draft legislative and regulatory proposals relating to the *Excise Tax Act* (GST/HST), the *Air Travellers Security Charge Act*, the *Excise Act, 2001*, the *Greenhouse Gas Pollution Pricing Act*, the *Underused Housing Tax Act* and the *Select Luxury Items Tax Act*. These income tax technical amendments and indirect tax proposals will be covered in two separate tax alerts.

Interested parties are invited to provide comments on these numerous proposed amendments by 30 September 2022.

Building a better working world

In addition to the draft legislative proposals relating to the 2022 federal budget income tax measures and other previously announced measures, consultations were also launched on the general anti-avoidance rule (GAAR). This consultation follows from the announcement in the 2020 fall economic statement, which was reiterated in the 2021 and 2022 federal budgets, of the government's intention to consult with stakeholders and members of the public on approaches to modernize Canada's GAAR. A consultation paper, *Modernizing and Strengthening the General Anti-avoidance Rule*, was released on 9 August 2022, and written representations on the relative merits of the approaches set out in the paper will be accepted by the Department of Finance until 30 September 2022. Additional details on this consultation will be provided in a separate tax alert.

Consultations were also launched, on that busy day for the Department of Finance, on the renewal of Canada's tariff preference programs for imports from developing and least developed countries (which are set to expire in 2024) and on design elements of a proposed framework for fuel, alcohol, cannabis and tobacco sales tax arrangements with Indigenous governments.

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

Business and international income tax measures

The draft legislative proposals include the following business and international income tax measures that were first announced in the 2022 federal budget:

- **Canada recovery dividend** – Introduction of the Canada recovery dividend in the form of a one-time 15% tax on bank and life insurer groups to be imposed under new Part VI.2 of the *Income Tax Act*. Such a group will include a bank or life insurer and any other financial institution (as defined for purposes of Part VI of the *Income Tax Act*) that is related to the bank or life insurer. The one-time tax will apply to the 2020 and 2021 average taxable income of any member in the group that is a bank, life insurer or other related financial institution at any time during its 2021 taxation year. The 2020 and 2021 taxable income used in calculating the average taxable income will be determined before any non-capital losses or net capital losses are applied to reduce the 2020 or 2021 taxable income. An exemption will be available for up to $1 billion of taxable income, to be shared among group members. The Canada recovery dividend will be imposed for the 2022 taxation year and will be payable in equal instalments over five successive taxation years (beginning with the 2022 taxation year). If the member of the bank or life insurer group has more than one 2022 taxation year, the tax will be imposed for the latest 2022 taxation year.

- **Additional tax on banks and life insurers** – Introduction of an additional tax of 1.5% on taxable income of members of bank and life insurer groups (determined in the same manner as for the Canada recovery dividend above). An exemption from this tax will be available for $100 million of taxable income, to be shared among group members and prorated for short taxation years. A special anti-avoidance rule is also introduced to prevent certain tax planning (involving the direct or indirect payment of an amount to a non-arm's length person or partnership that is not a bank or life insurer group member) from being undertaken to reduce or eliminate the additional tax payable. The additional tax will apply for taxation years ending after 7 April 2022 and will be prorated for taxation years straddling this effective date.

- **Hedging and short selling by financial institutions** – Amendments to deny the deduction for dividends received by a Canadian corporation from another Canadian corporation in certain circumstances where a two-thirds deduction is also claimed in respect of dividend compensation payments paid under a securities lending arrangement (SLA) by, for example, a registered securities dealer (RSD) within the same financial institution group, and the group does not have economic exposure to the Canadian shares on which the dividends were paid. Specifically, amendments will be introduced to deny the deduction for dividends received by a taxpayer on Canadian shares if an RSD that does not deal at arm's length with the taxpayer enters into transactions that hedge the taxpayer's economic exposure to the Canadian shares, where it can be reasonably be considered that the RSD or the taxpayer knew or ought to have known that this would result in the hedge and the two-thirds deduction under paragraph 260(6)(a) would have been deductible. In addition, amendments will similarly deny the deduction for dividends received by an RSD on Canadian shares that the RSD holds if the RSD eliminates all or substantially all of its economic exposure to the Canadian shares by entering into certain hedging transactions. In these two situations, where the deduction for dividends received is denied, the RSD will be permitted to claim a deduction for the full amount (rather than two-thirds) of dividend compensation payments made under the SLA entered into in connection with the hedging transactions. These amendments will apply to dividends and related dividend compensation payments paid after September 2022 for hedging transactions or related SLAs in place before 7 April 2022; for all other transactions, the amendments will apply to dividends and related dividend compensation payments paid or payable on or after 7 April 2022.

- **Accounting for insurance contracts under IFRS 17** – Numerous amendments related to the adoption of new accounting rules under IFRS 17, Insurance Contracts. Under IFRS 17, a new contractual service margin (CSM) reserve is introduced beginning 1 January 2023, generally representing a portion of profits on underwritten insurance contracts that will be deferred for accounting purposes and gradually released into accounting income over the estimated life of an insurance contract. For income tax purposes among various changes, amendments are proposed so that the CSM will not be deductible by life insurers (with the exception of the CSM associated with segregated funds, which will be fully deductible), mortgage insurers and title insurers. However, 10% of the CSM will be deductible for income tax purposes in respect of life (other than segregated funds), mortgage and title insurance contracts and will subsequently be included in income when certain conditions are met. In addition, among other changes, certain transitional rules are proposed for income tax purposes with respect to the accounting transition to IFRS 17, and consequential amendments are made to Part I.3 and Part VI of the *Income Tax Act*. These measures, including transitional rules, will apply for taxation years beginning after 2022.

- **Capital cost allowance (CCA) for clean energy equipment** – Expansion of CCA classes 43.1 and 43.2 to include certain equipment that is part of an air-source heat pump system that is primarily used for space or water heating, applicable for eligible property that is acquired and becomes available for use on or after 7 April 2022 (and that has not been used or acquired for use for any purpose before 7 April 2022). Amendments are also made to include the manufacturing or processing of air-source heat pumps designed for space or water heating as a qualified zero-emission technology manufacturing activity for purposes of the recently enacted zero-emission technology manufacturing deduction in section 125.2 of the *Income Tax Act*, effective as of 1 January 2022.

- **Investment tax credit for carbon capture, utilization and storage** – Introduction of a refundable tax credit for businesses that incur qualified expenditures related to carbon capture, utilization and storage (qualified CCUS expenditures) after 2021 and before 2041. Qualified CCUS expenditures will include the cost of acquiring eligible equipment used in qualified CCUS projects. Eligible equipment will include equipment that is used solely to capture, transport, store or use carbon dioxide (CO_2) as part of a qualified CCUS project and is situated in Canada. This equipment will be included in new CCA classes 57 and 58, which will have 8% and 20% declining-balance-basis CCA rates, respectively, and will be eligible for enhanced first-year depreciation under the accelerated investment incentive. Qualified CCUS projects will include CCUS projects that are expected to support the capture of CO_2 in Canada and, in addition to meeting various other conditions, have received an initial project evaluation from the Minister of Natural Resources. A CCUS project is a project that supports one or more parts of a CCUS process by capturing CO_2 that would otherwise be released in the atmosphere, or from ambient air, transporting the captured carbon, or storing or using the captured carbon. Tax credit rates will vary depending on the type of qualified CCUS expenditure. For qualified CCUS expenditures incurred after 2021 and before 2031, credit rates will be 60% for qualified carbon capture expenditures used to capture carbon from ambient air, 50% for other qualified carbon capture expenditures and 37.5% for qualified carbon transportation, storage or use expenditures. These credit rates will be reduced by half for eligible expenses incurred after 2030 and before 2041. The tax credit will be able to be claimed in respect of the taxation year in which qualified CCUS expenditures are incurred, regardless of when the related equipment becomes available for use. The extent to which the tax credit will be available will depend on the end use of the CO_2 being captured. For more information on additional design features of the CCUS tax credit, see the Department of Finance Backgrounder, *Additional Design Features of the Investment Tax Credit for Carbon Capture, Utilization and Storage: Recovery Mechanism, Climate Risk Disclosure, and Knowledge Sharing*, and EY Tax Alert 2022 Issue No. 31, *Proposed federal investment tax credit for CCUS*.

- **Exploration and development expenses relating to carbon capture, utilization and storage** – Introduction of new CCA classes 59 and 60 for intangible exploration expenses and development expenses related to the storage of captured carbon. Class 59 will have a 100% rate and will apply to expenses incurred after 2021 that are incurred for the purpose of determining the existence, location, extent or quality of a geological formation to permanently store captured carbon in Canada, including expenses for environmental studies or community consultations. Class 60 will have a 30% declining-balance rate and will generally apply to expenses incurred after 2021 in drilling, converting or completing a well in Canada for the permanent storage of captured carbon, and various other related expenses.

- **Critical mineral exploration tax credit** – Introduction of a new 30% tax credit for eligible exploration expenditures in respect of critical minerals that are renounced to flow-through share investors, applicable for expenditures renounced under eligible flow-through share agreements entered into after 7 April 2022 and on or before 31 March 2027. Critical minerals for the purpose of the credit will include copper, nickel, lithium, cobalt, graphite, rare earth elements, scandium, titanium, gallium, vanadium, tellurium, magnesium, zinc, platinum group metals and uranium. For expenses to be eligible for the credit, a qualified engineer or geoscientist will be required to certify that the expenditures to be renounced will be incurred as part of an exploration plan that primarily targets critical minerals. Expenditures claimed under the new tax credit will not be eligible for the existing mineral exploration tax credit.

- **Flow-through shares for oil, gas and coal activities** – Elimination of the flow-through share regime for oil, gas and coal activities, effective for expenditures renounced under flow-through share agreements entered into after March 2023.

- **Small business deduction** – Expansion of the range over which the business limit of a Canadian-controlled private corporation (CCPC) is reduced based on the combined taxable capital employed in Canada of the CCPC and its associated corporations, applicable to taxation years that begin on or after 7 April 2022. Under the current rules, a CCPC's business limit (and thus the amount of the small business deduction that may be claimed) is reduced on a straight-line basis when the CCPC and its associated corporations have combined taxable capital employed in Canada greater than $10 million and is eliminated when taxable capital is $15 million or more. The amendments provide greater access to the small business deduction by increasing the upper value of this range from $15 million to $50 million, so that the small business deduction is eliminated when a CCPC and its associated corporations have combined taxable capital employed in Canada of $50 million or more.

- **Substantive CCPCs** – Introduction of the concept of a "substantive CCPC" for the purpose of aligning the tax treatment of investment income earned and distributed by a substantive CCPC with the rules applicable to CCPCs, effective for taxation years ending on or after 7 April 2022, subject to transitional rules for certain transactions entered into before that date. Specifically, a "substantive CCPC" is defined as a private corporation (other than a CCPC) that is controlled, directly or indirectly in any manner whatever, by one or more Canadian resident individuals, or would, if all shares held by Canadian resident individuals were owned by a particular individual, be controlled by that particular individual. Under the amendments, a substantive CCPC will generally be taxed in the same manner as a CCPC with respect to investment income (i.e., a federal corporate income tax rate of 38.67% will generally apply to the aggregate investment income of the corporation, of which 30.67% will be refundable), and the aggregate investment income will increase the corporation's low rate income pool. Substantive CCPC status will only apply for these purposes, and corporations will continue to be treated as non-CCPCs for other purposes of the *Income Tax Act* (e.g., they will not be entitled to the small business deduction). Related amendments include the introduction of an anti-avoidance rule intended to address transactions or arrangements reasonably considered to be undertaken to avoid the additional 10.67% tax otherwise payable under section 123.3 of the *Income Tax Act* on the aggregate investment income. Other amendments facilitate the administration and enforcement of the new rules, including a one-year extension to the normal reassessment period for consequential assessments of Part IV tax arising from the assessment or reassessment of a dividend refund.

- **Deferring tax using foreign resident corporations** – Amendments to eliminate the tax-deferral advantage available to CCPCs and their shareholders earning investment income through controlled foreign affiliates, applicable for taxation years beginning on or after 7 April 2022. Specifically, the relevant tax factor applicable to CCPCs and substantive CCPCs is adjusted from 4 to 1.9 (i.e., the relevant tax factor currently applicable to individuals), so that a deduction in respect of foreign tax paid that fully offsets foreign accrual property income (FAPI) inclusions is available only where the foreign tax rate is at least 52.63% (rather than 25%). In addition, amendments are made to address the integration of FAPI that is repatriated to and distributed by CCPCs and substantive CCPCs to individual shareholders. These amendments include adjustments to the calculation of a CCPC's general rate income pool to exclude an amount equal to certain deductions claimed in respect of repatriations of a foreign affiliate's hybrid surplus and taxable surplus (under paragraphs 113(1)(a.1) and (b), respectively), and in respect of the payment of withholding tax to a foreign government on intercorporate dividends received from a foreign affiliate prescribed to be paid out of taxable surplus (under paragraph 113(1)(c)); the integration of these amounts will rather be addressed through the capital dividend account as mentioned below. Additional amendments are similarly made to the calculation of a CCPC's general rate income pool to exclude amounts deductible under paragraphs 113(1)(d) or subsection 113(2), both of which represent *de facto* returns of capital rather than actual dividends, effective for taxation years that begin on or after 9 August 2022. Amendments are also made to the capital dividend account of a CCPC (or substantive CCPC) to include, on repatriation, the amount of an intercorporate dividend deduction claimed with respect to a dividend paid out of hybrid surplus less the amount of withholding tax paid in respect of the dividend, the amount of an intercorporate dividend deduction claimed with respect to a dividend paid out of taxable surplus, and the amount of a withholding tax deduction claimed less the withholding tax paid in respect of repatriations of taxable surplus. These amendments also apply for taxation years beginning on or after 7 April 2022.

- **GAAR** – Amendment to the definition of "tax benefit" to include any reduction, increase or preservation of an amount that could at a subsequent time be relevant for purposes of computing a taxpayer's tax (or other amount payable under the *Income Tax Act*) or refund. As a result of this amendment and other related amendments, GAAR will apply to transactions that affect tax attributes that have not yet become relevant to the computation of tax. The amendments are in response to the decision in *1245989 Alberta Ltd. v. Canada (Attorney General)* (2018 FCA 114), which held that transactions that modify tax attributes do not give rise to a tax benefit under GAAR until the attribute is applied or used to reduce, avoid or defer tax. The amendments will apply to transactions that occur on or after 7 April 2022 and will also apply retroactively to transactions that occur prior to 7 April 2022, in respect of any notice of determination issued by the Canada Revenue Agency (CRA) on or after that date (determinations made prior to 7 April 2022, where all objection and appeal rights in respect of the determination have been exhausted before that day, will remain binding on taxpayers and the CRA).

- **Interest coupon stripping** – Amendments to ensure that the total Part XIII withholding tax paid on interest under an interest coupon stripping arrangement is the same as if the arrangement had not been undertaken (i.e., as if the interest were factually paid or credited to the nonresident lender). In general terms, an interest coupon stripping arrangement will be considered to exist if the following conditions are met: (1) a taxpayer (typically a Canadian resident borrower) pays or credits a particular amount to a person or partnership (the interest coupon holder) as interest on a debt (other than a specified publicly offered debt obligation) owed to another person or partnership (the non-arm's length creditor) that is a nonresident person with whom the taxpayer is not dealing at arm's length, or a partnership other than a Canadian partnership; and (2) the withholding tax that would be payable in respect of the particular amount, if the particular amount were paid or credited to the non-arm's length creditor, is greater than the withholding tax payable on the particular amount paid or credited to the interest coupon holder. If an interest coupon stripping arrangement exists, the taxpayer will be deemed, for purposes of the withholding tax rules, to pay an amount of interest to the non-arm's length creditor such that the withholding tax on the deemed interest payment equals the withholding tax otherwise avoided as a result of the interest coupon stripping arrangement. This measure will apply to interest paid or payable by a taxpayer to an interest coupon holder to the extent that the interest accrues on or after 7 April 2022, subject to transitional rules for certain interest coupon agreements or arrangements entered into before that date.

The draft legislative proposals also include the following business income tax measures that were first announced in the 2021 federal budget and subsequently released as draft legislative proposals on 4 February 2022 (as amended to take into account comments received since their initial release):

- **Mandatory disclosure rules** – Introduction of new rules to enhance Canada's mandatory disclosure requirements and give the CRA earlier access to relevant information on aggressive tax planning or transactions, including the following changes:
  - **Reportable transactions** – Amendments to the existing rules for reportable transactions to make the rules more effective and consistent with international leading practices. Specifically, the definition of "avoidance transaction" for 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. The proposed amendments have been modified since their initial release on 4 February 2022 to, among other things and in broad terms, remove the solicitor-client privilege definition (thereby relying instead on the meaning that has been developed under applicable Canadian case law), provide that confidential protection or contractual protection in the context of normal commercial transactions does not give rise to a reporting requirement where it does not extend to the tax treatment in respect of an avoidance transaction, and ensure that the reporting obligations do not apply to a person solely because the person provided clerical services or secretarial services with respect to a planning.

- **Notifiable transactions** – Amendments to provide the Minister of National Revenue with the authority to designate "notifiable transactions," which will 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 is provided for advisors to the extent of solicitor-client privilege). Samples of notifiable transactions that fall into the six categories of transactions (e.g., straddle loss creation transactions using a partnership) have been provided for consultation on 4 February 2022 in a Department of Finance backgrounder (no further update has since been provided on this consultation).

  A transaction will be a notifiable transaction if it is the same as, or substantially similar to, a transaction designated by the CRA (with the concurrence of the Department of Finance), or a transaction in a series of transactions that is the same as, or substantially similar to, a designated series of transactions. 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. The proposed amendments have been modified since their initial release on 4 February 2022 to, among other things and in broad terms, alleviate reporting obligations for employees (as well as for partners) where the employer or partnership has filed the required information return, and ensure that reporting obligations do not apply to a bank, an insurance corporation, or a credit union providing secondary or ancillary financial services, or to a person solely providing clerical or secretarial services.

- **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 about whether the tax treatment will be accepted as being in accordance with tax law. Under the proposed 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 IFRS or other country-specific GAAP 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., the amount of taxes at issue) will be required to be reported at the time 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 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 mandatory disclosure rules are intended to be effective in 2023 (i.e., either for taxation years beginning after 2022 or for transactions entered into after 2022) — the application date of the rules has been deferred by one year compared to the date initially mentioned in the 4 February 2022 proposals. However, penalties will not apply to transactions that occur before Royal Assent of the enacting legislation.

- **Avoidance of tax debts** – Introduction of new rules to address 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 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 (taking into account amendments made since the initial release of the proposals on 4 February 2022) the value of the property transferred and the consideration given for the property. In addition, a new penalty (as amended since its 4 February 2022 release) will be introduced for planners and promoters of tax debt avoidance schemes that are subject to the new anti-avoidance rules, 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 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 prescribed manner). 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 2023 (this application date has been deferred by two years compared to the date initially mentioned in the 4 February 2022 proposals), so that most corporations, not just those with gross revenue in excess of $1 million, will be required to file returns electronically. 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 2023 (this application date has been deferred by two years compared to the date initially mentioned in the 4 February 2022 proposals).

    - **Electronic notice of assessment** – New rules that allow the Minister of National Revenue to provide a notice of assessment electronically to an individual who filed their personal income tax return electronically and has authorized that notices or other communications may be made available in this manner. 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. This measure is effective on 1 January 2024 (this application date has been deferred by one year compared to the date initially mentioned in the 4 February 2022 proposals).

    - **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 2023 (this application date has been deferred by two years compared to the date initially mentioned in the 4 February 2022 proposals). 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 2024 (this application date has been deferred by two years compared to the date initially mentioned in the 4 February 2022 proposals). Failure to comply with this requirement will result in a penalty of $100 for each such failure. 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 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*. This measure will be effective on Royal Assent of the enacting legislation.

Measures concerning trusts

The draft legislative proposals also include the following measure concerning trusts that was previously included in the package of draft legislative proposals released on 4 February 2022 (as amended to take into account comments received since their release):

- **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 since the release of the proposals on 4 February 2022 expand the list of trusts excluded from application of the new reporting requirements to include a trust under an employee profit sharing plan, a registered supplementary unemployment benefit plan or a first home savings account (FHSA), and provide additional circumstances and conditions under which the requirement to provide additional information on the beneficiaries will be met (e.g., for a trust having some classes of units listed on a designated stock exchange, the requirement will be met where the required information is provided in respect of the beneficiaries of the unlisted classes of units). As a reminder, these measures will 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.

Personal and other income tax measures

The draft legislative proposals include the following personal and other income tax measures that were first announced in the 2022 federal budget:

- **Reporting requirements for registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs)** – Amendments that will expand the annual reporting required of financial institutions to the CRA to include the fair market value (determined at the end of the calendar year) of property held in each RRSP and RRIF they administer. This measure will apply to 2023 and subsequent taxation years.

- **Tax-free FHSA** – Introduction of a new tax-free FHSA to help Canadians save for a down payment on their first home. With this new registered account, prospective first-time home buyers will be able to save up to $40,000 (the lifetime contribution limit). Annual contributions will be limited to $8,000, and, following new amendments, unused contribution room up to $8,000 will be allowed to be carried forward to future years. FHSA carryforwards will only begin to accumulate after the opening of an individual's first FHSA. Contributions to an FHSA will be tax deductible, and income earned in the account will not be subject to tax. Qualifying withdrawals made to purchase a first home will be non-taxable. Various other rules will apply. These accounts will be available in 2023. For more information on FHSAs, see the Department of Finance Backgrounder, *Tax-Free First Home Savings Account*.

- **Residential property flipping rule** – Introduction of a new rule to ensure profits from flipping residential real estate are subject to full taxation and are not eligible for capital gains treatment or the principal residence exemption. Specifically, profits (i.e., gains) that arise from the disposition of residential real estate located in Canada (including a rental property) that was owned for less than 365 consecutive days will, subject to certain exceptions, be deemed to be business income (which is not eligible for the 50% capital gains inclusion rate), be inventory of the taxpayer's business and not be capital property of the taxpayer. The exceptions pertain to certain life events, such as the death of the taxpayer or a related person, a separation, a serious illness or disability, and certain employment changes, as well as involuntary dispositions (e.g., an expropriation). Where the new deeming rule applies, the principal residence exemption will not be available; a disposition of a flipped property will not result in a non-capital loss. If the new deeming rule does not apply because of one of the exceptions or because the property was owned for 365 consecutive days or more, it will be a question of fact as to whether the profits from the disposition are taxed as a capital gain or as business income. This new rule will apply in respect of dispositions that occur after 31 December 2022.

- **Multigenerational home renovation tax credit** – Introduction of a new 15% refundable multigenerational home renovation tax credit (for up to $50,000 in eligible expenses for a qualifying renovation), effective for the 2023 and subsequent taxation years (in respect of qualifying expenditures paid after 31 December 2022 for work performed or goods acquired after that date). A qualifying renovation is a renovation that creates a secondary unit to permit an eligible person (a senior or an adult with a disability) to live with a qualifying relation. The credit may be claimed by an individual who ordinarily resides (or intends to ordinarily reside) in the eligible dwelling within 12 months after the end of the renovation period and is the eligible person, the spouse or common-law partner of the eligible person, or a qualifying relation of the eligible person. The credit may also be claimed by a qualifying relation who owns the eligible dwelling. One qualifying renovation may be claimed in respect of an eligible person over their lifetime.

- **First-time home buyers' tax credit** – Amendments to double the first-time home buyers' tax credit amount from $5,000 to $10,000, which would result in a $1,500 tax credit to eligible home buyers. Spouses or common-law partners will be able to continue to split the credit, as long as the total combined credit does not exceed $1,500. This measure will apply to qualifying home purchases made on or after 1 January 2022.

- **Medical expense tax credit** – Amendments to effectively broaden the definition of "patient" for purposes of the medical expense tax credit where an individual relies on a surrogate or a donor of sperm, ova or embryos to become a parent. The amendments will allow medical expenses incurred in Canada and paid by the taxpayer, or the taxpayer's spouse or common-law partner, with respect to a surrogate mother (e.g., expenses paid by the intended parent to a fertility clinic for an in vitro fertilization procedure with respect to a surrogate mother) or a donor of sperm, ova or embryos to be eligible for the credit. In addition, the new rules will allow reimbursements paid by the taxpayer to a patient (under the expanded definition) to be eligible for the credit, provided that the reimbursement is made in respect of an expense that would generally qualify under the credit (e.g., reimbursements paid by the taxpayer for expenses incurred by a surrogate mother with respect to an in vitro fertilization procedure or prescription medication related to their pregnancy). Fees paid to fertility clinics and donor banks to obtain donor sperm or ova to become a parent will also be eligible for the credit. These changes will apply to expenses incurred in the 2022 and subsequent taxation years.

- **Defined benefit pension plans** – Amendments that will provide more flexibility to administrators of defined benefit pension plans (other than individual pension plans) by replacing the 90-day limit on the terms of a borrowing by a defined benefit pension plan, with a limit based on the assets and actuarial liabilities of the pension. This measure will apply to amounts borrowed by defined benefit pension plans (other than individual pension plans) on or after 7 April 2022.

- **Changes to the disbursement quota of registered charities** – Various changes to the disbursement quota, or minimum annual spending requirement, including:

  - Increasing the disbursement quota rate from 3.5% to 5% for the portion of property not used directly in charitable activities or administration that exceeds $1 million, to promote the timely disbursement of funds by larger charities

  - Ensuring expenditures on administration and management of the charity are not considered to be amounts expended on charitable activities carried on by the charity for satisfying its disbursement quota requirements

  - Amending the current relieving provision that allows a charity, on approval by the CRA, to report a deemed charitable expenditure for a taxation year where it cannot meet its disbursement quota, so that the CRA will, instead, have the discretion to grant a reduction in a charity's disbursement quota obligation for any particular tax year (as it is the case with the current relieving provision, the CRA will be allowed to publicly disclose information relating to an approved reduction in a charity's disbursement quota)

  - Removing the relieving provision relating to the accumulation of property by a charity (as it is no longer considered necessary)

The disbursement quota changes will apply for taxation years beginning on or after 1 January 2023, and the removal of the accumulation of property relieving rule will not apply to approved property accumulations resulting from applications submitted prior to 1 January 2023. The provision dealing with the public disclosure by the CRA will be coming into force on 1 January 2023.

Also included in the draft legislative proposals is, aside from the relevant measures dealing with electronic filing, payment, signature and correspondence requirements discussed earlier, the following measure that was first announced in the 2021 federal budget and previously included in the package of draft legislative proposals released on 4 February 2022 (as amended to take into account comments received since its initial release):

- **Defined contribution pension plans** – Amendments to permit plan administrators of defined contribution pension plans to correct certain under-contribution errors (subject to a dollar limit, the calculation of which has been amended since the 4 February 2022 proposals) and over-contribution errors made in any of the 10 immediately preceding years (instead of five as previously announced in the 2021 federal budget and included in the 4 February 2022 proposals), applicable in respect of additional contributions made, and amounts of overcontributions refunded, in 2021 and later years. The amendments also contain, among other things, simplified requirements to report these corrections.

Finally, the draft legislative proposals include the following measure:

- **Veterans' and active service members' benefits** – Exclusion from the computation of income of certain benefits for Canadian forces members, veterans, their spouses or common-law partners or surviving spouses or common-law partners, such as benefits provided under the Veterans Health Care Regulations and benefits provided to Canadian Forces members under the Canadian Armed Forces Self-Development Program. These changes will be deemed to come into force on 1 January 2018, except for benefits under the Canadian Armed Forces Self-Development Program, which will be deemed to come into force on 1 January 2021.

Learn more

For more information on the 2022 federal budget measures, refer to EY Tax Alert 2022 Issue No. 23, *Federal budget 2022-23: Growing a more resilient economy*, or contact your EY or EY Law tax advisor.

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