2021 Year-end tax planner

2021 was jampacked with new tax measures as Canada continued to cope with the COVID-19 pandemic. Governments focused on funding pandemic relief programs while planning for economic recovery. Unlike in 2020, the federal government along with all provincial and territorial governments released budgets this year that introduced some notable measures. Toward the end of 2021, a federal election call resulted in another minority government led by the Liberals.

This 2021 year-end tax planner summarizes key federal, provincial and territorial tax updates that middle market taxpayers should consider when preparing for 2021 tax planning opportunities and year-end obligations.

FEDERAL BUSINESS TAX CONSIDERATIONS

Employee stock options

Historically, qualifying employee stock options received preferential treatment that effectively taxed stock option benefits in the hands of employees at capital gains rates. Individuals were allowed to claim a deduction of one-half of the taxable benefit, i.e., a 50 per cent deduction. The stock option benefit, equal to the excess of the value of the shares received over the exercise price, is included in the employee's income at the time when the option is exercised.

In the 2019 Federal Budget, the government introduced its intention to limit the employee stock option deduction for high-income individuals employed at large and long-established corporations. A $200,000 annual cap on stock options eligible for a 50 per cent deduction was proposed. These new rules came into effect on July 1, 2021.

Specifically, the following changes apply to employee stock options granted on or after July 1, 2021:

- Employees can claim a 50 per cent deduction for options that vest in any particular year only to the extent that the fair market value of the underlying shares does not exceed $200,000 (annual vesting limit). Options are included in the $200,000 annual vesting limit in the year when they become vested. The fair market value of the underlying shares is determined with reference to the share price at the options' grant date.
- The vesting year for the purposes of the $200,000 annual limit:
  - If the option agreement specifies the calendar year in which the right to acquire shares becomes exercisable, the option is considered vested in that year.
  - If the option agreement does not specify the vesting year, the option will be deemed to vest on a pro rata basis over the term of the option up to a 60-month period starting the day after the agreement was entered into. This vesting period will likely apply in situations where options vesting is based on performance criteria.

There are some exceptions to the new limit, such as employee stock options granted by Canadian-controlled private corporations (CCPCs), or non-CCPC employers with annual gross revenues of $500 million or less.

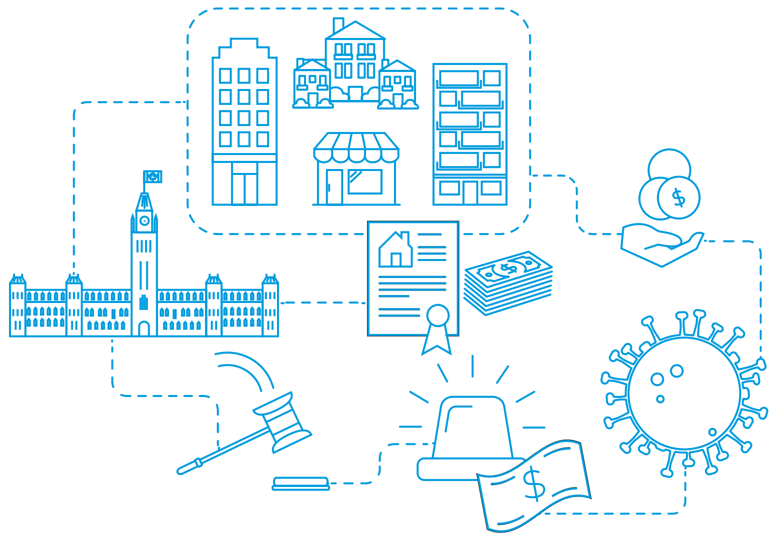
The $200,000 annual limit applies to all stock options agreements between an employee and their employer or any other corporation that does not deal at arm's length with the employer. If the individual has two or more employers who deal at arm's length with each other, the individual will have a separate $200,000 limit for each employer.

Where an employee has several identical stock options with some qualifying for the existing tax treatment and some subject to the new limit, the employee would be considered to exercise the stock options qualifying for the existing tax treatment first.

Employers are eligible for an income tax deduction in respect of a stock options benefit in excess of the $200,000 annual limit. The deduction can be claimed by the corporation that employs the employee, provided the stock option benefit is included in an employee's income subject to tax in Canada and the employer complies with the notification requirements.

Employers can also choose to designate shares, that are otherwise eligible for a 50 per cent employee deduction up to the $200,000 annual cap, as non-qualified securities. Employees will not be entitled to the employee deduction but, subject to certain conditions, the employer may be entitled to a tax deduction for the benefits realized by the employee.

Employers are required to notify employees in writing in respect of any non-qualified securities that are not eligible for a 50 per cent deduction no later than 30 days after the day the options are granted. Notification in a prescribed form (not yet available) should also be submitted to the Minister of National Revenue (Minister) on or before the filing-due date for the taxation year that includes the time when the options are issued.



Corporations should evaluate the impact of the changes on their stock option plans to ensure they are in compliance with these new rules.

For stock option plans implemented before July 2021, corporations should consider the dates of stock options' issuance and the application of grandfathering rules to confirm if options would fall under the old rules. Employers should also evaluate options' vesting periods to limit, where possible and beneficial, stock option benefits realized per employee in any particular year to less than the $200,000 annual limit. In addition, employers may wish to model the allocation of tax benefits between the corporation (corporate tax deduction for non-qualified securities) and employees (50 per cent stock option deduction up to $200,000 limit) when planning for the value of annual grants per employee and vesting periods.

Bill C-208 – An Act to amend the *Income Tax Act* (transfer of small business or family farm or fishing corporation)
One of the more notable changes for 2021 was the passing of private member's Bill C-208. On June 29, 2021, Bill C-208 received Royal Assent effectively amending section 84.1 of the *Income Tax Act* (Act).

Historically, the anti-avoidance rules contained in section 84.1, could convert the capital gain incurred by a shareholder on the sale of her business to a dividend when certain criteria were met, mainly where the purchaser was a non-arm's length corporation. The conversion of the capital gain to a dividend prevented the use of this lifetime capital gains exemption (LCGE) in these circumstances, resulting in a significantly higher tax bill than would be realized on a sale to a third party.

Bill C-208 amended section 84.1 to exempt qualified small business corporation (QSBC) shares and shares of farming and fishing businesses from the negative implications of section 84.1 where specific sale criteria is met. This preserves the capital gains treatment on a non-arm's length disposition of shares and access to the LCGE. In particular, the business must be sold to a corporation owned by a child or grandchild of the vendor and the purchasing corporation should hold the shares for a for a minimum of 60 months. Taxpayers will also be required to obtain an independent valuation of the business that is subject to sale.

These changes affect how entrepreneurs, farmers and fishers transition their business to the next generation, as well as reduce the applicable taxes.

Amendments to the current legislation are expected from the Department of Finance, and will likely narrow the applicability of the legislation. Until new legislation is introduced, taxpayers considering legitimate family business transitions to adult children or grandchildren can utilize the current legislation to affect the transfer in a tax efficient manner. Taxpayers should be cautious of transactions undertaken solely to avoid tax, which could be subject to Canada Revenue Agency (CRA) scrutiny and the application of the general anti-avoidance rule (GAAR).

Proposals from the Federal Budget

The first Federal Budget in almost two years was tabled by the Minister on April 19, 2021. Notable measures that middle market businesses should be aware of include the following:

Corporate tax rate reduction for zero-emission technology manufacturers

The Federal Budget proposed temporary reductions to corporate income tax rates on eligible zero-emission technology manufacturing and processing income as follows:

- From 15 per cent to 7.5 per cent, where the income is subject to the general corporate tax rate
- From 9 per cent to 4.5 per cent, where the income is subject to the small business tax rate

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

The reduced tax rates would be applicable for tax years beginning after 2021 and will be gradually phased out starting in 2029 and fully eliminated by 2032. Businesses earning income from zero-emission technology manufacturing and processing activities should review and plan for reduced rate eligibility starting next year.

CCA deduction for CCPC and immediate expensing

To enhance the capital cost allowance (CCA) deduction for CCPCs, the government introduced "immediate expensing" of certain depreciable property acquired on or after April 19, 2021, available for use before Jan. 1, 2024. The expense is limited to $1.5 million per taxation year shared amongst associated members of a group of CCPCs.

Property eligible for this new measure includes capital property subject to CCA other than long-term properties 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 Act, including the accelerated investment incentive.

This may be an opportunity for the CCPCs considering expansion in the near future to undertake capital investments by benefiting from the immediate deduction of capital assets costs at a low tax rate before January 2024. It is important to note that immediate expensing has not yet become law.

The CRA confirmed that it will not allow proposed immediate expensing until legislation is introduced. Furthermore, the CRA has disallowed the claims for some taxpayers. The CRA has stated that taxpayers would be able to amend returns in the future once the legislation is passed into law.

Accelerated capital cost allowance deductions for certain clean energy equipment

To make clean energy projects more fiscally attractive, the government expanded the CCA classes 43.1 and 43.2 eligible for enhanced CCA, to include additional types of clean energy generation and energy conservation assets. Businesses should review the updated list to confirm if anticipated investments in clean energy projects would qualify for the accelerated tax deductions. The expanded list comes into force as of April 19, 2021, the date of the Federal Budget. Restrictive changes will apply to additions that become available following 2023 once legislation is passed.

Federal election

In addition to these proposals, the 2021 federal election resulted in the Liberals securing enough seats to form a minority government. As such, it is likely that many of these proposals will be introduced by the end of 2021 and early 2022, as well as some additional measures introduced first in the election platform. Middle market businesses should start planning now in anticipation of the likely enactment of these proposals.

COVID-19 measures

Canada Emergency Wage Subsidy

The Canada Emergency Wage Subsidy (CEWS) was designed to support employers that suffered from a decline in revenue during COVID-19. It began in March 2020 and expired on Oct. 23, 2021. During the 2021 federal election campaign, the Liberal party proposed to extend the CEWS program past the tentative October 2021 end date, for businesses in the tourism sector experiencing a minimum 40 per cent revenue loss. Currently, this proposal has not been passed as legislation. Currently, no extensions for other industries have been proposed. The same reporting obligations from 2020 will continue to apply in 2021.

The CEWS is considered government assistance and therefore is taxable income. This means the employer is required to report the CEWS subsidy on its income tax return(s). Rather than being taxable when received, the CEWS is taxable immediately before the end of the related qualifying period.

Where an employer received the CEWS and fails to report the amount on its income tax, interest may be applicable, in addition to tax on the amount.

In 2020, employers were required to report amounts paid as salary, wages or other remuneration to each eligible employee on the respective employees' T4 slips for specific relevant periods. This was to assist the CRA with ensuring that any employees who received direct benefits were entitled to receive them. This information may also be used in CRA audits and reviews of subsidies received. There is no indication as to whether similar reporting will continue in 2021.

Canada Recovery Hiring Program

First introduced in the Federal Budget, the Canada Recovery Hiring Program (CRHP) provides a subsidy to help cover the cost of employee wages beginning on June 6, 2021, and ending on Nov. 20, 2021 (unless extended by the government). Pending legislation, the Liberal government has proposed to extend the CRHP until May 2022.

This subsidy is calculated based on how much an employer's eligible remuneration paid to employees increased from the time of the base period (March 14 to April 10, 2021) to the time of the claim period. The CRHP periods follow the same dates as CEWS and CERS periods.

For each claim period, eligible employers can claim either the CRHP or the CEWS, whichever is higher, but not both. The CRHP reporting requirement are identical to the CEWS (i.e., reporting obligations on the entity's T2 return and the employee's T4 slip).

Canada Emergency Rent Subsidy and Lockdown Support

The Canada Emergency Rent Subsidy (CERS) and Lockdown Support was introduced in September 2020 to help businesses partially offset their eligible rent expenses. Specifically, it provides rent and mortgage support to businesses, commercial property owners and renters. Like the CEWS, it is based on a revenue decline calculation and expired on Oct. 23, 2021, with a similar proposed extension into 2022 for businesses in the tourism sector experiencing a minimum 40 per cent revenue loss.

As with many other COVID-19 subsidies, CERS is considered government assistance and is taxable income to the recipient. It should be reported on the recipient's income tax return(s). Similar to CEWS, CERS is deemed to be taxable immediately before the end of the related qualifying period rather than when it is received. As the application deadline is 180 days from the period end, late applicants to the program may find they need to amend prior year tax returns.

Canada Emergency Business Account

The Canada Emergency Business Account (CEBA) provided interest-free business loans of up to $60,000. Twenty-five per cent of the first $40,000 of the loan and 50 per cent on the remaining $20,000 can be forgiven if the business repays the remaining 75 per cent and 50 per cent of the loan respectively by Dec. 31, 2022. After that date, the unpaid loan is converted to a three-year term subject to 5 per cent interest.

While businesses can no longer apply for this program, CEBA filing obligations extended into 2021. Where a business applied for CEBA, they must include the potential forgiven amount in its taxable income in the year the loan was received, even where the repayment criteria has not yet been met. Any underreported amounts may be subject to interest in addition to taxes payable. If the entity does not repay the loan on or before Dec. 31, 2022, thereby missing the forgiveness criteria, it will need to amend its prior return to remove the income inclusion.

Notable case law developments

Business transactions and exposure under section 160

Section 160 of the Act states that the CRA can assess a person (the transferee) for some or all of the tax debt of another person (the transferor) when four criteria are met. The purpose of the provision is to provide the CRA with recourse when a taxpayer tries to avoid paying a tax liability by transferring assets to a non-arm's length party at less than fair market value and therefore not having sufficient assets to satisfy its tax debt.

In *Eyeball Networks Inc. v. the Queen*, the Federal Court of Appeal (FCA) overturned the Tax Court of Canada's (TCC) decision and upheld the rule that section 160 of the Act does not apply to setoff notes in a corporate reorganization. Provided that the notes represent bona fide debts, the FCA also confirmed that mutual offset of the debts cannot trigger the application of section 160. The FCA's reasons provided clarification that the type of setoff commonly used in butterfly transactions and other corporate reorganizations should not typically attract section 160.

In *Damis Properties Inc. v. The Queen*, the TCC issued a decision that found both section 160 and the GAAR inapplicable. Specifically, the CRA attempted to extract tax from the vendors under section 160 on the basis that the transactions were not arm's length and not at fair market value. In the alternative, the CRA argued that GAAR should apply to the series of transactions. The CRA lost both arguments. The government addressed these loopholes in its Federal Budget, and these loopholes are discussed in the audit and enforcement considerations section of this tax planner.

Distribution on wind-up

The purpose of subsection 84(2) is to tax all distributions made by a Canadian resident corporation on the winding-up, discontinuance or reorganization of its business as a dividend, except to the extent the distribution represents a return of paid-up capital.

In *Foix v. The Queen*, a hybrid transaction occurred where the shareholders effectively "sold" cash to an arm's length buyer versus extracting the amounts prior to close. This allowed the sellers to claim capital gains treatment on the additional purchase proceeds received for excess cash in the business. The CRA successfully argued that subsection 84(2) applies to re-characterize a portion of the proceeds as a dividend. While the decision has been appealed, the broad application of subsection 84(2) is always of concern for sellers in a transaction context. The appeal will be closely watched to determine if the courts will narrow the application and overturn the decision.

Acquisition of control

Subsection 111(5) of the Act provides for loss carryforwards where control of a corporation is acquired. However, subsection 111(5) is designed to limit "trading" in loss corporations for profitable ones to essentially soak up the losses.

In *The Queen v. Deans Knight Income Corporation*, the FCA "rearticulated" the object, spirit and purpose of subsection 111(5) as restricting "the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of de jure control or otherwise." The TCC used the term "effective control" in its explanation of the object, spirit and purpose of subsection 111(5), which the parties incorrectly interpreted as being a synonym for *de jure* control. This decision casts a broader net and requirement for additional analysis under certain transaction forms (e.g., minority positions but control via outside agreements, debt investments with terms which provide effective control, etc.).

PERSONAL TAX CONSIDERATIONS

COVID-19 measures

Once again, COVID-19 was front of mind for individuals and the federal government alike throughout much of 2021. As we begin to see signs of economic recovery, the following government COVID-19 support programs ended in October 2021:

- Canada Recovery Benefit (CRB)
- Canada Recovery Sickness Benefit (CSRB)
- Canada Recovery Caregiving Benefit (CRCB)

While the payments for these programs have concluded, the income tax impacts will be present through to spring 2022. It is important for recipients to consider the tax impact these payments may have as the payments are taxable and must be reported as income on their 2021 tax return. While tax is withheld at the source, it is only withheld at a rate of 10 per cent; those who received payments from these programs frequently throughout 2021 along with other sources of income may have a tax bill where their effective rate is in excess of 10 per cent. For example, an individual in the lowest tax bracket could expect to pay additional tax on these payments ranging from 9 per cent to19.8 per cent, depending on their province or territory of residency. Planning for the April 30, 2022, personal tax filing and payment deadline can help mitigate any unpleasant surprises.

Enhancements to old age security

To provide additional support to seniors both during the pandemic and on an ongoing basis, the government introduced changes to old age security (OAS) for individuals 75 years of age and older, including an increase to OAS payments by an extra 10 per cent, for recipients aged 75 and older, commencing in July 2022.

Disability tax credit

The disability tax credit (DTC) 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 perform defined basic activities of daily living.

Aiming to improve the accessibility to the DTC, the government will expand eligibility by setting forth an updated list of mental functions necessary for everyday life such as attention, concentration, regulation of behaviour and emotions, and verbal and non-verbal comprehension. Additionally, a reduction in the required time spent on life-sustaining therapy is proposed.

These changes, as set forth in the Federal Budget, will result in an increased number of Canadians that meet the eligibility criteria once the legislation is passed into law. Individuals should consult their tax and medical professionals to determine their eligibility under the broader criteria.

Proposed vacant property tax

In response to Canada's skyrocketing housing prices, the federal government has proposed a tax on vacant and underused residential real estate owned by non-residents of Canada. The underused housing tax (UHT) is proposed to take effect on Jan. 1, 2022, at an annual rate of 1 per cent on the specified value of the property. Every residential property owner who is not exempt from UHT will be required to pay UHT on or before April 30 of the following calendar year as well as file an annual declaration with the CRA. There are various proposed exemptions to the UHT including property owned by Canadian citizens and permanent residents. Situational exemptions such as property rented at fair value or is uninhabitable for the full year, or property under renovations for a reasonable time period, is also available. Substantial penalties for non-compliance are also included in this proposal. We expect draft legislation to be introduced later in 2021.

Proposed tax on luxury vehicles, boats and aircraft

The Federal Budget proposed a new tax on the retail sales and imports of luxury cars and personal aircraft with a final sale price over $100,000, and boats priced over $250,000 (not including GST/HST, QST or PST), to be effective Jan. 1, 2022. Further details of the luxury tax were released in Aug. 25, 2021.

The luxury tax will be collected at point of sale or by Canada Border Services upon import and will generally apply to new passenger vehicles (such as sports cars and SUVs), new aircrafts (including airplanes, helicopters and gliders), and new boats (such as yachts, recreational motorboats and sailboats) when for personal use. Other recreational vehicles are exempt from the application of the tax.

For vehicles and aircraft priced over $100,000, the amount of tax will be the lesser of 10 per cent of the full value of the vehicle or aircraft and 20 per cent of the value above $100,000. For boats priced over $250,000, the amount of tax will be the lesser of 10 per cent of the boat's full value and 20 per cent of the value above $250,000. GST/HST will apply to the final sale price, inclusive of the luxury tax. The cost of after-market modifications made within a specific time-period is also proposed to be included in the final sale price. Where luxury vehicles are ordered after April 20, 2021 (the date of the announcement of the proposed tax),but will not be delivered to the purchaser until 2022, the luxury tax may still be applicable. In instances where the seller and purchaser of a specified good entered into a written sales agreement prior to April 20, 2021, the luxury tax does not apply.

Indexation adjustments

Increases to personal tax brackets, non-refundable credits and other amounts will be less significant for the 2021 tax year than that of prior years, due to a lower-than-average indexation of 1 per cent.

Personal tax bracket thresholds (federal)

Income level	Tax rate
Less than $49,020	15%
$49,021 – $98,040	20.5%
$98,041 – $151,978	26%
$151,979 – $216,511	29%
Greater than $216,511	33%

Personal tax bracket thresholds (Alberta)

Income level	Tax rate
Less than $131,220	10%
$131,221 – $157,464	12%
$157,465 – $209,952	13%
$209,953 – $314,928	14%
Greater than $314,928	15%

Personal tax bracket thresholds (British Columbia)

Income level	Tax rate
Less than $42,184	5.06%
$42,185 – $84,369	7.70%
$84,370 – $96,866	10.50%
$96,867 – $117,623	12.29%
$117,623 – $159,483	14.70%
$159,484 – $222,420	16.80%
Greater than $222,420	20.50%

Personal tax bracket thresholds (Ontario)

Income level	Tax rate
Less than $45,142	5.05%
$45,143 – $90,287	9.15%
$90,288 – $150,000	11.16%
$150,001 – $220,000	12.16%
Greater than $220,000	13.16%

Other

- 2021 OAS repayment threshold: $79,845
- 2021 lifetime capital gains exemption limit: $892,218
- 2021 Canada Pension Plan maximum annual employee and employer contribution: $3,166.45
- 2021 federal Employment Insurance maximum annual premium (employee): $889.54
- 2021 federal Employment Insurance maximum annual premium (employer): $1,245.36

New trust reporting rules

Trusts with a Dec. 31, 2021, or later year-end will soon be subject to new reporting rules. Historically, based on a CRA administrative position, a Canadian trust was generally required to file a T3 return only if the trust has tax payable or distributed all or part of its income or capital to its beneficiaries during the year.

Under the new reporting requirements, certain Canadian trusts must file a T3 return on an annual basis regardless of whether it earns income or makes distributions in the year. Additionally, a trust will be expected to file a beneficial ownership schedule with the T3 return. The schedule must disclose the name, address, date of birth (for a natural person), jurisdiction of residence, and taxpayer identification number (TIN) for each settlor, trustee, beneficiary and person who exerts control, or can override trustee decisions with respect to the allocation of income or capital of the trust.

The penalties for failure to comply with the new reporting requirements are $25 per day up to a maximum of $2,500, with stiffer penalties in circumstances of gross negligence. If the failure to comply was considered intentional or under circumstances amounting to gross negligence, the penalty is equal to 5 per cent of the value of the trust's properties in the year.

The government has yet to provide any additional guidance or updated forms with respect to this change and legislation has not been released yet regarding these changes.

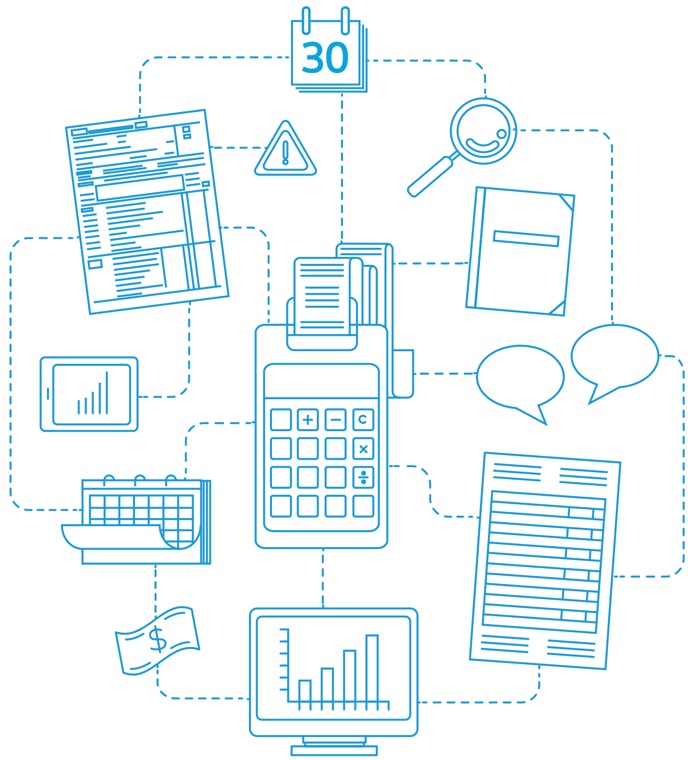
INTERNATIONAL TAX CONSIDERATIONS

Updated foreign affiliate reporting

In early 2021, the CRA released an updated T1134 form that significantly expanded the reporting requirements for foreign affiliates (FAs) and controlled foreign affiliates (CFAs) of Canadian residents (reporting entities). The revised form is applicable for reporting entities' taxation years that begin in 2021 or later and is due 10 months after the end of the taxation year.

The changes to the form are extensive and require substantial additional reporting. For example, the new form requires:

- Reporting related to legislative amendments to, among others, foreign affiliate dumping (FAD) rules, tracking interest rules and upstream loan rules.
- Disclosure of the amount of foreign accrual property losses (FAPLs) and foreign accrual capital losses (FACLs) incurred by CFAs during the current taxation year and whether such losses were carried forward and back.
- Disclosure of the adjusted cost base (ACB) of both common shares and preferred shares (if applicable) of top-tier FAs, including whether any elections were made and whether any changes occurred to the ACB during the year.
- Reporting of all dividends paid from one FA to another and whether any elections were made with respect to the dividend ordering rules.



These new requirements underscore the importance of maintaining and updating surplus computations on a timely basis. The additional reporting reflects information that should already be analyzed and quantified for the reporting entities' Canadian income tax returns, which are due much earlier than the T1134 form. As such, taxpayers who are fully compliant with the current rules may not find the revisions to be very onerous.

International tax reform

On Oct. 8, 2021, the Organisation for Economic Co-operation and Development (OECD) announced that 136 countries, including Canada, have agreed on the elements of the landmark two-pillar plan on international tax reform.

- Pillar One: Aims to re-allocate some taxing rights over multinationals from their home countries to the markets where they have business activities and earn profits, regardless of whether multinationals have a physical presence there. Countries are aiming to sign a multilateral convention during 2022, with effective implementation in 2023. The convention is already under development and will be the vehicle for implementation of the newly agreed taxing right under Pillar One, as well as for the standstill and removal provisions in relation to all existing digital service taxes (DST) and other similar relevant unilateral measures.
- Pillar Two: Aims to implement a global anti-base erosion rule through the introduction of a global minimum corporate tax rate of 15 per cent that countries can use to protect their tax bases. It will apply to companies with revenue above €750 million and is estimated to generate around US $150 billion in additional global tax revenues annually. The OECD will develop model rules for bringing Pillar Two into domestic legislation during 2022, to be effective in 2023.

This is a significant development which updates and finalizes the July political agreement entered into by the members of the Inclusive Framework. This agreement fundamentally reforms the international tax rules and will ensure that multinationals pay a fair share of tax wherever they operate. Middle market companies should carefully review the model rules as they are likely to affect their business decisions, and their current intercompany transactions.

Digital services tax

The Federal Budget proposed to implement a temporary DST at a rate of 3 per cent of revenue generated from digital services that rely on data and content distributions from Canadian users on large businesses (both foreign and domestic) that meet 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 C$20 million in that particular calendar year.

In light of the landmark international tax reform agreement reached on Oct. 8, the government of Canada announced that it will continue drafting the DST rules but delay its implementation until Jan. 1, 2024. If the OECD's international tax agreement is not implemented by Jan. 1, 2024, Canada will implement its DST which would be payable as of 2024 in respect of revenues earned as of Jan. 1, 2022.

Non-resident companies without a physical presence or permanent establishment in Canada who make profits from supplying digital services in Canada (e.g., online advertising, sales from user data, digital intermediary services, etc.) should carefully review their revenue streams to identify tax compliance exposures in anticipation of these potential reporting requirements.

Hybrid mismatch arrangements

Hybrid mismatch arrangements (HMAs) are cross-border tax avoidance structures that use differences in the income tax treatment of entities or instruments under Canada's tax laws and one or more other countries, to claim a deduction in one country in respect of a cross-border payment. The receipt of the payment is not included in the ordinary income of the recipient in the other country. They also include arrangements where a deduction is claimed in two or more countries in respect of a single expense.

The Federal Budget proposed to implement the following changes in two different legislative packages, the first to take effect on July 1, 2022, and the second to take effect no earlier than 2023:

- Payments made by a Canadian resident 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.
- Amounts received by a Canadian resident under HMAs would be included in income and if the payment is a dividend from a foreign affiliate, it will not be deductible in computing taxable income of the Canadian resident.
- A Canadian resident is not permitted to claim a deduction against their income if it receives amounts from a non-resident under HMAs that are deductible for foreign income tax purposes.

These rules would neutralize the effect of HMAs by aligning the Canadian income tax treatment with the income tax treatment in a foreign country. Corporations with international structures should revisit these to determine whether they are affected by the proposed HMA rules.

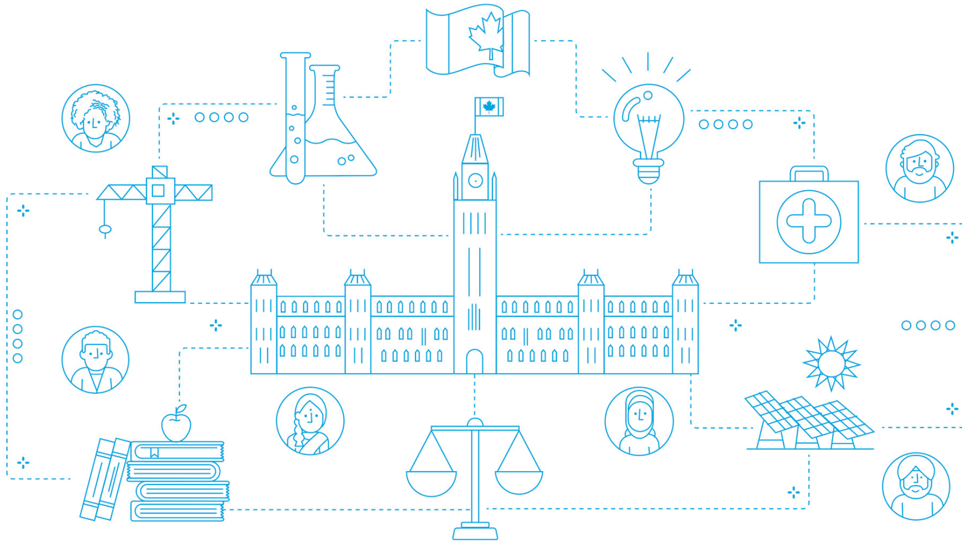
Interest deductibility limits

Canada's tax laws allow the deduction of interest expense if the borrowed funds are used to generate income. However, excessive debt or interest expense may be placed in Canadian businesses that may erode the tax base.

Canada currently limits interest deductions on excessive cross-border debt primarily through "thin capitalization" rules. These rules generally limit the deduction of interest expense on debt owing to "specified" non-residents (which generally means significant shareholders and non-arm's length persons), where the debt exceeds a 1.5-to-1 debt-to-equity ratio. From the government's perspective, the major shortcomings of the thin capitalization rules are that the rules only apply to debt and interest expense owing to significant "specified" non-resident shareholders. The rules also allow a significant degree of flexibility in terms of the rate of interest that a corporation may pay.

The Federal Budget proposed to introduce a new interest deductibility rule that limits a corporation's interest deduction. The deduction would be 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 would also apply to trusts, partnerships and Canadian branches of non-resident taxpayers. The rules would be phased in with a fixed ratio of 40 per cent of tax EBITDA for taxation years beginning on or after Jan. 1, 2023, but before Jan. 1, 2024; and 30 per cent for taxation years beginning on or after Jan. 1, 2024. The limits on interest deductions would apply to existing and new borrowings.



Exceptions from the new rule would be available for:

- CCPCs that, together with associated corporations, have taxable capital employed in Canada of less than $15 million; and
- 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 denied the interest deduction would be able to carry forward the deduction for up to 20 years or carry back the deduction for up to three years.

It is important to note that the interest deductibility limitation rules, if enacted, would apply concurrently to the thin-cap rules and apply regardless of whether the relevant interest is payable to a related party or to an arm's length lender.

Canadian corporations that have entered financing arrangements with non-resident non-arm's length entities should review their current financing arrangements to determine the potential impact of the proposed interest deduction limitation rules. Corporations should consider refinancing group loans to benefit from current low interest rates, and learn how these proposed rules will affect their overall tax rate in the future.

COVID-19-related International income tax issues and travel restrictions

In 2020, the CRA released certain guidelines to address potential issues arising due to travel restrictions imposed because of COVID-19. These guidelines provided administrative relief from March 16, 2020, to Sep. 30, 2020 (the initial relief period). The CRA extended some of the relief provided in the initial period into 2021. In particular, the CRA:

- Extended the administrative relief in respect of individual income tax residence.
- Clarified some of the CRA's views regarding the effect of the travel restrictions on the determination of a permanent establishment (PE) in Canada.
- Provided an outline of the Canadian income tax and compliance requirements of certain cross-border employees and provided some relief in respect of these requirements.

Permanent establishment
The supplemental guidance provides the following clarification on the tests for PE:

Fixed place of business PE
The CRA notes that an individual working remotely from their home or short-term residence in Canada while the travel restrictions remain in place will generally not meet the requirement for a fixed place of business. However, this relief will not apply should the employee(s) continue to exercise their employment duties in Canada after the lifting of the travel restrictions, or if the individual and their employer take action to establish the workspace in Canada as an office of the employer with a semblance of permanence and is at the employer's disposal.

Agency PE
The CRA notes that the requirement that the agent habitually exercise the right to conclude contracts will generally not be met where an individual who has the right to conclude contracts on behalf of their employer is doing so from Canada solely because of the travel restrictions. This relief could change for both the period of time during which the travel restrictions are in place as well as afterwards if the employee remained in Canada past the lifting of the travel restrictions and continued to exercise the right to conclude contracts.

Services-based PE
The CRA notes that this test will not be met provided that the individual in Canada is not working on projects for Canadian customers.

Non-resident entities that have employees working in Canada due to travel restrictions should consider the potential Canadian tax implications if the employees decide to work from Canada even after travel restrictions are lifted.

Individual tax residency
The COVID-19 pandemic has redefined how we work in more ways than we could possibly imagine. To ensure that business could carry on as usual, employers needed to be accustomed to employees working remotely and allow a "virtual assignment" due to different travel restrictions resulting in cross-border employees.

Virtual assignments might create many risks for employers and employees in terms of tax and payroll compliance and PE. Foreign employers should understand that even one employee working remotely from Canada triggers a Canadian payroll obligation. It is the employer's responsibility to administer Canadian payroll, including withholding and remitting Canadian income taxes and possibly Canadian social security taxes (Canadian pension plan and employment insurance) for the employee(s) located in Canada. The employer must also remit, out of pocket, a matching contribution on the social security taxes, and issue a Canadian wage slip (Form T4) for the employee(s) at year-end. To facilitate these obligations, the foreign employer is required to obtain a Canadian business number (BN).

The extension of the administrative relief is applicable for the following items:

Individual income tax residency
The CRA will not consider a foreign individual temporally in Canada to be a deemed Canadian tax resident if they were only physically in Canada as a result of the travel restrictions. This is in effect until the earlier of the date of the lifting of the travel restrictions, or Dec. 31, 2021.

Cross-border employment income—Canadian resident employees
Employees who receive a notification that they must remit income tax instalments in 2021, as a result of larger than usual Canadian income tax payable for 2020, may request to have interest and penalties waived if charged by the CRA. Employees can fill out Form RC4288 Request for Taxpayer Relief—Cancel or Waive Penalties or Interest, and submit all supporting documents along with the form, such as a detailed description of their employment arrangement, Form W-2, U.S. 1040 return, U.S. account transcript and any other document that confirms the receipt of a U.S. refund.

TRANSFER PRICING CONSIDERATIONS

Government assistance

Many businesses have utilized the government's assistance programs to reduce the economic impact of the COVID-19 pandemic. However, it can be challenging to accurately apply transfer pricing policies to intercompany transactions, where government assistance has been received.

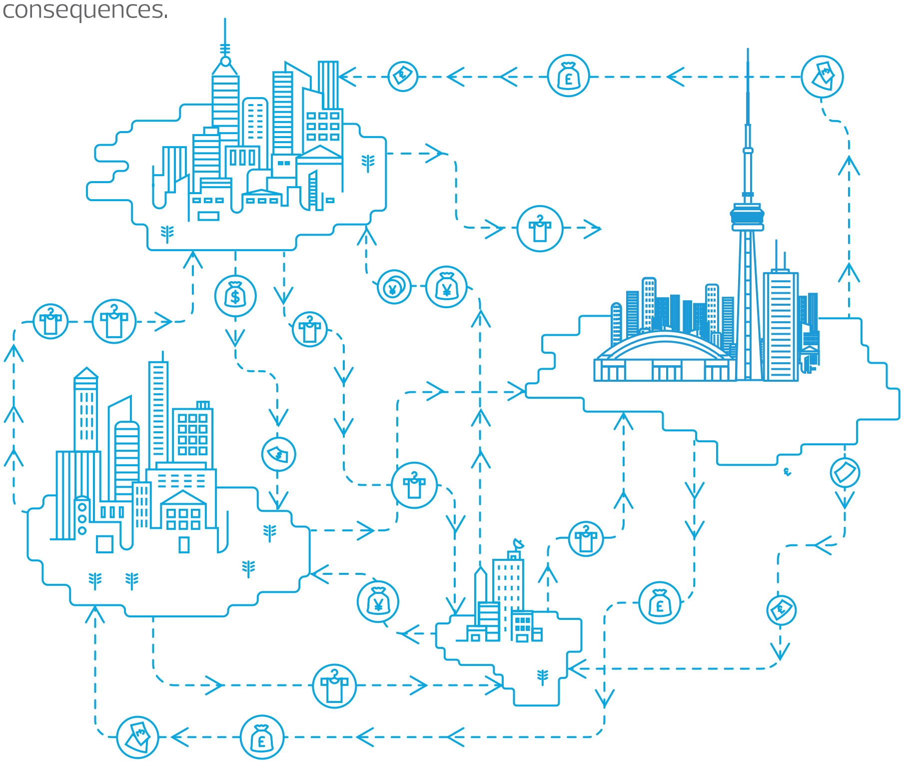
At the end of 2020, the OECD released its policy responses to COVID-19. The OECD included its stance on government assistance programs by acknowledging that the receipt of government assistance can affect intercompany pricing. Notwithstanding, the CRA also had historic guidance on government assistance and has generally taken the position that government assistance should not be used to reduce any inbound intercompany payments to Canada.

Overall, businesses receiving government assistance should consider performing an analysis to determine its impact on the pricing of intercompany transactions and include the analysis as support in their transfer pricing documentation to mitigate future risks and audit exposure.

Losses due to COVID-19

Due to the ongoing pandemic and economic downturn, businesses have incurred extraordinary monetary losses. As such, multinational enterprises may have questions regarding the allocation of losses and COVID-19 specific costs between associated entities and its consequences.

The OECD guidance provides reasonable flexibility and a framework to help assess the reasonableness of losses given various transfer pricing models. Groups experiencing either losses in specific countries, or more broadly losses throughout their organization, should consider their intercompany policies and how to support their positions.



Transfer pricing audits

The CRA temporarily suspend its audit activities starting March 2020 to support Canadians through the COVID-19 pandemic. This included the CRA ceasing to accept requests for information relating to ongoing audits, finalizing those audits, issuing reassessments, and suspending information request deadlines. This suspension initially was to remain until June 2020; however, audits did not resume until later in 2020.

Although a perception exists that the CRA is focusing its audits activity on COVID-19 government relief programs, this has not resulted in a decrease of other audit activity. The CRA is likely to continue ramping up and investing in audit activity relating to taxpayers with global operations, especially, due to the recent international tax developments on equitable global tax regimes.

Discontinuation of LIBOR

The London Interbank Offered Rate (LIBOR) is an interest rate benchmark commonly in intercompany lending arrangements. A concern over relevancy of LIBOR as a benchmark has evolved drastically, resulting in the LIBOR being discontinued at the end of 2021.

The Alternative Reference Rates Committee selected the secured overnight financing rate as a new benchmark to replace the US dollar LIBOR. Similarly, the Canadian Alternative Reference Rate Committee is promoting the use of the Canadian overnight repo rate average as a risk-free interest rate benchmark.

Ultimately, taxpayers with intercompany loans using LIBOR need to refinance their lending with instruments adopting new benchmarks or consider switching to fixed rates.

Transfer pricing case law of note

In *The Queen v. Cameco Corporation*, the Supreme Court of Canada (SCC) dismissed the Minister's application for leave to appeal, effectively ending Canada's landmark transfer pricing case.

The Minister reassessed Cameco to include all the gains its European subsidiary earned from selling uranium in its taxable income. At the TCC, the Minister alleged that the creation of the European subsidiary was a sham established to avoid Canadian taxes and, in the alternative, that the transfer pricing rules applied to allow the Minister to reallocate the profits to Cameco. The TCC dismissed both arguments.

At the FCA, the Minister's only argument was that the transfer pricing rules applied because Cameco would not have entered the same transactions with arm's-length persons. The FCA disagreed, finding that Cameco's transactions with its European subsidiary were on arm's-length terms and, therefore, compliant with Canada's transfer pricing rules.

As a result of the FCA's decision and the SCC's denial to hear an appeal, the Federal Budget proposed to reform Canada's transfer pricing rules. In particular, the Department of Finance will release a consultation paper to provide stakeholders with an opportunity to comment on possible transfer pricing rule amendments. The government may try to establish transfer pricing rules that focus on the substance of the transactions rather than the form or agreements of the transactions (i.e., rules that look beyond the legal agreement, and other support for the related-party transactions).

INDIRECT TAX CONSIDERATIONS

New rules for digital economy businesses

Effective July 1, 2021, some non-residents of Canada may be required to register for, collect and remit GST/HST on sales made that are related to a digital economy business. The new rules affect non-resident vendors that sell directly to consumers in Canada when using their own websites, or when using online marketplace platforms made available to them by digital platform operators (DPOs) to facilitate their sales made to Canadian consumers in excess of $30,000 over any 12-month period.

The simplified regime also requires digital platform operators that do not carry on business in Canada and are not registered for GST/HST to register for a GST/HST account if sales made to Canadian consumers exceed $30,000 over any 12-month period.

The new rules apply to the provision of services and access to digital products (such as software, mobile apps, online video gaming, and video and music streaming) made to consumers in Canada. Canadian consumers are defined to include purchasers who are resident in Canada that are not registered for GST/HST under the regular rules.

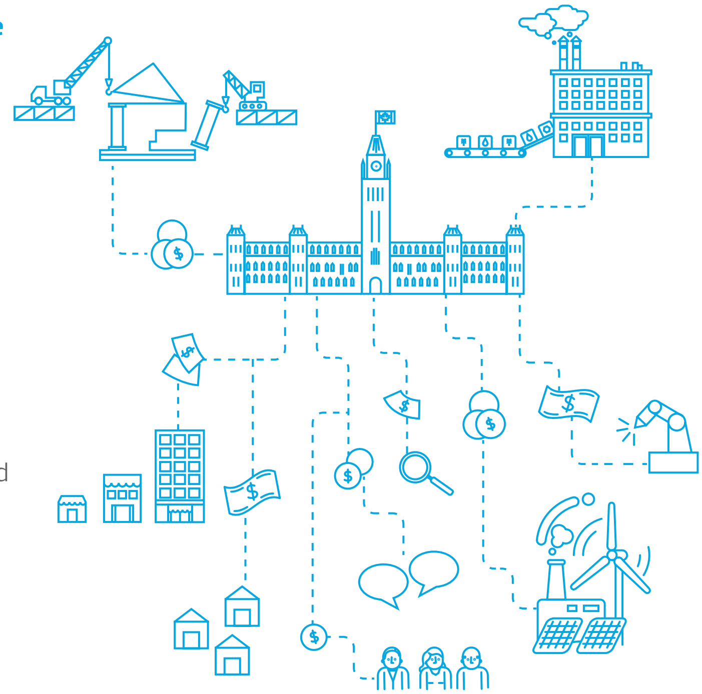
Non-resident vendors caught by these new rules will be permitted to use a simplified CRA administered online portal to register for GST/HST. However, they will not be entitled to claim input tax credits (ITCs) to recover taxes paid on purchases.

As these rules do not apply to sales made to Canadian businesses that are registered for GST/HST, non-resident vendors will need to determine the GST/HST registration status of each customer and must maintain certain information as evidence where collection of tax was not required. In addition, it may be prudent to confirm that any GST/HST registration numbers received are valid by accessing the CRA "GST Registry."

Where registration is required, and in order to determine the appropriate sales tax rate that should apply, the supplier must determine the province of residence of the consumer. Indicators such as the purchaser's home or business address, IP address, or other information that may be specified in the future by the CRA can be used to make this determination.

The new simplified regime also applies to accommodation platform operators who facilitate taxable supplies of short-term accommodation in Canada made by suppliers who are not registered for the GST/HST. In this case, the accommodation platform operator will be deemed to have made the supply and will be responsible for collecting and remitting the tax.

New (additional) requirements to register under the general GST/HST regime



Effective July 1, 2021, non-resident vendors are required to register under the general GST/HST rules when they sell goods to be delivered or made available to Canadian consumers through their website on their own account (i.e., without the use of a distribution platform), other than goods sent by mail or courier from an address outside Canada. The rules apply if total sales exceed (or are expected to exceed) C$30,000 over a 12-month period.

Distribution platform operators (whether resident and non-resident) are required to register under the general GST/HST regime when goods that are stored in and/or sourced from fulfillment warehouses in Canada, or shipped from a place in Canada to a purchaser in Canada, are sold by non-registered vendors to Canadian consumers (i.e. purchasers are not registered for GST/HST) through the DPO's platform.

In general, platform operators that facilitate sales by third-party suppliers will be jointly liable for collecting and remitting GST/HST with some exceptions, such as where the third-party supplier has provided false information.

The proposed rules for registration of remote suppliers and DPOs selling goods require these sellers to register and remit tax using the regular GST/HST registration system. As registrants under the general GST/HST system, non-resident vendors and DPOs are eligible to claim investment tax credits in respect of the tax paid on inputs used in their commercial activities, including tax paid on imports.

During a 12-month transition period starting on July 1, 2021, the CRA will take a practical approach to compliance and will exercise discretion in administering these measures.

Practical considerations and takeaways

Non-resident suppliers of digital products, services, taxable goods supplied through fulfilment warehouses, online marketplaces and/or remote seller websites may want to consider the following next steps:

- Determine if they are required to register for GST/HST under the proposed simplified method or under the general GST/HST registration.
- Determine if a registration under the proposed simplified method is appropriate or if a normal GST/HST registration would be more beneficial, particularly in relation to claiming investment tax credits.
- Ensure billing, online check-out and accounting systems can charge the correct rate of GST/HST and track the GST/HST collectible.
- Ensure that systems can track and retain the GST/HST registration status of customers.
- Ensure these systems can track and retain each customer's country and province of residence.

Businesses who operate digital platforms affected by these proposals will need to take into consideration all of the above, as well as the GST/HST registration status of their non-resident and resident suppliers using a platform to make sales. Where purchases made through the platform are made by persons who are not registered for GST/HST, the platform operator will only have an obligation to charge and collect GST/HST on those sales, but not on sales made by persons who are already registered for GST/HST. These changes will lead to additional complexity for platform operators.

QST harmonization to new GST/HST rules for digital economy businesses

On May 20, 2021, the Ministère des Finances du Québec announced the harmonization/alignment of the QST system with the changes in the federal legislation noted above. In order to mirror the GST/HST rules, Quebec has implemented additional registration requirements under the general system for suppliers and operators of distribution platforms located outside Quebec that store or deliver property to consumers in the province. The rules require them to register for QST purposes where the taxable sales for any 12-month period exceed C$30,000 where:

- The sales are being made or facilitated to a customer residing in Quebec that is not registered for QST purposes; and
- The goods are stored in Quebec or are shipped from outside Quebec and delivered to a customer in Quebec, other than by courier or messenger.

GST/HST and QST payable on taxable benefits

For calendar year 2021, employers that provide goods and services that are deemed to be taxable benefits to their employees are required to remit GST/HST and QST applicable to these benefits.

Generally, if a benefit is taxable for income tax purposes, the benefit will also be subject to GST/HST and/or QST. In certain circumstances, employers may not be able to determine the tax that must be remitted until after the T4/RL1s (due by the end of February 2022) have been completed and filed. Correspondingly, GST/HST/QST related to the taxable benefits must be included on the GST/HST or QST return for the reporting period that includes the month of February 2022.

As an example, an employer claims 100 per cent of the input tax credits (ITCs) related to the monthly lease of a company vehicle provided to a particular employee for his/her exclusive use. Once the T4/RL1 has been completed and the taxable benefit associated with the vehicle has been determined, the employer will be required to pay back the portion of the ITC/input tax rebate (ITR) related to the taxable benefit.

Employers cannot generally determine the tax that must be remitted until after the T4/RL1s have been filed. As such, employers are required to include GST/HST/QST deemed to have been collected on the taxable benefit on their GST/HST and/or QST returns for the reporting period that includes the month of February 2022.

In addition, employers may be required to remit tax related to taxable benefits not normally eligible for an ITC or ITR, but where ITCs and ITRs were claimed when the good or service was purchased/provided to the employee.

Tax on luxury goods

As mentioned under personal tax implications, a tax on select luxury goods was proposed in the 2021 Federal Budget and comes into effect on Jan. 1, 2022.

Even though the consumer is responsible for paying the luxury tax on select goods, businesses selling high-end vehicles, aircrafts or boats must collect, report and remit this tax in the appropriate circumstances. This tax applies to vehicles and aircraft priced over $100,000 and boats priced over $250,000. Individuals and businesses may be required to register with the CRA under the luxury tax regime as a registered vendor if:

- The individual or business sells a select good of that type in the ordinary course of their business activities; and
- One of the following sets of circumstances exists:
  a. The individual or business has, at any time, sold a select good for which the price threshold is met and physical possession of that select good has been transferred to another person in Canada; or
  b. The individual or business expects, within the next year, to sell a select good which meets the price threshold and expects to transfer the physical possession of that select good to another person of Canada.

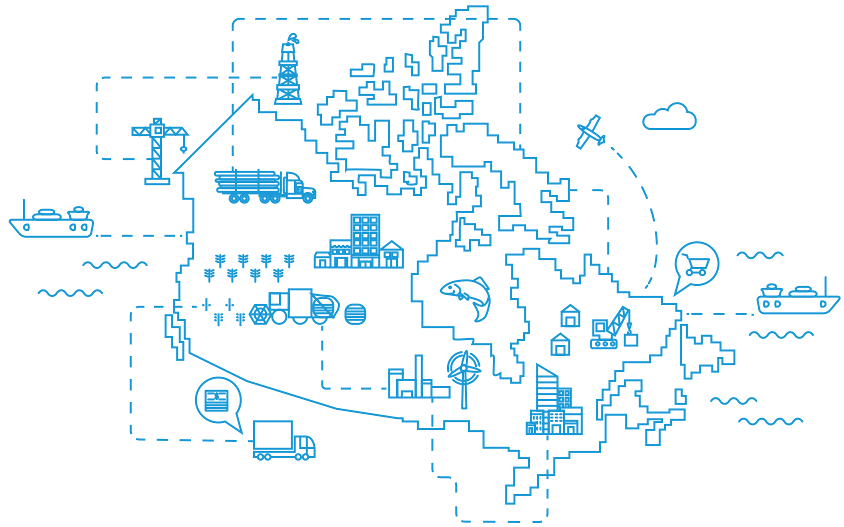
Individuals and business that are required to register under the luxury tax regime must apply for registration before the earlier of either:

- The day on which the physical possession of the select good that triggers the obligation to register is transferred to the registrant, or
- The day on which physical possession of the select good is transferred to its purchaser.

In instances where the registrant is an importer of a select good, the obligation to register is the day on which the registrant imports the select good or makes the required remittance to Canada Border Services.

Where a vehicle, aircraft or boat is leased to a consumer rather than sold, the lessor will be required to pay the luxury tax because the vehicle, aircraft or boat is deemed to be transferred to the lessor on a taxable basis. This would mean that the luxury tax is applicable on the deemed transfer at the time the lease is entered into.

The reporting periods for registered vendors under the luxury tax regime are expected to be calendar quarters in most scenarios, with registered vendors required to file a luxury tax return each quarter.



CREDITS AND INCENTIVES

The Canadian government offers many programs outside of the tax system to improve the competitiveness of particular business sectors. Globalization and enhancements of remote communications provides businesses with ease of access to financial assistance in other jurisdictions. The Canadian government has strengthened grant programs in order to open eligibility to more industries and foster regional growth. As Canadian middle market businesses continue to navigate additional infection waves and recover from the COVID-19 pandemic it is important for all businesses to take full advantage of the government programs available to them in their province.

Grants

These are cost-sharing contributions made to companies based on criteria set out in the grant program. Funding may be subject to certain documentation or post-submission compliance requirements, and failure to meet these requirements could hinder approval for future funding. To ensure success when applying for grants, businesses should meet all the criteria set out in the grant program as failing to do so may cause the application to be rated lower in comparison to others. Grants can be very generous with cost-share funding ranging from 15 per cent to 83 per cent depending on the program.

Contributions (repayable, non-repayable)

These are controlled contributions (performance-based grants) that include terms and conditions, as specified in a contribution agreement or contract with the granting program, which must be met by a recipient before funding is given.

Loans

The government offers low or no interest loans that provide capital for businesses. Often the financing methods and repayment requirements vary from conventional loan arrangements with financial institutions. These loans could be administered directly from a government agency or other agencies such as the Business Development Bank of Canada.

Equity financing

Governments may invest directly in businesses, with the advantage of less stringent demands than those of venture capitalists or other private investors.

Tax reductions, refunds or credits

Tax credits are generally more favourable than tax deductions or exemptions because tax credits reduce a taxpayer's tax liability. However, businesses that are not profitable (and therefore do not have taxable income) will not benefit from credits unless they are considered a CCPC or operate in provinces where the credits are fully refundable. If a business is not profitable and does not meet the CCPC criteria, a direct grant would be more beneficial than a non-refundable credit.

Given the vast number of programs in Canada, entrepreneurs and tax professionals should consider the following when navigating government incentives programs:

- Applying early before the start of the project(s) or before funds are depleted.
- Ensuring that projects meet 100 per cent of the fund's eligibility criteria to receive an approval (though this does not guarantee funding).
- Building relationship with funding advisors to identify all the potential incentives available for the past and future projects.

The government has continued to put a premium on funding initiatives that involve job creation, commercializing innovations and increasing exports. The COVID-19 pandemic has affected the funding landscape significantly. Funding in the past year for export-based programs has decreased due to a reduction of movement. Furthermore, the government may investigate the benefits of these projects as these industries emerges from the COVID-19 pandemic. When applying for funding, businesses should consider the additional benefits that their projects will have, such as regional economic growth, job retention and job creation to increase the likelihood of approval.

Scientific Research and Experimental Development (SR&ED) program

No changes were made this year to the SR&ED program. However, if a business collected the CEWS, the amount of CEWS received by an employer will reduce the amount of salary or wage expenditures eligible for SR&ED input tax credits if the assistance was applied for the employees directly engaged in SR&ED activities. The CEWS received for employees not directly engaged in SR&ED will still be considered income earned for tax purposes and therefore does not need to be deducted for SR&ED.

PROVINCIAL TAX CONSIDERATIONS

Alberta

Innovation Employment Grant

New for 2021 is the Innovation Employment Grant (IEG). The program is open as of Jan. 1, 2021, and essentially replaces the previous Alberta SR&ED tax credit program. This tax credit is available to small and medium-sized corporations that undertake R&D in Alberta.

Although the IEG is called a grant, it is delivered through Alberta's corporate tax system and does not follow a formal application process. Eligible corporations claim the grant when they file their provincial corporate tax return. Eligible corporations include those with taxable capital under $50 million and eligible expenditures are the same as those under the federal SR&ED program.

The IEG has two components:

- A grant equal to 8 per cent of eligible R&D expenses a corporation incurs in Alberta, up to the corporation's base level of spending (a corporation's base level of spending is determined by calculating the corporation's average qualifying R&D spending over the previous 2 years)
- A grant equal to 20 per cent of eligible R&D expenses a corporation incurs in excess of the corporation's base level of spending

The amount of the benefit is limited to $4 million in annual R&D spending, for a maximum credit of $800,000. The IEG program is a refundable credit. This means that the amount by which the IEG exceeds the corporation's tax otherwise payable for the year (net of any other Alberta tax or other amount owing by the corporation to Alberta) will be paid to the corporation as a refund. Eligible corporations will need to start accounting for this change on their 2021 year-end tax return.

Education property tax

The Alberta government has announced that it will keep the 2021/2022 education property tax rate at the same level as the prior year. For residential and farmland properties, the education property tax is a rate of $2.56 per $1,000 of the total equalized assessment value. For non-residential properties, the education property tax rate is $3.76 per $1,000 of equalized assessment value.

Property tax on oil and gas sector

To encourage new investments in the oil and gas sector and improve the viability of existing assets, the Alberta government is implementing various property tax changes over the next few years, including:

- Introducing a three-year property tax holiday on new wells and pipelines from the property tax year beginning in 2022 and ending in 2024.
- Eliminating the well-drilling equipment tax in 2021.
- Reducing assessment values by up to 35 per cent for shallow gas wells and associated pipelines until the 2023 tax year.

British Columbia

Increased employment incentive

The increased employment incentive (IEI) provides a one-time refundable tax credit to employers that either created new jobs for workers or increased payroll for existing low or middle-income employees in the fourth quarter of 2020. The IEI will be 15 per cent of the amount by which the eligible remuneration paid to eligible employees in the qualifying period exceeds total eligible remuneration paid for all eligible employees in the base period. Eligible businesses must apply for the IEI by Dec. 31, 2021.

Mining flow-through share tax credit

The B.C. mining flow-through share tax credit allows individuals who invest in flow-through shares to claim a non-refundable tax credit of 20 per cent of renounced mining expenditures. In order to align with the temporary federal timelines due to COVID-19, the eligibility period for expenditures to qualify for the mining flow-through share tax credit has been temporarily extended by 12 months.

The extension applies to flow-through share agreements entered on or after March 1, 2018, and before 2021, when using the general rule. It also applies to agreements entered in 2019 or 2020 when using the look-back rule.

British Columbia provincial sales tax

Effective April 1, 2021, the expanded provincial sales tax registration requirements for resident and non-resident suppliers of software and telecommunication services came into force.

All suppliers of telecommunication services and software are required to register as a collector under the B.C. provincial sales tax act if they meet the following criteria:

- Accept orders originating in B.C. for telecommunication services, or software to be used on devices ordinarily located in B.C.;
- Sell telecommunication services or software to be used on devices ordinarily located in B.C.; and
- Have revenue or expected revenue generated from the sales of software or telecommunication services will exceed $10,000 over a twelve-month period.

Businesses selling telecommunication services or software to be used on devices ordinarily located in B.C. should consider if they need to register a supplier.

B.C. provincial sales tax temporary rebate

To help with the impacts of COVID-19 and encourage business spending, the government is providing a provincial sales tax rebate for assets described in the CCA classes 8, 10, 12, 16, 38, 43, 43.1, 43.2, 46, 50, 53, 54, and 55 if the asset was purchased between Sept. 17, 2020, and Sept. 30, 2021.

There are two rebate application periods: April 1, 2021, to Sept. 30, 2021; and Oct. 1, 2021, to March 31, 2022. Businesses are permitted to submit two applications during the second period but at most, two rebate applications can be submitted.

Manitoba

Expansion of interactive digital media tax credit

The interactive digital media tax credit is a refundable corporate income tax credit that provides interactive digital media companies with a tax credit valued at up to 40 per cent of eligible project costs incurred to develop an interactive digital media product in Manitoba. Moreover, eligible product development activities now include add-on activities, such as downloadable content, on-going maintenance and updates, and data management and analysis. This is now a permanent credit that will be available indefinitely. The credit will provide a financial boost to companies planning to invest in Manitoba's interactive digital media industry.

Education property tax rebate

The government is commencing its phasing out of education property taxes. Properties that are exempt from education property taxes or that pay grants in lieu or payments in lieu of taxes are not eligible for the education property tax rebate. In 2021, property tax owners are eligible for rebates as follows:

- Owners of residential properties and farm properties are entitled to a 25 per cent rebate of the school division special levy and the community revitalization levy. Residential properties include single dwelling units, condos, and multiple unit dwellings.
- Owners of other properties (such as commercial, industrial, railway, institutional, pipelines and designated recreational) will receive a 10 per cent rebate of the school division special levy and the education support levy.

The eventual elimination of education property taxes will put Manitobans on equal footing with other provinces.

Manitoba retail sales tax

Manitoba announced during their 2021 budget that effective Dec. 1, 2021, streaming service providers, online marketplaces, and online accommodation service providers will be required to collect and remit PST.

The proposed legislation is not expected to be released until the fall of 2021.

Ontario

Increase of the regional opportunities investment tax credit

The regional opportunities investment tax credit (ROITC) is a refundable corporate income tax credit available for CCPCs that make qualifying investments in certain geographic areas in Ontario. Qualifying investments include eligible expenditures related to building, renovating, or purchasing eligible commercial and industrial buildings and other assets.

The government increased the ROITC to 20 per cent (up from 10 per cent) of qualifying expenditures between $50,000 and $500,000 for properties that become available for use in the period beginning on March 24, 2021, and ending before Jan. 1, 2023. Based on the rules set out in the Act, a property is considered available for use in the taxation year in which the owner can start claiming capital cost allowance.

The enhanced ROITC provides an opportunity for businesses to explore the specified regions in Ontario for expansion and investment opportunities at a relatively low tax cost.

Digital Main Street Program

To help businesses in Ontario create and enhance their online presence, the government launched the Digital Main Street Program in partnership with the federal government. The program provides digital transformation grants, an online learning platform, training programs, and digital service squads that offer technical support under the program to small business owners. The program provides an opportunity to small businesses to achieve digital transformation and extend their reach into new markets.

Enhanced childcare tax credit

The childcare access and relief from expenses (CARE) tax credit provides low- and moderate-income families with support of up to 75 per cent of eligible childcare expenses. In 2021, the credit has been temporarily increased by 20 per cent. This has the effect of increasing the average CARE tax credit from $1,250 to $1,500. Families that are eligible for the CARE tax credit will receive the benefit of the enhanced tax credit when they file their 2021 T1 returns.

Quebec

Reduction of small business income tax rate
As of Jan. 1, 2021, CCPCs that are eligible for the small business deduction (SBD) are entitled to a preferential corporate tax rate of 4 per cent (reduced from 5 per cent) on the first $500,000 of their taxable income. For the taxation years ending after March 25, 2021, the tax rate is further reduced to 3.2 per cent, thereby making the Quebec small business rate on par with the Ontario small business rate.

In addition, greater flexibility is available to CCPCs in the service and construction sectors for calculating paid hours for the purpose of determining eligibility for the SBD. Previously, CCPCs in the service and construction sectors were required to have employees with at least 5,500 remunerated hours to benefit fully from the SBD. However, as a result of the shutdown of certain business operations due to COVID-19, CCPCs can use the number of paid hours from the immediately preceding taxation year when determining eligibility.

These two measures will reduce provincial corporate tax obligations for CCPCs. As a result, CCPCs should review and, as necessary, adjust their installment payments.

Increase of investment and innovation tax credit
The investment and innovation tax credits (C3i) are available to businesses that acquire certain eligible properties, such as manufacturing or processing equipment, general-purpose electronic data processing equipment or certain management software packages between March 10, 2020, and Jan. 1, 2025. The amount of the tax credit can be up to 20 per cent depending on (i) the amount of expenditure, (ii) the type of eligible property acquired, and (iii) the territory of the eligible property. For acquisitions on or after March 26, 2021, and before Dec. 31, 2022, the C3i tax credit rates is doubled, meaning it can be up to 40 per cent.

Tax holiday for large investment projects
The tax holiday for large investment projects provides relief to eligible businesses from income taxes and contributions to the health services fund (HSF). The amount of the relief is equal to a maximum of 15 per cent of the investments made, spread over a maximum of 15 years. To further increase the productivity and the production capacity of businesses, the following enhancements to the tax holiday for large investment projects have been provided:

- All digitization projects, regardless of sector, will be eligible for the tax holiday up to Dec. 31, 2024
- The startup period will be extended for 12 months for current initial certificate holders
- Assistance for upgrade projects will be accelerated.

Saskatchewan

Small business tax rate
The rate will increase to 1 per cent on July 1, 2022, and return to 2 per cent on July 1, 2023.

AUDIT AND ENFORCEMENT CONSIDERATIONS

Increased activity
After suspending audit activity for roughly six months in 2020 due to the pandemic, the CRA made up for lost time in 2021. Assisted by the federal government's pledge of significant financial resources to increase the volume and effectiveness of audits, CRA auditors actively conducted audits, demanded documents and issued reassessments. This section sets out the audit trends from 2021 and what can be expected in 2022.

CEWS and CERS audits
By the end of 2021, the federal government will have distributed roughly $100 billion in CEWS and CERS subsidies. The legislation was drafted and passed quickly to meet the demands of businesses but is complex and fraught with traps. Eligibility, revenue inclusion calculations to determine revenue decline and eligible employment payment subsidies are all possible points of contention.

Unsurprisingly, the CRA established special audit teams and risk detection processes to audit the CEWS and CERS programs. CEWS audits started late in 2020, have continued in 2021, and will continue in 2022.

The requests for information in an initial CEWS or CERS audit letter can be comprehensive. Items requested include:

- Minute books
- Revenues for the past three years
- Revenue decline computations
- Payroll information
- Subsidies and other programs the business benefited from that could impact a CEWS or CERS claim
- Signed attestation forms
- Exceptions and elections relied on

Businesses should review to ensure they have all necessary documents to support CEWS and CERS applications in advance of any audit so that they are prepared when CRA initiates an audit.

While businesses should expect that CEWS and CERS audits will increase in 2022, the CRA can initiate an audit and redetermine a CEWS or CERS entitled at any time. In other words, there is no limitation period within which the CRA must issue a notice of determination that reduces or eliminates a CEWS or CERS amount or imposes penalties.

If the CRA issues a notice of determination reducing or eliminating the CEWS or CERS entitlement and the businesses intends to dispute the determination, a business must file a notice of objection within 90 days of the date of the notice of determination.

Documents and information the CRA can demand in an audit

There has been an increase in the number of court decisions over what information and documents the CRA is allowed to demand from a taxpayer during an audit. This increase could be a result of taxpayers being less cooperative in audits, or of the CRA broadening its interpretation of the legislative authority to demand documents under Act subsection 231.2(1) "for any purpose related to the enforcement and administration of the Act". Whatever the reason for the increase in disputes, the CRA has been largely successful in these cases. The following principles have emerged from the recent federal court decisions:

- The CRA is entitled to demand documents in electronic format even though there is no requirement in the legislation that a taxpayer provide information in a specific format (*Tellza Inc. v. MNR*, 2021 FC 853).
- If documents regarding services between the taxpayer and another entity do not exist, the taxpayer is required to provide information describing the relationship and the transactions between the parties. It is insufficient simply to state that documents do not exist where there is a relationship between parties (*Miller v. MNR*, 2021 FC 851).
- Judicial authority is not needed for the CRA to demand documents and information about unnamed persons when the subject of the audit is a named person (*Ghermezian v. MNR*, 2020 FC 1137 and *Zeifmans LLP v. MNR*, 2021 FC 363).

Based on these cases, taxpayers should expect that CRA audit requests for information will be robust. If requests appear to be too broad, taxpayers should consider asking the CRA auditor for clarification as to how the request relates to the subject matter under audit rather than simply refusing to provide information.

New audit and enforcement measures from the Federal Budget

The Federal Budget included significant changes to increase certain reporting requirements, provide enhanced collection measures to the CRA for collecting unpaid taxes, and enhance the CRA's audit and enforcement powers. Some of the proposals are scheduled to go into effect on Jan. 1, 2022, while others do not yet have a timetable for implementation.

New mandatory disclosure rules

The Federal Budget proposed two new types of mandatory disclosures and lowered the bar for the existing mandatory disclosure of 'reportable transactions' as defined in subsection 237.3(1). Currently, 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, and
3. The taxpayer entering into the transaction receives contractual protection against failure to achieve a tax benefit from the transaction.

Under the Federal Budget proposals, a reportable transaction is an avoidance transaction that has one out of three hallmarks.

One of the new concepts introduced is that of a notifiable transaction. This term has not yet been defined, but we can expect that it will mean any transaction that the Minister considers abusive of the Act, or transactions of interest. After such a designation, taxpayers who enter 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.

The other new concept is mandatory disclosure for 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. 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, and
- 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 rules would be required to provide 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.

These new mandatory disclosure rules are scheduled to go into effect on Jan. 1, 2022, but as of the date of writing, the government has not released proposed legislation.

If a taxpayer fails to comply with the mandatory disclosure rules, the potential consequences can include (i) an extension of the normal reassessment period—the normal reassessment period clock would not start until the taxpayer complies with the mandatory disclosure requirements; and (ii) financial penalties up to $100,000 for not reporting an uncertain tax treatment and up to $25,000 or 25 per cent of the tax benefit received for not reporting a notifiable transaction or a reportable transaction.

Increasing the scope and application of CRA's collection powers

Under section 160 of the Act, the CRA can assess one person for the unpaid tax debt of another person in certain circumstances. One of the criteria for the CRA to engage section 160 is that the taxpayer with the unpaid tax transfers property to the other person for less than fair market value consideration. Another criterion is that the two taxpayers do not deal at arm's length at the time of the transfer of property.

The government lost two key cases in which it used section 160 to assess a taxpayer for another's unpaid tax debt. In *Eyeball Networks Inc. v. The Queen* (2021 FCA 17), the government argued that the court should use a results-based, economic-reality approach when considering the value of the consideration the appellant provided when it acquired property from the tax debtor. The Federal Court of Appeal rejected this argument, citing that section 160 requires a point-in-time determination of the value of the consideration transferred. In *Damis Properties Inc. v. The Queen* (2021 TCC 24), the government argued that parties on opposite sides of a transaction were working together to achieve a tax benefit. They should not be considered as dealing at arm's length and the government should be allowed to use section 160 to collect one party's unpaid tax debt from the other party. The Tax Court of Canada disagreed, finding that the parties had separate interests. One party sought to maximize its after-tax return from the sale of the property and other party sought to make profit by eliminating tax liabilities in a subsidiary. Thus, the parties were not acting in concert and not acting without separate interests.

As a result of these cases, the Federal Budget proposed to bolster section 160 with a series of anti-avoidance rules that would deem certain criteria of section 160 met, including:

- Deeming arm's length parties not to be dealing 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.

Procedural changes to audits

The Federal Budget also proposed to impose additional requirements on taxpayers during a CRA audit. Specifically, there is proposed legislation that if passed, would give CRA auditors the power to compel oral interviews in an audit and would require that a taxpayer provide reasonable assistance to auditors. Oral interviews are fraught with potential problems, as an auditor and a taxpayer could interpret statements in different ways, and without a written record that can be referred to afterwards, there is a potential for adverse results.

Taxpayers should be mindful of this proposed requirement moving forward and should look to establish ways to ensure that any oral interview is properly documented and that the CRA auditor acknowledges and agrees with the documented record of the oral interview.

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