2021 Canada Federal Budget: Detailed Commentary

On April 19, 2021, Canada's Minister of Finance, Chrystia Freeland, released Canada's 2021 Budget (Budget), the federal government's first Budget in more than two years and first since before the pandemic.

The Budget addresses three fundamental challenges: (1) conquering COVID-19 itself, (2) climbing out of the COVID-19 economic recession, and (3) building a better, fairer and more innovative future.

The first challenge, conquering COVID-19 itself, includes securing and distributing vaccines to the provinces, and continuing to provide financial support to businesses to make it through the third wave of lockdowns. This includes, among other measures, extending the Canada Emergency Wage Subsidy (CEWS), the Canada Emergency Rent Subsidy (CERS), and other subsidy and benefit programs.

The second challenge, climbing out of the economic recession, includes new investments and other financial support to help businesses hire employees and expand their operations after the lockdowns of the third wave are over, and a substantial portion of Canadians are vaccinated.

The third challenge, building a better, fairer and more innovative future, includes the most significant and far-reaching measures in the Budget. For example, it includes a commitment to a universal affordable childcare program within 18 months; significant tax measures to incentivize green transformation; details on taxing digital service providers; a luxury tax on aircrafts, vehicles and boats; measures to increase corporate taxes on multinational entities; proposals for increased disclosure on tax returns; and enhanced audit powers for the Canada Revenue Agency (CRA). There is a clear focus on attempting to correct the perceived inequalities in the tax system, something the government started in November's Fall Economic Statement, and now continues with full force and vigor in the 2021 Budget.

Leading up to the Budget there has been conversation about potential tax measures and increases the government might propose, but the Budget is largely silent on this front. In particular, the Budget does not include:

- A change to the federal corporate income tax rates or the $500,000 small business limit (except to reduce the rates for certain manufacturing and processing income, as set out below);
- An increase to federal personal income tax rates;
- A wealth tax;
- An elimination or cap on the principal residence exemption; or
- ·An increase in the capital gains tax rate.

This tax alert summarizes the business and personal income and indirect tax measures in the 2021 Budget relevant to the middle market, including international tax and transfer pricing considerations, credits and incentives, and audit and enforcement measures.

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COVID-19-RELATED MEASURES

Extension of Canada Emergency Wage Subsidy

The Canada Emergency Wage Subsidy program (CEWS), designed to support employers that suffered from a decline in revenue during COVID-19, is currently set to expire in June 2021. However, the Budget extends the program to Sept. 25, 2021, although it proposes to reduce the maximum subsidy over the course of the extension. The Budget also provides the government with the authority to extend the CEWS until Nov. 20, 2021.

In addition, the Budget sets out the following in respect of the CEWS:

- Subsidy rate structures from June 6, 2021 to Sept. 25, 2021, as set out in Table 2 of the Budget.
- For the periods beginning from July 4, 2021, only employers with a revenue decline of more than 10% would be eligible for CEWS.
- For the periods from June 6, 2021 to Aug. 28, 2021, the weekly wage subsidy for a furloughed employee has been changed.
- Reference periods for the qualifying periods from June 6, 2021 to Sept. 25, 2021, as set out in Table 3 of the Budget.
- Additional alternative baseline remuneration periods to align the qualifying period with the corresponding month.
- Introducing repayment of CEWS for the qualifying periods beginning after June 5, 2021, by a publicly listed corporation that increases its specified executive's 2021 pay as compared to the pay in 2019.

The CEWS has been, and remains, an invaluable subsidy for businesses, covering a portion of payroll expenses. Businesses should continue to evaluate their eligibility for CEWS, as eligibility can change from month to month.

Extension of Canada Emergency Rent Subsidy and Lockdown support

The Canada Emergency Rent Subsidy (CERS) and Lockdown Support were introduced to help businesses partially offset their eligible rent expenses. The Budget extends the CERS and Lockdown Support from June 6, 2021 to Sept. 25, 2021, but the maximum base rent subsidy rate is reduced for qualifying periods from July 4, 2021 to Sept. 25, 2021 as follows:

- Period 18: July 4 to July 31 – 60%
- Period 19: Aug. 1 to Aug. 28 – 40%
- Period 20: Aug. 29 to Sept. 25 – 20%

As of July 4, 2021, only entities with a revenue decline of greater than 10% will be eligible to claim the CERS. The Lockdown Support rate will remain at 25% for the qualifying periods from June 6, 2021 to Sept. 25, 2021.

Canada Recovery Hiring Program

The Budget introduces a new subsidy program that is modelled after the CEWS: the Canada Recovery Hiring Program (CRHP). The CRHP is a subsidy for eligible employers that experience a revenue decline (to be calculated in a manner similar to the CEWS) from June 6, 2021 to Sept. 25, 2021. Employers can claim either CRHP or CEWS for a particular qualifying period, but not both.

In order to qualify for the CRHP, an eligible employer's revenue decline in a qualifying period must be greater than:

- 0% for the period June 6, 2021 to July 3, 2021
- 10% for the period July 4, 2021 to Nov. 20, 2021

Unlike the CEWS, the CRHP is available to the employers as a proportion of the increase in remuneration paid to employees, which is the difference of total eligible remuneration paid to eligible employees for the qualifying period and the baseline period. The amount of subsidy is up to 50% of the increase in remuneration, on a maximum of $1,129 per week.

Businesses that experience a revenue decline may be able to cover a portion of their payroll cost using the CRHP, and need to gauge the benefit of the CRHP over the CEWS in order to maximize the subsidy.

Introducing the Canada Digital Adoption Program

In order to help small and medium-sized businesses adopt new digital technologies, the Budget introduces the Canada Digital Adoption Program that aims to provide small businesses with two streams of support:

- Providing micro-grants to help businesses offset the costs of going digital and support from digital trainers
- Providing advisory expertise for technology planning and financing options to businesses

This program will help small businesses digitize and take advantage of e-commerce opportunities.

Extended timelines for the Canadian Film or Video Production Tax Credit and the Film or Video Production Services Tax Credit

The Canadian Film or Video Production Tax Credit (CPTC) is a 25% refundable tax credit available to productions certified to be Canadian film or video productions. Similarly, Film or Video Production Services Tax Credit (PSTC) is a 16% refundable credit available to foreign films and videos produced in Canada.

In respect of productions for which eligible expenditures were incurred in taxation years ending in 2020 or 2021, the Budget proposes to temporarily extend the following timelines by 12 months, subject to certain waiver conditions. For the CPTC, an extension will be available for (i) the timeline for incurring qualifying expenditures, (ii) submitting a certificate of completion to the Canadian Audiovisual Certification Office and (iii) producing a written agreement with a Canadian distributor or a broadcaster. For the PSTC, the extension will be available when aggregate expenditure thresholds are met for film or video productions.

Businesses undertaking film or video production will benefit from the extended timelines.

Extension of COVID-19 benefits and employment insurance sickness benefits

The government previously waived the one-week waiting period for all EI benefit claims submitted between Jan, 31, 2021, and Sept. 25, 2021. Additionally, the government increased the number of weeks that EI and the CRB, CRSB and CRCB were available, and extended them to self-employed individuals who would not normally have qualified for EI.

The Budget proposes an increase of the eligible CRB period for an additional 12 weeks, from 38 weeks up to a maximum of 50 weeks. The first four weeks of the additional weeks (39 to 42) will provide $500 per week, and the remaining eight weeks (43 to 50) will provide $300 per week. In addition, the government proposes to extend the CRCB by four weeks to a maximum of 42 weeks at $500 per week, conditional on other caregiving options, especially for children, not being sufficiently available.

Finally, to support those that are ill and do not have access to paid sick time from their employers, the government proposes to extend EI sickness benefits from 15 weeks to 26 weeks. This appears to be a permanent extension to help individuals with all types of illness, and will take effect in the summer 2022.

BUSINESS INCOME TAX MEASURES

Corporate tax rate reduction for zero-emission technology manufacturers

The Budget temporarily reduces the corporate income tax rate on eligible zero-emission technology manufacturing and processing income as follows:

- From 15% to 7.5%, where the income is subject to the general corporate tax rate; and
- From 9% to 4.5%, where the income is subject to the small business tax rate.

Taxpayers will qualify for the reduced corporate tax rate if at least 10% of gross revenue from all active businesses carried on in Canada is derived from eligible activities. However, no changes are proposed to increase the individual dividend tax credit when dividends are paid from the after-tax income.

The reduced tax rates would be applicable for tax years beginning after 2021 and will be gradually phased out, starting in tax years beginning in 2029 up to 2031. Businesses earning income from zero-emission technology manufacturing and processing activities should avail of the benefit of reduced tax liability, following the decline in the rate.

Introducing immediate expensing

To enhance the Capital Cost of Allowance (CCA) deduction for Canadian-controlled private corporations (CCPCs), the Budget proposes "immediate expensing" of certain depreciable property. The expense is available for property acquired on or after April 19, 2021, that is available for use before Jan. 1, 2024. The expense is limited to $1.5 million per taxation year, which must be shared amongst associated members of a group of CCPCs.

Property eligible for this new measure would be capital property subject to CCA, other than property in CCA classes 1 to 6, 14.1, 17, 47, 49 and 51.

CCPCs can claim the $1.5 million immediate expensing in addition to all other existing provisions of the Income Tax Act, including the Accelerated Investment Incentive. This may be an opportunity for the CCPCs considering expansion in the near future to undertake investments, at a low tax cost.

CCA for clean energy equipment

On November 21, 2018, the federal government introduced immediate expensing for investments in specified clean energy generation and energy conservation equipment (CCA Class 43.1 and 43.2). The Budget proposes to expand the list of CCA classes to include additional types of investments and changes the eligibility criteria of certain types of equipment.

INTERNATIONAL BUSINESS INCOME TAX MEASURES

Canada continues to be an active participant of the base erosion and profit shifting (BEPS) Action Plan, which addresses (among other things) tax avoidance strategies that exploit gaps and mismatches in tax rules between different countries. The government has already introduced several measures in response to the BEPS Action Plan, including the ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The Budget builds on the BEPS Action Plan by proposing to implement two more recommendations from the BEPS Action Plan designed at curtailing international tax avoidance: rules to address Hybrid Mismatch Arrangements (HMAs), and to limit interest deductibility in certain circumstances.

Hybrid Mismatch Arrangements

HMAs are cross-border tax avoidance structures that exploit differences in the income tax treatment of business entities or financial instruments under the laws of two or more countries to produce mismatches in tax results. The Budget proposes the following changes:

- Payments made by Canadian residents under HMAs would not be deductible for Canadian income tax purposes to the extent they give rise to a further deduction in another country, or are not included in the ordinary income of a non-resident recipient (ordinary income means income that is subject to tax at full tax rate and does not benefit from any exemption, exclusion, deduction, credit or other comparable tax relief).
- Any amount of the payment received by a Canadian resident from the HMAs would be included in income. If the payment is a dividend, no dividend deduction is available for certain dividends received from foreign affiliates.
- To the extent that a payment made under an HMA by an entity that is not a resident in Canada is deductible for foreign income tax purposes, the Canadian resident is not permitted to claim a deduction against the income.

The Budget proposes to implement these changes in two different legislative packages, the first taking effect July 1, 2022, and the second taking effect no earlier than 2023. The government intends to release the legislative packages for stakeholder comment before finalizing or implementing the legislation.

In effect, these rules would neutralize the effect of HMAs by aligning the Canadian income tax treatment with the income tax treatment in the foreign country. Corporate groups that currently have international structures in place, or are in the process of implementing international structures, should revisit their structures and financing arrangements to determine whether they are affected by the proposed HMA rules.

Limitations on excessive interest deductions

In Canada, interest expense is generally deductible against the income of the borrower if the borrowed funds are used to generate income. However, the deductibility of interest raises the potential that excessive debt or interest expense can be placed in Canadian businesses in a way that erodes the tax base, for example though interest payments to related non-residents in low-tax jurisdictions. Currently, a number of rules, including the thin capitalization rules, are in place to provide protection of the Canadian tax base from erosion due to excessive interest expense, but the scope of these rules is limited.

The Budget proposes to introduce new interest deductibility rules that limit a corporation's interest deduction based on a fixed ratio of the corporation's taxable income before taking into account interest expense, interest income, income tax and deductions for depreciation and amortization, with each of these items determined for income tax purposes ("tax EBITDA").

The proposed rules, which would also apply to trusts, partnerships and Canadian branches of non-resident taxpayers, would be phased in with a fixed ratio of 40% of tax EBITDA for taxation years beginning on or after Jan. 1, 2023, but before Jan. 1, 2024, and 30% for taxation years beginning on or after Jan. 1, 2024. The limits on interest deductions would apply with respect to existing and new borrowings.

Exceptions from the new rule would be available for (i) CCPCs that, together with associated corporations, have taxable capital employed in Canada of less than $15 million and (ii) groups of corporations and trusts whose aggregate net interest expense among Canadian members is $250,000 or less. In addition, it is expected that standalone Canadian corporations and Canadian corporations that are members of a group that do not include non-residents would, in most cases, not be subject to the interest deduction limitation.

An entity that is subject to the denial of the interest deduction would be able to carry forward the deduction for up to 20 years, or back for up to three years. In addition, Canadian members of a group that have a ratio of net interest below the fixed ratio would generally be able to transfer the unused capacity to other Canadian members of the group whose net interest deductions could otherwise deduct the interest. Also included is a "group ratio" rule that would allow an entity to deduct interest in excess of the fixed ratio of tax EBITDA where the entity is able to demonstrate that the ratio of net third-party interest to book EBITDA of the consolidated group, implies that a higher deduction limit would be appropriate. A consolidated group for this purpose means the parent company and all of its subsidiaries that are fully consolidated in the parent's audited consolidated financial statements.

Draft legislative proposals are expected to be released for comments in the summer.

The proposed rules further tighten the deductibility of interest expense. Canadian businesses should review their current financing arrangements to determine the potential impact of the proposed rules.

DIGITAL SERVICES TAX MEASURES

The Budget proposes to implement a temporary Digital Services Tax (DST) on large businesses (both foreign and domestic) at a rate of 3% of revenue generated from digital services that rely on data and content distributions from Canadian users. The DST would take effect on Jan. 1, 2022, and is intended to serve as an interim measure until an acceptable common international approach is developed and implemented.

The DST would apply to revenue from online business models under the following streams (in-scope revenue):

- Online marketplaces that help match sellers of goods and services with potential buyers, whether or not the platform facilitates completion of the sale, with certain exceptions
- Social media that facilitates interaction between users or between users and user-generated content
- Online advertising that targets based on data gathered from users of an online interface. This includes online interfaces such as online marketplaces, social media platforms, internet search engines, digital content streaming services, and online communications services
- The sale or licensing of data gathered from users of an online interface
- The DST will apply in a particular calendar year to an entity that meets, or is a member of a business group that meets, the following criteria:
- Global revenue from all sources of €750 million or more in the previous calendar year (the threshold for country-by-country reporting under an OECD standard)
- In-scope revenue associated with Canadian users of more than $20 million in the particular calendar year

Firms subject to the DST are required to file an annual return following the end of the reporting period (proposed to be the calendar year) and make one annual payment. A group would be able to designate an entity to file the DST return and pay the DST liability on behalf of the group. Each entity in a group will be jointly and severally liable for DST payable by any of the group members.

Similar to other non-income taxes, the DST will be deductible in computing taxable income for Canadian income tax purposes. However, it will not be eligible for a credit against Canadian income tax payable.

The government will engage provinces and territories to discuss the implications of the DST and welcome feedback by June 18, 2021, from stakeholders on the proposed approach. The draft legislation implementing the DST is expected to be released for public comment during the summer.

It is now critical for multinational enterprises to review their online presence and revenue streams to identify potential compliance and tax exposures, to prepare for these potential reporting requirements in the future.

TRANSFER PRICING MEASURES

The government proposes to reform its transfer pricing rules, as its losses at all levels of court in The Queen v. Cameco Corporation resulted in the government realizing that the current transfer pricing rules fall short of what the government had intended.

In the coming months, the Department of Finance will release a consultation paper to provide stakeholders with an opportunity to comment on possible transfer pricing rules amendments. The government may try to establish transfer pricing rules that focus on the substance of the transactions, rather than the form of the transactions or agreements, i.e., rules that look beyond the legal documents, legal agreements, and other support for the related-party transactions.

AUDIT AND ENFORCEMENT MEASURES

The Budget proposes significant changes that increase reporting requirements, provide enhanced collection measures for unpaid taxes, and enhance the CRA's audit and enforcement powers. The government's stated objective with these proposals is to close loopholes and reduce the perceived inequalities in the tax system.

Mandatory disclosure rules

There are five material proposed changes that would enhance the mandatory disclosure rules: expanding the 'reportable transaction' rules; creating a new reporting requirement for 'notifiable transactions'; creating a new requirement for certain corporations to report uncertain tax treatments; extending the applicable reassessment period in certain circumstances; and imposing substantial penalties for failure to comply with the reporting requirements.

Reportable transactions

A 'reportable transaction' is an avoidance transaction that has two out of the following three hallmarks: (1) a promoter or advisor receives contingent fees related to the transaction; (2) the promoter or advisor requires 'confidential protection' related to the transaction; or (3) the taxpayer entering into the transaction receives 'contractual protection' against failure to achieve a tax benefit from the transaction. Currently, a taxpayer must report a reportable transaction on or before June 30 of the year following the year in which the transaction became a reportable transaction.

The Budget proposes to amend the definition of a reportable transaction so that it would include an avoidance transaction that has only one of the three hallmarks.

Notifiable transactions

A 'notifiable transaction' is a new concept in the Budget. The Minister of National Revenue, with the concurrence of the Minister of Finance, would have the authority to designate a transaction or a series of transactions as a notifiable transaction. After such designation, a taxpayer that enters into a notifiable transaction or a transaction that is substantially similar to a notifiable transaction would be required to report the transaction to CRA on a prescribed form. Notifiable transactions would include both transactions that the CRA has found to be abusive and transactions identified as transactions of interest.

The timing for the reporting requirement for both reportable transactions and notifiable transactions will be 45 days after the earlier of (1) the date the taxpayer entered into the transaction, and (2) the date the taxpayer became contractually obligated to enter into the transaction.

The proposals regarding reportable transactions and notifiable transactions are intended to provide information to the CRA to improve audit efficiency and effectiveness.

Uncertain tax treatments

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 courts will accept the tax treatment. The United States requires that certain corporations report uncertain tax positions, and the Budget proposes to adopt this policy by requiring that specific corporations report uncertain tax treatments. A corporation would generally be required to report an uncertain tax treatment in respect of a taxation year where the following conditions are met:

- The corporation is a resident of Canada or is a non-resident corporation with a taxable presence in Canada
- The corporation has at least $50 million in assets at the end of the financial year
- The corporation, or a related corporation, has audited financial statements prepared in accordance with IFRS or country-specific GAAP
- There is uncertainty in respect of the corporation's Canadian income tax for the taxation year reflected in those audited financial statements (i.e., the corporation concluded that it is not probable that the taxation authority will accept an uncertain tax treatment)

A corporation subject to these proposed rules would be required to provide, at the time it files its tax return, the quantum of taxes at issue, a concise description of the relevant facts, the tax treatment taken, and whether the uncertainty relates to a permanent or temporary difference in tax.

Reassessment period

The normal reassessment period is generally three or four years, depending on the type of taxpayer. However, the Budget proposes that, if a taxpayer does not comply with a mandatory reporting requirement for a taxation year in respect of a transaction, the normal reassessment period would not commence in respect of the transaction, and as such, a reassessment of the year in respect of the transaction would not become statute-barred.

Penalties

A taxpayer that does not file a required form to disclose a reportable transaction or a notifiable transaction in accordance with these proposals would face a penalty of $500 per week to up to the greater of $25,000 and 25% of the tax benefit. A promoter or advisor would face a penalty equal to (i) the fees received plus, (ii) $10,000 plus, (iii) $1,000 per day, during which the failure continues to a maximum of $100,000.

A corporation that does not comply with the proposed disclosure for uncertain tax treatments would face a penalty of $2,000 per week, to a maximum of $100,000.

Combating abusive tax-debt avoidance

Section 160 of the Income Tax Act provides that the CRA can assess a person (the transferee) for some or all of the tax debt of another person (the transferor) if (i) the transferor transferred property to the transferee, (ii) the transferor had a tax debt at the time of the transfer, (iii) the transferor and transferee were not dealing at arm's length at the time of the transfer, and (iv) the transferee paid less than fair market value for the property. Section 160 has broad scope, however, the government alleges that taxpayers are engaging in complex transactions to transfer their assets to a non-arm's length person in a manner that leaves them without the assets necessary to pay their tax debts while avoiding the application of section 160.

As a result, the government proposes to bolster section 160 with a series of anti-avoidance rules. In particular, the proposed anti-avoidance rules would:

- Deem a tax debt to crystallize before the end of the taxation year in which the property is transferred
- Deem arm's length parties not to be deal at arm's length in circumstances where at one time in the series of transactions the parties were not dealing at arm's length, and it is reasonable to conclude that one of the purposes of a transaction (or series of transactions) was to cause both the parties to deal at arm's length at the time of transfer of property
- When determining the value of the property transferred, the overall result of the series would be considered, rather than simply using those values at the time of the transfer

If passed, these proposed anti-avoidance rules would enhance the scope and application of section 160 applied to transfers of property that occur on or after April 19, 2021.

Audit authorities

The Budget proposes amendments to various provisions to ensure that CRA has the authority to conduct audits and undertake other compliance activities, such as the CRA's powers to compel oral interviews during an audit. In particular, the Budget proposes to require persons to answer all proper questions in the form specified by the CRA official.

Furthermore, the Budget proposes additional investment of approximately $300 million to strengthen CRA's audit powers to increase the volume of GST/HST audits of large businesses, develop a process to detect fraudulent GST/HST refund and rebate claims, and enhance the CRA's capacity to identify tax evasions involving trusts.

If these proposals are passed, taxpayers should be prepared for audits in which they are required to agree to an audit interview instead of responding to audit questions in writing.

CREDITS, INCENTIVES AND OTHER BUSINESS MEASURES

Increased funding for Strategic Innovation Fund to support industrial transformation

The Budget proposes to provide the Strategic Innovation Fund with an incremental increase of $7.2 billion over seven years on a cash basis, starting in 2021-22. The funding is intended to support and accelerate industrial transformation in scaling up clean technology, industry 4.0 R&D or capital investment, aerospace industry recovery and long-term resilience building in bio-manufacturing sector. Businesses making significant investments in those priority areas may consider leveraging the Strategic Innovation Fund as a financing option.

Climate action and a green economy

The government seeks to accelerate Canada's net-zero transformation through innovation by providing $5 billion over seven years to the Net Zero Accelerator though the Strategic Innovation Fund. This funding would allow the government to provide financial support for jobs and projects that will help reduce domestic greenhouse gas emissions across the Canadian economy.

In addition, the Budget proposes to introduce an investment tax credit for capital invested in carbon capture, utilization and storage (CCUS) projects beginning in 2022, with the goal of reducing emissions by at least 15 mega-tonnes of carbon dioxide annually.

The government will provide more details on the design of the investment tax credit and the rate of the incentive. Canadian companies adopting the leading CCUS technologies are the target recipients and should ensure they apply for the credit once it becomes available. Other companies that may be eligible for the credit include companies involved in direct air capture projects and in supporting hydrogen production.

Support for Canadian farms in clean technology

The government intends to scale up climate solutions by supporting initiatives for low-carbon, fuel-efficient ways of farming. Specifically, the Budget proposes subsidies for the following:

- The purchase of efficient grain dryers
- Projects aimed at accelerating emission reductions by improving nitrogen management, increasing adoption of cover cropping, and normalizing rotational grazing
- Protecting existing wetlands and trees on farms, including through a reverse auction pilot program
- Powering farms with clean energy and moving away from diesel

Farmers looking to make significant capital expenditures in these areas and in other green initiatives should consider applying for the new funding programs.

Support for local tourism businesses

The Budget proposes to establish a $500 million Tourism Relief Fund, administered by the regional development agencies. The fund will support investments by local tourism businesses in adapting their products and services to public health measures and other investments that will help them recover from the pandemic, and position themselves for future growth.

Tourism businesses should consider leveraging this fund to adapt to the post-COVID-19 economy.

PERSONAL INCOME TAX MEASURES

The government presents the Budget as being for the middle class and helping more people enter the middle class, with a special focus on women in the economy and new graduates.

The government also aims to support young people by waiving the accrual of interest on Canada Student Loan and Canada Apprentice Loans for an additional year, until March 31, 2023. Furthermore, the government proposes to raise the financial assistance income threshold for students from $25,000 to $40,000.

While there are no changes to personal tax rates or the introduction of a national pharmacare program, the government proposes a number of tax credit enhancements. To help pay for the tax credit enhancements, the Budget proposes a tax on vacant housing comparable to British Columbia's Speculation and Vacancy tax, as well as a luxury tax on high-priced passenger vehicles, personal aircraft, and boats.

COVID-19 benefit taxation

Where an individual received a government benefit in respect of COVID-19 and later determines that he or she was not entitled to that benefit, the individual must repay the amount received. Currently, the benefit must be included as income in the year it is received, and the repayment is allowed as a deduction in the year it is repaid. When the repayment does not occur in the year the benefit was received, it may result in tax owing in the year and a deduction in the subsequent year; where income levels change between the two years it can result in a net tax payable.

The Budget proposes an amendment to the current policy and would allow taxpayers who make repayments in 2021 or 2022 to claim the deduction in the year in which the benefit was received, by way of filing an adjustment to the tax return for the year the benefit was received. This measure includes repayments made under the following programs, as long as they are paid before Dec. 31, 2022:

- Canada Emergency Response Benefits / Employment Insurance Response Benefits (CERB)
- Canada Emergency Student Benefits (CESB)
- Canada Recovery Benefits (CRB)
- Canada Recovery Sickness Benefits (CRSB)
- Canada Recovery Caregiving Benefits (CRCB)

This new policy will ensure that repayments align with when individuals received the benefits, and will possibly alleviate some income tax debts. While this measure is unlikely to receive Royal Assent before the April 30, 2021, personal tax filing and payment deadline, individuals can take comfort in the fact that interest related to amounts outstanding will be reversed, once the tax debt is adjusted for any repayments after year-end.

Disability Tax Credit

The Disability Tax Credit (DTC), with a value of $1,299 for 2021, is a non-refundable credit intended to offset the impact of disability-related costs. In order to claim this credit, a taxpayer must have a certificate confirming they have a severe and prolonged impairment in physical or mental function, or be blind, and that impairment, even with appropriate treatment and devices, results in a markedly restricted ability to perform defined basic activities of daily living.

To improve accessibility to the DTC, the Budget sets forth an updated list of mental functions necessary for everyday life, adding functions such as attention, concentration, regulation of behaviour and emotions, and verbal and non-verbal comprehension, thereby expanding eligibility for the DTC.

The proposed changes to the DTC should increase the number of Canadians that meet the eligibility criteria. This improved eligibility criteria is estimated to result in an additional 45,000 people qualifying for the credit. Individuals should consult their tax and medical professionals to determine their eligibility under the broader requirements.

Enhancements to Old Age Security

In light of the economic challenges faced by many seniors during the pandemic, the Budget proposes the following increases to Old Age Security (OAS) benefits for individuals 75 years of age and older:

- A one-time payment of $500 in August 2021 to OAS recipients who will be 75 or over as of June 2022.
- Proposed legislation to increase regular OAS payments for recipients age 75 and older by 10%, commencing in July 2022. Full pensioners would receive an additional $766 in the first year; payments would be indexed to inflation going forward.

The proposed changes to OAS benefits will result in the creation of a two-tier system for eligible pensioners—one level of payment for those 65 to 74 years of age, and one for those 75 years of age and over.

Vacant property tax

In an effort to prevent non-residents from parking their wealth in Canadian real estate, which is perceived to increase the price of housing, as indicated in [November's Fall Economic Statement], the government proposes a 1% tax on the value of vacant or underused residential real estate owned by non-resident, non-Canadians. The 1% tax will be levied annually beginning Jan. 1, 2022; however, the reporting requirement will not begin until 2023. Penalties will apply for failure to comply with the reporting requirement. Canadian citizens and permanent residents are exempt from this reporting requirement.

The government will release a consultation paper in the next few months to provide stakeholders with an opportunity to comment on this proposal.

INDIRECT TAX MEASURES

New tax on selected luxury goods

The Budget proposes to introduce a luxury tax on the sale of new luxury cars and personal aircraft priced over $100,000, and boats priced over $250,000, effective Jan. 1, 2022. For vehicles, aircraft and boats sold in Canada, the tax would apply at the point of purchase if the final sale price paid by a consumer (not including the GST/HST or provincial sales tax) exceeds the $100,000 or $250,000 thresholds. Importations of vehicles, aircraft and boats would also be subject to the tax, and collected at the time of import by CBSA.

For vehicles and aircraft, the tax rate would be the lesser of 10% of the full value, and 20% of the value over $100,000. For boats, the tax rate would be the lesser of 10% of the full value, and 20% of the value over $250,000. Large aircraft, public sector and rescue aircraft, and air ambulances are excluded.

GST/HST and potentially other sales taxes will apply to the final sale price, including the proposed tax. Further details will be announced once the proposal has received Royal Assent.

GST/HST for e-commerce sellers

The Budget proposes several amendments to the GST/HST rules for e-commerce sellers and digital platform operators (e.g., Air BNB) originally proposed in [November's Fall Economic Statement], to clarify certain provisions and help to ensure the rules operate effectively.

Safe harbour rules for remote sellers of all taxable supplies under simplified registration regime

Platform operators are required to register for, charge and report GST/HST on taxable supplies made on behalf of underlying vendors who are not registered for GST/HST and who sell through the operators' platforms. Platform operators must rely on the seller (i.e., registered for GST/HST or not) to determine whether GST/HST is collectible on the sale.

The Budget proposes that the third-party seller and the platform operator be jointly and severally liable for the collection and remittance of tax, if the seller provides false information to the platform operator. However, the proposals will limit the liability of the platform operator for failing to collect and remit tax if the platform operator reasonably relied on information provided by the seller.

Eligible deductions

Under the original proposed rules, a simplified GST/HST registration framework is available for certain suppliers and platform operators who supply services or digital products. Generally, a person registered for GST/HST under the simplified framework will not be entitled to claim input tax credits (ITCs) to recover GST/HST paid on taxable inputs. The Budget now proposes an amendment to clarify that these suppliers will be entitled to deduct amounts for bad debts and certain provincial HST point-of-sale rebates offered to purchasers.

Threshold amount determination

Under the proposals for cross-border sales of services and digital products, non-resident suppliers or distribution platform operators are required to register for GST/HST if their sales or sales through their platforms exceed, or are expected to exceed, $30,000 over any rolling 12-month period. The Budget proposes amendments to clarify that zero-rated sales are not to be included in the threshold calculations.

Platform operator information returns

Platform operators will be required to file annual information returns if they facilitate supplies of short-term accommodations in Canada through the platform, or facilitate sales of tangible goods located in fulfillment warehouses in Canada by non-registered vendors. The Budget proposes to clarify that the filing of information returns by platform operators applies only to those that are registered, or are required to be registered, for GST/HST.

GST/HST on certain supplies made by billing agents

The Budget proposes to relieve GST/HST on the supply of services by billing agents to persons who are registered for GST/HST under the simplified framework. This proposal will ensure that businesses registered under the simplified framework are not paying unrecoverable GST/HST on services supplied by billing agents, given ITCs cannot be claimed under the simplified framework.

Authority for the Minister of National Revenue to register a person

The Budget proposes an amendment to provide the Minister of National Revenue (the Minister) with the authority to register any person for GST/HST under the simplified framework where the Minister believes the person should be registered for GST/HST. This mirrors the current rules for GST/HST under the normal registration framework and other jurisdictions that have adopted similar remote seller rules.

Administration and enforcement grace period

The Budget provides that the CRA will work with businesses, including platform operators affected by the proposed rules, to assist them in meeting their obligations. The CRA will take a practical approach to compliance and exercise discretion in administering the proposed rules during a 12-month transition period starting July 1, 2021, for businesses that show they have taken reasonable measures, but are unable to meet their obligations for operational reasons.

Enhancements to ITC documentary requirements rules

Currently, the ITC information rules require basic information on an invoice, receipt or other source document, to validate the refund claim on pretax purchases less than $30. Additional source document information must be obtained by a claimant where the purchase is $30 or more, but under $150. Further information is required for a purchase that is $150 or more.

The Budget proposes to increase these thresholds to $100 and $500 respectively, presumably to alleviate issues for ITC claimants and their vendors that provide the necessary information on source documents. This change is proposed to take effect for purchases on or after April 19, 2021.

A further change now allows a billing agent (i.e., a person that only bills customers for a principal's taxable supply) to use its legal name and GST/HST registration number on source documentation provided to customers. Previously, the ITC information rules required a claimant to obtain the underlying principal's business name and GST/HST registration to claim an ITC. This change is also proposed to take effect on April 19, 2021.

Improvements to GST/HST new housing rebate

Under the current GST/HST new housing rebate program, consumers buying new homes from a builder must pay GST or HST, which may be reduced by any eligible new home rebate available for the GST or federal part of the HST (i.e., 5%) up to a maximum of $6,300, where the home's value is less than $450,000 (and subject to various other criteria). One of the key conditions to be met requires the purchaser(s) to intend to occupy the new home as their, or a relative's, primary place of residence. The existing rules do not permit a rebate where two or more of the purchasers are unrelated to one another.

The Budget will remove this limitation and require only one purchaser to intend to use the new home as their, or a relative's, primary place of residence to claim the rebate (subject to meeting the other existing conditions). The change will extend to new owner-built homes, new cooperative housing units, and new homes built on leased land—it will also include the provincial portion of HST where applicable, subject to any limitations on the maximum rebate.

The proposed rule is intended to take effect for new homes purchased through a purchase and sale agreement dated on or after April 19, 2021. For owner-built homes, the proposed change will take effect upon substantial completion (generally 90% complete) of construction or substantial renovation that occurs on or after April 19, 2021.

Rebate of excise tax for goods purchased by provinces

Currently, a rebate of excise tax (e.g., on fuels, etc.) can be claimed by either the vendor of the goods or an eligible province. The proposed change requires that a rebate can only be claimed by an eligible province (i.e., a province that has not agreed to pay federal indirect taxes) unless the province has made a joint election with the vendor to allow the vendor to claim the rebate. This clarifies who is entitled to claim the provincial-use rebate on excise tax paid for goods purchased by an eligible province for its own use.

For eligible provinces, there is a rebate of excise taxes on motive fuels, air conditioners in automobiles, and fuel inefficient vehicles. Ultimately, there is no difference to the province or the vendor; however, a province that makes an election with a vendor will not be required to pay the tax up front, allowing the vendor to claim it, compared to the existing rules where the province must file a refund.

Excise duty on tobacco

Effective April 20, 2021, the excise duty rate for cigarettes will increase by $4 per carton on 200 cigarettes. Vendors that have stock on hand at the start of the day after April 19, 2021, will have to file a return and pay the increased duty ($0.03 per cigarette) by June 30, 2021.

Excise duty on vaping products

Similar to the duty on tobacco, the Budget proposes to add an excise duty for vaping products under the Excise Act, 2001 (the Act). The duty applies to vaping liquids either produced in, or imported into, Canada for use in a vaping device, but will not apply to cannabis-based vaping products. The duty applies to all other products whether they contain nicotine or not.

Changes to customs duties and the importation process

The government proposes two changes to customs in the Budget titled "Improving Duty and Tax Collection on Imported Goods". There was not much detail provided on the exact changes, and additional information on legislative and future regulatory changes are expected.

Changes to the "purchaser in Canada" concept

The Budget proposes amendments to the Customs Act with respect to the valuation of imported goods. These new amendments are expected to help promote fairness to all importers, and retain consistency with international rules. Finance Canada perceives that importers with foreign ties have an advantage to import goods at a lower value by using a previous sales price, thus allowing the importers to pay lower amounts of duties and taxes on imported goods. The amendments would ensure that all importers value goods based on the last sale for export to a purchaser in Canada.

Modernizing the customs duties payment process

The Budget also proposes to modernize payment processes for commercial importers that are subject to the Customs Act and regulations. These amendments will streamline and harmonize billing cycles for commercial importations, including flexibility for certain types of corrections without incurring penalties or interest. These amendments would correspond with the implementation of the CBSA Assessment and Revenue Management (CARM) system that will come into effect in spring 2022.

OTHER MEASURES

The federal minimum wage is $15 per hour, and the government is implementing a national early learning and childcare system for all Canadians that will cost taxpayers an average of $10 per day.

Pro-rated application of Part X.2 tax

Currently, where a registered investment mutual fund trust or mutual fund corporation does not meet the investor requirements to qualify, it is restricted to only holding investments that would be qualified investments for an RRSP. If it holds non-qualified investments, it is liable for Part X.2 tax of 1% per month on the fair value of the non-qualified investments.

The government proposes to amend Part X.2 to compute the 1% monthly tax on a pro-rata basis. The tax would only apply based on the amount of the shares or units of the registered investment held by investors that are not currently subject to the Qualified Investment Rules, such as RRSPs.

Part X.2 tax will be calculated on a 'look-through' basis rather than applied to each unit or share, regardless of ultimate ownership. This change will apply in each month after 2020 for all entities. It will also apply to months before the 2021 year where the CRA has not determined the final Part X.2 tax liability by April 19, 2021.

Correcting contribution errors in defined contribution pension plans

There is currently no mechanism in the Income Tax Act to correct under-contributions to a defined contribution plan, and mechanism for correcting over-contributions and receiving a refund of premiums is onerous for plan administrators. The Budget proposes to allow entities to correct both over- and under-contributed amounts through prescribed form.

This measure will allow plan administrators to correct errors in contributions without onerous filings.

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