2022

Federal Budget Overview

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Finance Minister Chrystia Freeland tabled her second budget on April 7, 2022. The Budget comes amid hopes that Canada at last may be opening up from the Covid-19 pandemic, but also amid concerns about climate change and shifting economic and defense priorities coming from the war in Ukraine. In this overview we'll highlight some of the government's initiatives and priorities for the coming year.

Although the government will not be raising personal income tax rates in this Budget, it will be taking measures to increase the tax revenue it collects from the very highest income earners, including proposals for a new minimum tax regime to be released in the fall of 2022 to replace or enhance the existing alternative minimum tax regime. On the corporate side, the government is proposing measures to limit aggressive tax avoidance by financial institutions, expanding the anti-avoidance rules, and strengthening the General Anti-Avoidance Rule (GAAR).

Here are some highlights of the important numbers from the Budget:

Economic Numbers

Real GDP grew by 4.6% in 2021. This rate is lower than last year's forecast of 5.8% growth. The government expects real GDP growth for 2022 of 3.9%, down from earlier projections of 4.2%. The downward revision has occurred because of renewed restrictions in several provinces caused by the fast spread of the Omicron variant.

The government cited several employment and labour market indicators which suggest that Canada is coming out of the economic downturn caused by Covid-19. In particular, Canada's unemployment rate fell to 5.5% (below its pre-pandemic rate, and near its 50-year low of 5.4% from May 2019).

Still, the government noted that Russia's invasion of Ukraine is depressing global economic growth. The government referred to forecasts from the Organization for Economic Cooperation and Development (OECD) that forecast a 1% reduction in global economic growth and global inflation at least 2.5% higher than otherwise.

The government noted that Canada's rate of inflation hit 5.7% in February, its highest level since August 1991. It noted underlying causes for inflation as global pressures on prices for goods, higher food and energy prices, and strong demand for housing. The government also noted that China's struggle to contain Covid-19 outbreaks with lockdowns has also disrupted global supply chains, leading to price increases.

Debt and Deficit

The government expects to run a deficit of $113.8 billion for 2021-22. This is a more optimistic result than it expected last year, when it projected a deficit of $154.7 billion. It projects the deficit to decline to $8.4 billion by 2026-27, representing 0.3% of GDP.

The debt, meanwhile, stands at 46.5% of GDP for 2021-22, with an expectation that it will decline to 41.5% of GDP by 2026-27. These figures are an improvement over the government's projections from last year, where it expected the debt to remain in the 50% of GDP range for most of the decade.

Other Measures

The Budget includes several new programs and some old ones that the government has been moving along from previous years. Among them:

- **Dental care:** Dental care will start with under-12 year olds in 2022, expanding to under 18-year olds, seniors and those living with a disability in 2023, before moving to full implementation in 2025. The program will be restricted to families with an annual income under $90,000, and no co-pays for those earning less than $70,000.
- **Pharma care:** The government expects to table and pass a Canada Pharmacare bill by the end of 2023. After that, the government will task the Canadian Drug Agency to develop a national formulary of essential medicines and bulk purchasing plan.
- **Climate change measures:** The government is introducing various measures to reduce carbon pollution, build a clean energy sector, protect Canada's lands, lakes and oceans, and move towards a net zero carbon economy. Highlights from these measures include:

- Mandating that at least 20% of new light-duty vehicles sold by 2026 will be zero-emission vehicles, and at least 60% by 2035.
- Encouraging carbon capture utilization and storage (CCUS) technologies through a refundable investment tax credit for businesses that incur CCUS expenses for projects that permanently store CO_2, starting in 2022. There are different credit rates for different types of projects. For example, investments in direct air capture projects would attract a 60% tax credit.
- Providing $183.1 million over five years to reduce plastic waste and encourage plastic circularity (keeping plastic in use longer, to reduce waste).
- Provide funds for further research into small modular reactors, including an enhanced regulatory system.

- **Long-term care reform:** Although the government noted that it had provided funding of up to $4 billion to help keep senior citizens safe in long term care facilities as part of its Covid-19 Economic Response Plan, it did not include any initiatives in the Budget to provide lasting reforms for Canada's long term care system.
- **Strengthening the Canada Revenue Agency (CRA):** The Budget notes the importance of enforcement in maintaining a fair tax system by, among other things, prosecuting tax evasion and discouraging aggressive tax planning schemes. To this end the Budget will provide an additional $1.2 billion over the next five years to the CRA to help it expand audits of larger entities and non-residents engaged in aggressive tax planning, increase the investigation and prosecution of those engaged in tax evasion, and to help the CRA educate Canadians on their obligations under Canada's tax system.

Personal Income Tax Measures

The 2022 federal Budget contains several measures affecting individuals, including several incentives designed to make housing more affordable. Here is a summary of those measures:

Tax-Free First Home Savings Account

The Budget proposes to create the Tax-Free First Home Savings Account (FHSA). This new registered account will help individuals save for their first home. Contributions to a FHSA would be tax-deductible and income earned in an FHSA would not be subject to tax. Qualifying withdrawals from an FHSA made to purchase a first home would be non-taxable.

To open an FHSA, an individual must be a resident of Canada, and at least 18 years of age. The individual must not have lived in a home that they owned either:

- at any time in the year the account is opened, or
- during the preceding four calendar years.

Individuals would be limited to making non-taxable withdrawals in respect of a single property in their lifetime. Once an individual has made a non-taxable withdrawal to purchase a home, they would be required to close their FHSAs within a year from the first withdrawal and would not be eligible to open another FHSA.

Contribution and Lifetime Limit

The lifetime limit on contributions would be $40,000, subject to an annual contribution limit of $8,000. Unused annual contribution room could not be carried forward, meaning an individual contributing less than $8,000 in a given year would still face an annual limit of $8,000 in subsequent years. An individual would be permitted to hold more than one FHSA, but the total amount that an individual contributes to all of their FHSAs could not exceed their annual and lifetime FHSA contribution limits.

This new FSHA account would allow a couple to use an amount of $80,000 to purchase an eligible first home.

Transfer to or from Registered Retirement Savings Plan

An individual could transfer funds from a FHSA to a registered retirement savings plan (RRSP) before the year they turn 71 or registered retirement income fund (RRIF).

Transfers to an RRSP or RRIF would not be taxable at the time of transfer. The transfers would not reduce, or be limited by, the individual's available RRSP room. If an individual has not used the funds in their FHSA for a qualifying first home purchase within 15 years of first opening an FHSA, the FHSA would have to be closed. Any unused savings could be transferred into an RRSP or RRIF, or must otherwise be withdrawn on a taxable basis.

Individuals would also be allowed to transfer funds from an RRSP to an FHSA on a tax-free basis, subject to the $40,000 lifetime and $8,000 annual contribution limits. These transfers would not restore an individual's RRSP contribution room.

Home Buyers' Plan (HBP) and FHSA

An individual will not be permitted to make both an FHSA withdrawal and an HBP withdrawal in respect of the same qualifying home purchase.

The FHSA should be ready to start at some point in 2023.

Home Buyers’ Tax Credit

First-time home buyers who acquire a qualifying home can obtain up to $750 in tax relief by claiming the First-Time Home Buyers’ Tax Credit (HBTC). The value of this non-refundable credit is calculated by multiplying the credit amount of $5,000 by the lowest personal income tax rate (15 per cent in 2022).

The Budget proposes to double the HBTC amount to $10,000, which would provide up to $1,500 in tax relief to eligible home buyers. Spouses or common-law partners would continue to be able to split the value of the credit as long as the combined total does not exceed $1,500 in tax relief.

This measure would apply to acquisitions of a qualifying home made on or after January 1, 2022.

Multigenerational Home Renovation Tax Credit

The Budget proposes to introduce a new Multigenerational Home Renovation Tax Credit. The proposed refundable credit would provide recognition of eligible expenses for a qualifying renovation. A qualifying renovation would be one that creates a secondary dwelling unit to permit an eligible person (a senior or a person with a disability) to live with a qualifying relation. The value of the credit would be 15 per cent of the lesser of eligible expenses and $50,000.

This measure would apply for the 2023 and subsequent taxation years.

Home Accessibility Tax Credit

The Home Accessibility Tax Credit is a non-refundable tax credit that provides recognition of eligible home renovation or alteration expenses in respect of an eligible dwelling of a qualifying individual. A qualifying individual is an individual who is eligible to claim the Disability Tax Credit at any time in a tax year, or an individual who is 65 years of age or older at the end of a tax year. The value of the credit is calculated by applying the lowest personal income tax rate (15 per cent in 2022) to an amount that is the lesser of eligible expenses and $10,000. The Budget proposes to increase the annual expense limit of the Home Accessibility Tax Credit to $20,000.

This measure would apply to expenses incurred in the 2022 and subsequent taxation years.

Residential Property Flipping Rule

Property flipping involves purchasing real estate with the intention of reselling the property in a short period of time (normally less than 12 months) to realize a profit. Profits from flipping properties are fully taxable as business income, meaning they are not eligible for the 50-per-cent capital gains inclusion rate. Where the new deeming rule applies, the Principal Residence Exemption would not be available. It would remain a question of fact whether profits from the disposition are taxed as business income.

The Budget proposes to introduce a new deeming rule to ensure profits from flipping residential real estate are always subject to full taxation.

The measure would apply to residential properties sold on or after January 1, 2023

A ban on Foreign Investment in Canadian Housing

The Budget announces restrictions that would prohibit foreign commercial enterprises and people who are not Canadian citizens or permanent residents from acquiring non-recreational, residential property in Canada for a period of two years.

Annual Disbursement Quota for Registered Charities

Registered charities are generally required to expend a minimum amount each year, referred to as the disbursement quota (DQ). The DQ is currently equal to 3.5 per cent of the registered charity's property not used directly in charitable activities or administration.

The Budget proposes to increase the DQ rate from 3.5 per cent to 5 per cent for the portion of property not used in charitable activities or administration that exceeds $1 million.

These measures would apply to charities in respect of their fiscal periods beginning on or after January 1, 2023.

Business Income Tax Measures

Substantive CCPCs

Deferring Tax Using Foreign Entities

Budget 2022 proposes to align the taxation of investment income earned and distributed by "substantive" Canadian controlled private corporations (CCPCs) with the control (in law or in fact) rules that currently apply to CCPCs. The measures would contain:

- an anti-avoidance rule to address particular arrangements or transactions where it is reasonable to conclude that these arrangements, transactions, or series of transactions were undertaken to avoid the anti-deferral rules applicable to investment income
- a one year extension of the normal reassessment period for any consequential assessment of Part IV tax that arises from a corporation being assessed or reassessed a dividend refund.

The effect of the amendments would include:

- Substantive CCPCs earning and distributing investment income would be subject to the same anti-deferral and integration mechanisms as CCPCs.

- Investment income would be subject to a federal tax rate of 38 ⅔ per cent, of which 30 ⅔ per cent would be refundable upon distribution.

- The investment income earned by substantive CCPCs would be added to their "low rate income pool" such that distributions of such income would not entitle the shareholders to the enhanced dividend tax credit.

- Substantive CCPCs would continue to be treated as non-CCPCs for all other purposes of the *Income Tax Act*.

This measure would apply to taxation years that end on or after Budget Day. An exception would be provided where the taxation year of the corporation ends because of an acquisition of control caused by the sale of all or substantially all of the shares of a corporation to an arm's length purchaser. The purchase and sale agreement pursuant to which the acquisition of control occurs must have been entered into before Budget Day and the share sale must occur before the end of 2022.

Deferring Tax Using Foreign Resident Corporations

Budget 2022 proposes to eliminate the tax-deferral advantage available to CCPCs and their shareholders earning investment income through controlled foreign affiliates. These measures would apply to taxation years that begin on or after Budget Day.

Small Business Deduction

Budget 2022 proposes to extend the range over which the business limit is reduced based on the combined taxable capital employed in Canada of the CCPC and its associated corporations. The new range would be $10 million to $50 million (from $15 million) (see diagram below).

This change would allow:

- more medium-sized CCPCs to benefit from the small business deduction (and thus be taxed at a reduced corporate tax rate of 9 per cent rather than the general corporate tax rate of 15 per cent), and

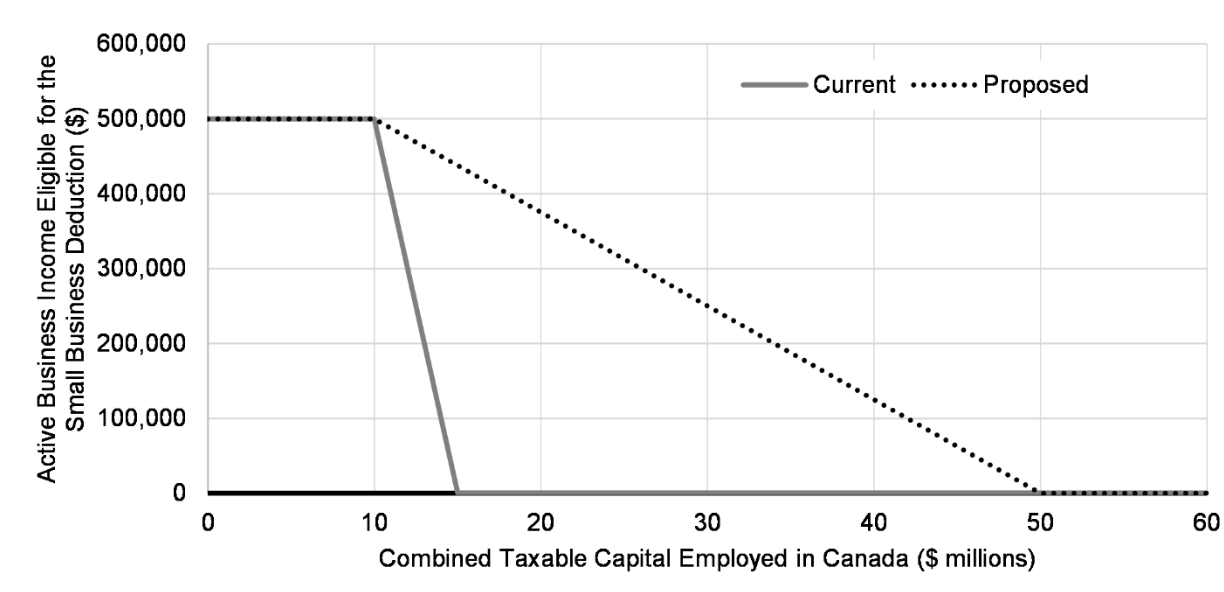
- increase the amount of qualifying active business income that can be eligible for the small business deduction.

For example, a CCPC with:

- $30 million in taxable capital would have up to $250,000 of active business income eligible for the small business deduction ($0 currently);

- $12 million in taxable capital would have up to $475,000 of active business income eligible for the small business deduction ($300,000 currently).

Current and Proposed Reductions of the Business Limit Based on Taxable Capital



This measure would apply to taxation years that begin on or after Budget Day.

Genuine Intergenerational Share Transfers

Budget 2022 announces a consultation process for Canadians on how the existing rules (introduced on June 29, 2021 in Bill C-208) could be modified to protect the integrity of the tax system while continuing to facilitate genuine intergenerational business transfers. The government is planning to table a bill this coming fall after the conclusion of the consultation process.

Comments are due by June 17, 2022 and can be sent to: intergenerational-transfers-transfertsintergenerationnels@fin.gc.ca.

Application of the General Anti-Avoidance Rule to Tax Attributes

Budget 2022 proposes amendments to the *Income Tax Act* to provide that the general anti-avoidance rule (GAAR) be amended so that the GAAR can apply to transactions that affect tax attributes (such as increases in the capital dividend account). This measure would apply to notices of determination issued on or after Budget Day.

Canada Recovery Dividend

Budget 2022 proposes to introduce a Canada Recovery Dividend (CRD) in the form of a one-time 15-percent tax on bank and life insurer groups. The CRD would:

- be determined based on a corporation's taxable income for taxation years ending in 2021.
- include a proration rule for short taxation years.
- include an allocation rule where bank and life insurer groups subject to the CRD would be permitted to allocate a $1 billion taxable income exemption by agreement among group members.
- be imposed for the 2022 taxation year, and
- be payable in equal amounts over five years.

Additional Tax on Banks and Life Insurers

Budget 2022 proposes to introduce an additional tax of 1.5 per cent of the taxable income for members of bank and life insurer groups (determined in the same manner as the CRD). Bank and life insurer groups subject to the additional tax would be permitted to allocate a $100 million taxable income exemption by agreement among group members.

This tax would apply to taxation years that end after Budget Day. For a taxation year that includes Budget Day, the tax would be prorated based on the number of days in the taxation year after Budget Day.

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