Canadian Tax and Legal Alert

2023 federal budget highlights

March 28, 2023

Deputy Prime Minister and Minister of Finance, the Honourable Chrystia Freeland, presented Budget 2023 entitled “A Made-in-Canada Plan: Strong Middle Class, Affordable Economy, Healthy Future” in the House of Commons on March 28, 2023.

A summary of the economic and tax highlights contained in the budget is provided below.

Deloitte professionals can help you understand how these measures may impact your business. If you have any questions, please reach out to your Deloitte advisor or any of the individuals noted in this alert.

C-suite briefing notes

What wasn't there

- Notwithstanding continued budget deficits, there were no broad increases to personal or corporate income tax rates, no increases in goods and services tax (GST) or harmonized sales tax (HST), and no new taxes on wealth, inheritance or capital. The capital gains inclusion rate remains at 50%.

- While the government confirmed its intentions and proposed timelines concerning implementation of the global minimum tax rules and other international tax measures designed to reallocate taxing rights among jurisdictions, no further details or draft legislation were proposed. Draft legislation to implement Pillar Two is expected in the coming months.

- Additionally, no new draft legislation for a number of other important tax measures was released. Interest deductibility (excessive interest and financing expenses limitation), anti-hybrid proposals and substantive Canadian-controlled private corporation (CCPC) measures all remain in various proposal stages. There was no update on reforms to the mandatory disclosure regime for certain tax transactions, which was effectively deferred in the 2022 Fall Economic Statement.

Tax on share buybacks and targeted measures for financial institutions

Consistent with the announcements in the 2022 Fall Economic Statement, a 2% tax on share buybacks has been introduced for publicly listed corporations and real estate investment trusts (REITs), effective January 1, 2024. The tax will apply on the net change in fair market value of equity repurchased and issued during a taxation year. The measure is expected to generate approximately $2.5 billion over the next five years.

Financial institutions will be subject to taxation on dividends from portfolio investments, which previously benefitted from a deduction. The measure is expected to generate approximately $3.15 billion over the next five years. This change represents a fundamental policy shift and will increase Canadian taxation of financial institutions, in particular – banks and insurers. Canada had existing anti-avoidance rules to limit the ability of corporations to claim the intercorporate dividend deduction on portfolio shares where the investor was not fully exposed to the risk of ownership. The proposed change will virtually eliminate the opportunity for financial institutions to benefit from the intercorporate dividend deduction on any portfolio investment.

Continued investment on our journey toward net zero

Building on announcements in the 2022 Fall Economic Statement, details on refundable investment tax credits (ITCs) were announced. These ITCs have an estimated cost of approximately $16.6 billion over the next five years. As refundable credits, these incentives will provide immediate funding for investments by a range of entities, regardless of their ultimate income tax liability.

The ITCs are intended to ensure Canada's competitiveness relative to recent incentives implemented in the United States through the *Inflation Reduction Act* and are subject to labour requirements. The credits relate to the following areas for capital investment and are described in further detail below:

Investment Tax Credit	Maximum ITC rate
Clean Hydrogen	40%
Clean Technology Manufacturing	30%
Clean Technology (includes Geothermal Energy)	30%
Clean Electricity	15%

The Clean Electricity ITC may be claimed by taxable and non-taxable entities, such as Crown corporations and publicly owned utilities, corporations owned by Indigenous communities, and pension funds.

The government confirmed that the scientific research and experimental development (SR&ED) program would continue to be a “cornerstone” of Canada’s innovation strategy. The review of the SR&ED program, including consideration for a patent box, remains underway.

Measures relevant to high-income individuals and shareholders of private corporations

Consistent with comments in Budget 2022 and the Fall Economic Statement, the government has proposed changes to an enhanced minimum tax on high-income individuals which would take effect in 2024. The measures increase the individual federal minimum tax from 15% to 20.5%, while making a number of changes to the computation which will require further analysis and modeling for individual taxpayers. The measure is expected to generate approximately $3.0 billion over the next five years.

The government introduced clarifications on rules concerning intergenerational business transfers, which were previously enacted through a private members bill in June 2021, to ensure that the rules apply only where a genuine intergenerational business transfer takes place. The clarifications, while largely technical, also include additional relief in the form of an expanded 10-year capital gains reserve for transfers that satisfy the new conditions. The clarifications are expected to generate approximately $1.0 billion over the next five years.

Finally, a new type of entity, the Employee Ownership Trust, was introduced, which is intended to provide business owners with a mechanism to sell a controlling interest in their business to an employee group with certain tax incentives.

Modernization of the general anti-avoidance rule, including an introduction of a 25% penalty

The government has proposed significant changes to the general anti-avoidance rule (GAAR), including reducing the standard for its application, introducing a 25% penalty, extending the statute barred period and introducing an economic substance rule. The 25% penalty and extension to the statute barred period can both be avoided if the transaction is disclosed to the Canada Revenue Agency (CRA), including on a voluntary basis. The economic substance rule would require that a lack of economic substance be considered in determining whether there is a misuse or abuse of the Income Tax Act.

While an effective date for these was not announced, the proposed changes to the GAAR, including the economic substance rule, may need to be considered in the context of ongoing transactions.

Further Details on Tax Measures

Resource sector and environmental measures

- **Introduction of a refundable investment tax credit for eligible projects to produce clean hydrogen**, previously announced in the 2022 Fall Economic Statement. The credit rate is applied, based on the assessed carbon intensity (CI) of the hydrogen that is produced, to the cost of eligible equipment that is acquired and becomes available for use in Canada on or after March 28, 2023, and before 2034. The credit rates are as follows:
    - 40% for a CI of less than 0.75 kg;
    - 25% for a CI greater than or equal to 0.75 kg, but less than 2 kg; and
    - 15% for a CI greater than or equal to 2 kg, but less than 4 kg.

  The tax credit would be phased out starting in 2034 and fully phased out for property that becomes available for use after 2034.

- **Introduction of a 15% refundable tax credit for eligible clean electricity investments**, available to be claimed as of the day of Budget 2024 for projects that did not begin construction before March 28, 2023, and would not be available after 2034.

- **Expansion of the eligibility of the 30% refundable clean technology tax credit**, announced in the 2022 Fall Economic Statement, to include geothermal energy systems that are eligible for Class 43.1 treatment and that are acquired and become available for use on or after March 28, 2023. The phase out of the credit will begin in 2034 rather than 2032 as previously announced.

- **Creation of a 30% clean technology manufacturing refundable tax credit** for investments in new machinery and equipment used to manufacture or process key clean technologies, and extract, process or recycle key critical minerals. The credit will apply to property acquired after January 1, 2024, until 2034.

- **Announcement of additional design details for the refundable ITC for carbon capture, utilization, and storage (CCUS)** that was proposed in Budget 2022, including the eligibility of dual use equipment, addition of British Columbia as an eligible jurisdiction, treatment of refurbishment costs, and recovery of refurbishment investment tax credits, among other changes.

  For the clean technology, clean hydrogen, and clean electricity ITCs, Budget 2023 proposes the introduction of labour requirements to qualify for the rates described above. If businesses do not meet the requirements, the credit rate will be reduced. The labour requirements for the ITC for CCUS will be announced at a later date.

  Businesses can claim only one of the ITCs for clean hydrogen, CCUS, clean technologies, clean electricity, or clean technology manufacturing, if a particular property is eligible for more than one of these tax credits. However, multiple tax credits may be available for the same project, if the project includes different types of eligible property. Businesses would be able to fully benefit from one of most of these tax credits and the Atlantic investment tax credit.

- **Extension of reduced corporate tax rates for zero-emission technology manufacturers** by another three years until 2034, subject to phase-out starting in 2032. In addition, the eligibility for the reduced rates is extended to include the manufacturing of nuclear fuels and heavy water for taxation years starting after 2023.

- **Expansion of the eligibility for the critical mineral exploration tax credit** to include lithium from brines, applicable to flow-through share agreements entered into after March 28, 2023, and before April 2027.

Private corporations and high net worth individuals

- **Numerous proposed changes to the alternative minimum tax (AMT)** applicable to high-income individuals for taxation years beginning after 2023, including the following:

  - An increase to the exemption amount from $40,000 to the lower end of the fourth federal tax bracket (approximately $173,000 for 2024);

  - An increase in the AMT rate from 15% to 20.5% (the rate applicable to the second federal tax bracket); and

  - A broadening of the AMT base, including:
    - A 100% inclusion rate for most capital gains and stock option benefits;
    - A 30% inclusion rate for capital gains realized on the donation of public securities (in line with the existing inclusion rate for capital gains eligible for the lifetime capital gains exemption, the treatment of which remains unchanged);

    - A 50% limitation on deductions in respect of various items including, but not limited to, interest expenses and carrying charges to earn property income, non-capital loss carryforwards, and employment expenses (other than those incurred to earn commission income); and
    - A 50% limitation on most non-refundable tax credits (including those for charitable donations) that can be credited against the AMT.

- **Introduction of Employee Ownership Trusts** as a new type of entity, effective January 1, 2024, which will provide a mechanism to facilitate the ownership of a controlling interest in eligible businesses by employee groups. Eligible businesses must have all or substantially all of the fair market value of their assets attributable to assets used in an active business carried on in Canada.

  - Vendors will be eligible for a 10-year capital gains reserve (as opposed to the existing five-year reserve), on the sale of an eligible business.

  - Certain technical changes to facilitate the use of trusts as a vehicle for long-term employee ownership. This included an exception for Employee Ownership Trusts from the 21-year deemed disposition rule and certain shareholder loan rules.

- **Refinements to previously announced rules intended to facilitate genuine intergenerational transfers** of qualifying businesses, effective for transactions taking place on or after January 1, 2024.

  - Specifically, Budget 2023 proposes additional conditions that must be met in order for gains in respect of transferred shares not to be recharacterized as deemed dividends. Such gains will also be eligible to be spread over a period of up to 10 years pursuant to a newly proposed capital gains reserve.

  - The proposals contemplate two types of genuine transfers: an immediate transfer (generally occurring within a three-year timeframe in accordance with arm's length terms), and a gradual transfer (generally occurring over a five-to-ten-year period, with characteristics that are consistent with typical estate freeze transactions).

  - The conditions applicable to either type of transfer pertain to the transfer of control (both legal and factual in the case of immediate transfers), economic interests, and management of the business, as well as requirements that the children retain control of, and remain involved with, the business for a set period of time following the transfer. For these purposes, children include grandchildren, stepchildren, nieces, nephews, grandnieces, and grandnephews.

  - A joint election would be required to treat a transfer as an immediate or gradual business transfer, with children (as defined above) being jointly liable for incremental tax payable by the transfer as a result of any listed conditions not being met.

  - Additional relieving rules in respect of subsequent arm's length transfers are also proposed.

  - A three- or ten-year extension of the statute barred date in respect of immediate and gradual transfers, respectively, is also proposed.

Business tax measures

- **Implementation of the 2% tax on share buybacks by public corporations**, announced in the 2022 Fall Economic Statement. The tax applies as of January 1, 2024, to the annual net value of repurchases of equity by public corporations and certain publicly traded trusts and partnerships in Canada. Businesses are not subject to the tax in a year if its gross repurchases of equity are less than $1 million.

- **Elimination of the dividend received deduction in respect of dividends received by financial institutions** on shares that are mark-to-market property, effective for dividends received after 2023.

- **Changes to the Income Tax Act so that the fees or premiums** paid on or after March 28, 2023, for the purposes of securing or renewing a letter of credit for a Retirement Compensation Arrangement (RCA) that is supplemental to a registered pension plan will not be subject to the refundable tax. Furthermore, employers will be allowed to request a refund of 50% of the retirement benefits paid after 2023, up to the amount of refundable tax previously paid in respect of fees or premiums paid for letters of credit by RCAs.

- **Numerous proposed modifications to the GAAR**, though no effective date for their application has been announced. A public consultation period on the proposals will be open until May 31, 2023, following which, the government intends to release revised draft legislation and announce the effective date of its application.

- **Proposed modifications to the GAAR** include the following:

    - A three-year extension of the statute barred date for GAAR assessments, as well as the introduction of a penalty equal to 25% of the tax benefit obtained. The disclosure of the transaction to the CRA can eliminate the penalty exposure and prevent the postponement of the statute barred date. An amendment to the mandatory disclosure rules is also proposed to permit voluntary disclosure.

    - A significant lowering of the threshold for the existence of an avoidance transaction pursuant to a change from a “primary purpose” to a “one of the main purposes” test.

    - A rule stating that a lack of economic substance is indicative, but not determinative, of misuse or abuse, subject to the existing requirement to identify the object, spirit, and purpose (OSP) of relevant provisions of the Income Tax Act. A lack of economic substance will not indicate misuse or abuse where a transaction achieves tax results that are consistent with the OSP of the relevant provisions.

    - A non-exhaustive list of factors which may indicate a lack of economic substance, including:

        - No change in the opportunity for profit or gain, and risk of loss, for the taxpayer and all non-arm’s length taxpayers, because of a circular flow of funds, offsetting financial positions, or the timing between steps in a series including the transaction;
        - The expected value of the tax benefit, as determined at the time the transaction was entered into, was reasonably expected to exceed the economic return (determined without regard to Canadian or foreign tax benefits); and
        - It might reasonably be concluded that the entire, or almost the entire, purpose for undertaking or arranging the transaction was to obtain the tax benefit.

    - The introduction of a preamble to the GAAR, clarifying its intended scope and purpose, and notably the intention that it can apply regardless of whether a given tax strategy is foreseen.

International tax measures

- **Draft legislation to implement select components of a global minimum tax regime** (in accordance with the Organization for Economic Cooperation and Development’s (OECD’s) Pillar Two framework) will be released in the coming months. Specifically, Canada intends to implement an income inclusion rule and domestic minimum top-up tax for fiscal years of ultimate parent entities of multinational enterprises beginning on or after December 31, 2023. Legislation to implement the under-tax profits rule is intended to apply for fiscal years beginning on or after December 31, 2024.

- **Confirmation that Canadian legislation to enact the various components of Pillar Two will closely follow the detailed model rules**, as well as the associated commentary and agreed administrative guidance, including all agreed safe harbours.

- **Negotiations concerning a multilateral convention** to implement rules that would reallocate taxing rights under the OECD's Pillar One framework are on-going. Budget 2023 indicates that the objective is for such a convention to be signed by mid-2023, such that the rules will enter into force in 2024.

- **Updated draft legislation to implement a Canadian Digital Services Tax (DST)** will be released for public comment prior to the introduction of enacting legislation in Parliament. Budget 2023 reiterates the intention for the DST to come into force only if the above-noted convention to implement Pillar One rules is not in force by 2024. Once in force, the DST would be payable as of 2024 in respect of revenues earned as of January 1, 2022.

Personal tax measures

- **Introduction of a one-time increase to the goods and services tax credit** (referred to as the "Grocery Rebate").

- **Various relieving measures** concerning the deduction for tradespeople's tool expenses, Registered Education Savings Plans, and Registered Disability Savings Plans.

Sales and excise tax measures

- **A number of targeted indirect and customs tax measures** were announced including:

    - Amendment of the GST/HST treatment of payment card clearing services;

    - Temporary cap on the inflation adjustment for excise duties on alcohol to 2% for one year;

    - Allowing quarterly excise duty remittances for licensed cannabis producers rather than monthly;

    - Increases to the Air Travellers Security Charge (ATSC) rates in respect of chargeable emplanements on or after May 1, 2024; and

    - Renewal of the General Preferential Tariff and Least Developed Country Tariff programs until the end of 2034.

Your dedicated team

National

Philippe Bélair
Canadian Tax & Legal Leader
Tel.: 514-393-7045

Rob Jeffery
National Tax Policy Leader
Tel.: 902-721-5593

Mike Smith
National Tax Office Leader
Tel.: 403-267-0661

Regions

Atlantic
Katie Rogers
Regional Tax Leader
Tel.: 506-663-6728

Ontario
Brian Brophy
Regional Tax Leader
Tel.: 416-601-5844

Quebec & NCR
Martin Vézina
Regional Tax Leader
Tel.: 514-393-7139

Prairies
David Arthur
Regional Tax Leader
Tel.: 403-267-1859

British Columbia
David Mueller
Regional Tax Leader
Tel.: 604-673-2661

Deloitte LLP
Bay Adelaide Centre, East Tower
8 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada