A Review of the Draft Federal Tax Legislation Released on August 9, 2022

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On August 9, 2022, the Department of Finance Canada released a package of draft legislation implementing tax measures first announced in the 2022 Federal Budget and updating draft legislation previously released on February 4, 2022 (the "Proposal"). Canadians are invited to provide their feedback on the Proposal by September 30, 2022.

This article provides a summary of the proposed measures concerning the following three categories: trusts; business and international income tax; and personal and other income tax.

Trusts

Enhanced Reporting Requirements for Trusts

Amendments to various reporting requirements for trusts, including the filing of trust returns and the provision of additional beneficial ownership information for express trusts, are included in the Proposal. Currently, trusts are only required to file a T3 return in years where the trust has taxes payable, or it makes a distribution to one or more beneficiaries. Pursuant to the Proposal, trusts will now be required to file a T3 return every year, regardless of whether the trust has any tax payable or distributes any portion of its income.

Business and International Income Tax

The Application of the General Anti-Avoidance Rule (GAAR) to Tax Attributes

The definition of "tax benefit" as it relates to the GAAR is proposed to be amended to include any transactions that impact the amount of a tax attribute relevant to the future computation of tax, even if the attribute has not yet been utilized.

Mandatory Disclosure Rules

The application of the mandatory disclosure rules, first released in February 2022, is to be delayed by one year. These rules include the expansion of the definition of a "reportable transaction" and the disclosure obligations for "notifiable transactions" and uncertain tax positions. The amendments to the mandatory disclosure rules are intended to encourage disclosure of aggressive tax planning.

The Small Business Deduction

The small business deduction is currently eliminated when a Canadian-Controlled Private Corporation (CCPC) and its associated corporations have a combined taxable capital in Canada greater than $15 million. This value is increased to $50 million in the Proposal, resulting in the elimination of the small business deduction when the combined taxable capital of a CCPC and its associated corporations exceeds $50 million.

Substantive Canadian-Controlled Private Corporations

The Proposal includes the introduction of a new category of corporation, the "substantive CCPC", which would be taxed as if it were a CCPC on all investment income and taxable capital gains. A "substantive CCPC" is defined as a private corporation resident in Canada, other than a CCPC, that is controlled, directly or indirectly by one or more Canadian resident individuals. This definition captures corporations that would have been CCPCs but for the fact that a non-resident or public corporation has the right to acquire shares as well as corporations that have ceased to be "Canadian".

Eliminating Flow-through Shares for Oil, Gas and Coal Activities

The flow-through share regime for oil, gas and coal activities is to be eliminated under the Proposal. Expenditures related to fossil fuel sector activities will no longer be permitted to be renounced to investors through the use of flow-through share agreements entered into after March 31, 2023.

Use of Foreign Resident Corporations

The current tax-deferral advantage available to CCPCs and their shareholders earning investment income through controlled foreign affiliates is to be eliminated under the Proposal.

Interest Coupon Stripping

The Proposal addresses the potential avoidance of Part XIII withholding tax by ensuring that the tax paid on interest under an interest coupon stripping arrangement would be the same as if the arrangement had not been undertaken.

Capital Cost Allowance (CCA) for Clean Energy Equipment

CCA classes 43.1 and 43.2 are to be expanded under the Proposal to include certain equipment that is part of an air-source heat pump system used primarily for space or water heating.

The Investment Tax Credit for Carbon Capture, Utilization and Storage

The Proposal includes the introduction of a refundable tax credit that would be available to businesses that incur qualified expenditures related to carbon capture, utilization and storage after 2021 and before 2041. Acquisitions of eligible equipment would be included in new CCA classes 57 and 58.

Exploration and Development Expenses Relating to Carbon Capture, Utilization and Storage

New CCA classes 59 and 60 are introduced in the Proposal for intangible exploration expenses and development expenses related to the storage of captured carbon.

The Critical Mineral Exploration Tax Credit

The Proposal includes the introduction of a new 30% tax credit for eligible exploration expenditures in respect of critical minerals that are renounced under flow-through share agreements.

The Avoidance of Tax Debts

New anti-avoidance rules are introduced in the Proposal to address arrangements designed to avoid joint and several tax liability on non-arm's length transfers of property for insufficient consideration. Under the Proposal, planners and promoters of such schemes may also incur a penalty.

Electronic Filing Requirements

Several new measures are included in the Proposal to facilitate increased tax compliance through electronic means. These include changes to the default method of correspondence for businesses that use the CRA My Business Account and the elimination of the mandatory electronic filing threshold for corporate income tax returns.

The Canada Recovery Dividend and the Additional Tax on Banks and Life Insurers

The Proposal includes the introduction of the Canada Recovery Dividend: a one-time 15% tax on bank and life insurer groups to be imposed under the new Part VI.2 of the *Income Tax Act.* Also included is the introduction of an additional 1.5% tax on taxable income of members of bank and life insurer groups.

Hedging and Short Selling by Canadian Financial Institutions

Where hedging and short selling transactions have the effect of eliminating the economic exposure to shares held by registered securities dealers, or persons in a group that includes a registered securities dealer, the Proposal includes new rules applicable to deny certain tax benefits for the registered securities dealer or group member.

International Financial Reporting Standards for Insurance Contracts (IFRS 17)

Numerous amendments are included in the Proposal concerning the adoption of new accounting standards for insurance contracts contained in IFRS 17 and how these standards are to be utilized for income tax purposes.

Personal and Other Income Tax

Changes to the Annual Disbursement Quota of Registered Charities

Several changes to the disbursement quota of registered charities are included in the Proposal such as increasing the disbursement quota from 3.5% to 5% for assets not used directly in charitable activities or administration that exceed $1 million.

Reporting Requirements for Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs)

The Proposal includes the expansion of the annual reporting required of financial institutions to the CRA to include the fair market value of property held in each RRSP and RRIF that they administer.

The Tax-Free First Home Savings Account (FHSA)

The Proposal includes the introduction of the Tax-Free FHSA which would allow prospective first-time home buyers the opportunity to save $40,000 on a tax-free basis.

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The Residential Property Flipping Rule

The Proposal includes the introduction of a new rule that would deem profits arising from the sale of a residential property located in Canada, owned for less than 365 days, to be business income and therefore not eligible for capital gains treatment or the principal residence exemption.

The Multigenerational Home Renovation Tax Credit

A 15% refundable multigenerational home renovation tax credit was introduced in the Proposal for up to $50,000 in eligible expenses for a qualifying renovation.

The First-Time Home Buyers' Tax Credit (HBTC)

The HBTC amount would be doubled from $5,000 to $10,000 under the Proposal, resulting in a $1,500 tax credit to eligible home buyers.

The Medical Expense Tax Credit for Surrogacy and Other Expenses

The Proposal includes expanding the definition of "patient" for the medical expense tax credit to include individuals who rely on a surrogate or a donor of sperm, ova or embryos to become parents.

Borrowing by Defined Benefit Pension Plans

The Proposal includes changes to the borrowing restrictions applicable to registered defined benefit pension plans that are not individual pension plans. These changes would increase flexibility for plan administrators by removing the existing 90-day limit on the terms of borrowing.

Fixing Contribution Errors in Defined Contribution Pension Plans

The Proposal provides plan administrators of defined contribution pension plans with the ability to correct certain under-contribution errors and over-contribution errors made in any of the 10 preceding years.

Please contact our **TDS tax lawyers** for more information on the changes proposed in the draft legislation.