Recent Tax Updates

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February 2022 Tax Announcements

- Government released several important tax proposals on February 4, 2022, including
  - Draft legislation for immediate CCA expensing announced in Budget 2021- Royal Assent for this portion now done
  - Expanded reporting requirements for Trusts
  - Mandatory Disclosure Rules
  - The Excessive Interest and Financing Expenses Limitation (“EIFEL”) Regime

Expanded Reporting Requirements for Trusts

- *Current rules & CRA administrative policy*
  - T3 trust return not required to be filed if it meets the exceptions listed in the T3 Guide, e.g. no tax payable, not a s.94 or 75(2) trust, no allocation >$100 to beneficiaries, etc.
  - Bare trusts are completely ignored.

New Trust Reporting Rules

- New trust reporting rules originally announced in the 2018 federal budget. The rules were to be imposed for the 2021 reporting year going forward but was eventually deferred.
- Budget 2018 draft legislation released on July 27, 2018.
- Now Budget 2022 draft legislation, released in August 2022, states that the new trust reporting rules will apply to taxation years that end after December 30, 2022.

Expanded Reporting Requirements for Trusts

Proposed Changes

- Beginning for tax years ending after December 30, 2022 (this means all 2022 calendar year trusts), all express trusts must file T3, with very limited exceptions.
- Disclosure will include name, address, DoB, jurisdiction and TIN for each trustee, beneficiary, settlor (includes non-arm's length lender), or person who has ability to exert influence over trustee decision.
- "*For the purposes of this section, a trust includes an arrangement under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property*" ← **bare trusts need to file T3s!**
- A person who fails to file "knowingly or … gross negligence" is liable for penalty of the greater of $2,500 and 5% of the FMV of property held by the trust.

New Trust Reporting Rules cont'd

- The new reporting requirements will include additional disclosures as part of an expanded T3 trust income tax and information return.
- Proposed subsection 150(1.2) contained in the draft legislation makes subsection 150(1.1) – the exceptions for filing tax returns - inapplicable for certain trusts. In other words, if the conditions of new subsection 150(1.2) apply, then the trust must annually file a T3 return.
- New subsection 150(1.2) applies to a trust that is resident in Canada and is an *express trust*. The phrase express *trust* is not explicitly defined in the draft legislation nor is that phrase currently used in the Act.
- Budget 2018 Notes: *An express trust is generally a trust created with the settlor's express intent, usually made in writing (as opposed to a resulting or constructive trust, or certain trusts deemed to arise under the provisions of a statute).*

New Trust Reporting Rules cont'd

- Proposed subsection 150(1.2) contains a long list of certain trusts that will be exempt from the new reporting rules including:
  - trusts that have been in existence for less than three months at the end of the year;
  - trusts that hold assets with a total fair market value that does not exceed $50,000 throughout the year if the only assets held by the trust throughout the year are one or more of cash, certain debt obligations, publicly traded shares or debt, mutual fund corporation shares or trust units or an interest in a related segregated fund;
    - Notably absent from this list are private corporation shares and real estate. Accordingly, if a trust holds private corporation shares or real estate, it will be required to file a T3 return.
  - certain lawyers' trust accounts;
  - registered trust accounts like TFSAs, RRSPs, RRIFs, etc.
  - graduated rate estates;
  - registered charities;
  - mutual fund trusts; and
  - certain other exceptions.

New Trust Reporting Rules cont’d

- Budget 2022 draft legislation includes new subsection 150(1.3) and 150(1.4).
- Subsection 150(1.3) – **[Inclusion of bare trusts and arrangements]** For purposes of section 150, “a trust includes an arrangement under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust’s property.”
- Subsection 150(1.4) – **[Exception for solicitor-client privilege]** “For greater certainty, subsections (1.1) to (1.3) do not require the disclosure of information that is subject to solicitor-client privilege.”

New Trust Reporting Rules cont'd

- If a trust fails to make the necessary disclosures on time, then the normal failure to file penalties will apply under subsection 162(7) of the Act ($25/day to a maximum of $2,500).
- However, if the failure to disclose the required trust information is done knowingly or under circumstances amounting to gross negligence or as a result of a failure to comply with a demand made by the Canada Revenue Agency ("CRA"), the subsection 162(7) penalties will not apply and instead proposed subsections 163(5) and (6) will impose a penalty equal to the greater of:
  - a) $2,500 or
  - b) 5% of the highest amount of the fair market value of the trust assets.
- **Ouch!**

New Trust Reporting Rules cont'd

- The new trust reporting rules will apply to deemed resident trusts under section 94 of the Act.
- Any tax practitioner who has worked through the Canadian deemed resident trust rules will know that these rules are horrifically complex. Careful!!
- Proposed subsection 204.2(1) of the Regulations to the Act sets out the required information that will need to be disclosed and includes
  - the name, address, date of birth (if applicable), the jurisdiction of residence of and the Tax Identification Number of:
    - trustee(s),
    - beneficiary(ies),
    - settlor
    - persons who have the ability to exert influence over trustee decisions (commonly this person is often referred to as a "protector")

New Trust Reporting Rules cont'd

- Problem with defining "settlor" pursuant to subsection 17(15)….too broad.
- For more information, see our firm's September 9, 2022 blog at https://moodysprivateclient.com/enhanced-tax-reporting-for-trusts-starting-2022/.
- Expect revised T3 forms for new trust reporting rules:
  - About 2 years ago, a draft T3 was circulated amongst the Tax Committee members of CPA Canada.
  - Haven't seen any activity in this space since.

New Trust Reporting Rules – What to Do?

- Review trust deeds for applicable information.
- Weed out questions now rather than at the busy T3 season.
- In our opinion, eventually balance sheets and income statements for trusts will also need to be provided. That is likely years down the road though.
- Get ready now.
- Kenneth Keung and Kim G C Moody podcast about new rules - https://moodysprivateclient.com/podcasts/new-canadian-trust-reporting-rules/
- Carolyn Wong et al blog about new rules:
- https://moodysprivateclient.com/enhanced-tax-reporting-for-trusts-starting-2022/

Mandatory Disclosure Rules

- Proposed - 3 types of disclosure:
  1. Reportable Transactions
  2. Notifiable Transactions
  3. Reportable uncertain tax treatment (should generally only apply for taxpayers who have audited financial statements prepared in accordance with IFRS or other GAAP relevant for public companies)
- Originally proposals would apply to transactions occurring in taxation years beginning after 2021, but were delayed to 2022, and now deferred to 2023 (based on August 2022 proposed draft legislation).

Mandatory Disclosure Rules – Reportable Transactions

- Expansion of existing reportable transaction rules.
- Expand existing reportable transaction definition by requiring only:
  - <u>One</u> out of three hallmarks (instead of two) –
    - Fee based on amount of a tax benefit
    - Confidential protection
    - Contractual protection
  - AND one of the main purposes of the transaction or series is to obtain a tax benefit.
- Any taxpayer, promoter, or advisor subject to these rules would be required to report the transaction to the CRA by filing the information return within 45 days of the earlier of the date the taxpayer becomes contractually obligated to enter, or actually enter, into the transaction.
- Significant penalties could apply for non-compliance.

Mandatory Disclosure Rules – Notifiable Transactions

- Proposal gives CRA (with concurrence of Minister) power to designate types of transactions as “notifiable transactions”. So far, the following have been designated:
  - Manipulating “Canadian-controlled private corporation” status to avoid anti-deferral rules.
  - Straddle loss creation transactions using a partnership.
  - Avoiding the 21-year deemed disposition rule for trusts.
  - Manipulating bankrupt status to reduce debt forgiveness.
  - Using the anti-avoidance rules designed to restrict tax attribute trading to avoid an acquisition of control of a corporation.
  - Using back-to-back lending arrangements to avoid the thin capitalization rules or non-resident withholding tax.

Mandatory Disclosure Rules – Notifiable Transactions

- Any transaction same or "substantially similar" to the designated transactions must be disclosed. This is to be "*interpreted broadly in favour of disclosure*".
- A taxpayer who enters into a notifiable transaction (or a promoter or advisor who promotes or advises on a notifiable transaction, subject to an exception for solicitor-client privilege) would be required to report the transaction to the CRA by filing an information return within 45 days of the earlier of the date the taxpayer becomes contractually obligated to enter, or actually enter, into the transaction.
- Significant penalties apply for non-compliance.

Mandatory Disclosure Rules – Penalties for Non-Compliance

- Taxpayers
  - $500 per week for each failure to report a reportable transaction or a notifiable transaction, up to the greater of $25,000 and 25 per cent of the tax benefit; or
  - for corporations that have assets that have a total carrying value of $50 million or more, $2,000 per week, up to the greater of $100,000 and 25 per cent of the tax benefit.
  - For uncertain tax treatments only: $2000 per week, up to maximum of $100,000.
- Advisors and promoters – For each failure to report, the total of:
  - 100 per cent of the fees charged by that person to a person for whom a tax benefit results;
  - $10,000; and
  - $1,000 for each day during which the failure to report continues, up to a maximum of $100,000.

Mandatory Disclosure Rules – Unlimited Reassessment Period

- No provision for a limitation period under draft legislation because normal reassessment period (i.e. the “statute-barred” limitation) does not commence in respect of the transaction until taxpayer has complied with the reporting requirement.

- Therefore, non-compliant taxation years will never become statute-barred.

Mandatory Disclosure Rules – Carve out for Solicitor-Client Privilege

- Proposed subsection 237.4(20) for notifiable transactions:
  - "*For greater certainty, for the purpose of this section, a lawyer who is an advisor in respect of a notifiable transaction is not required to disclose in an information return in respect of the transaction any information in respect of which the lawyer, on reasonable grounds, believes that a client of the lawyer has solicitor-client privilege.*"
  - Equivalent provision for reportable transactions [237.3(17)] already exists.
- However, SCP is not a panacea:
  - SCP applies to communications between solicitor and client, not facts.
  - May not prevent mandatory disclosure of identity of the client engaging in reportable / notifiable transaction.

Excessive Interest and Financing Expenses Limitation ("EIFEL") Regime

- The EIFEL regime is intended to apply to taxation years beginning on or after January 1, 2023.
- An "excluded entity" is not subject to EIFEL. There are three separate categories of excluded entities:
  - CCPCs with less than $15M taxable capital in the associated group (the "*small CCPC exception*");
  - Groups with total "Net Interest and Financing Expenses" of $250,000 or less (the "*de minimis exception*"); and
  - Groups that carry on all or substantially all of their business in Canada, do not have any foreign affiliates, do not have any specified shareholders or specified beneficiaries who are non-resident persons, and pay all or substantially all of their Net Interest and Financing Expenses to persons other than tax-indifferent investors (the "*domestic exception*").

Excessive Interest and Financing Expenses Limitation ("EIFEL") Regime

- Where it applies, the EIFEL rules are very complicated.
- Generally speaking, net interest and other financing expenses may only be deducted to the extent it doesn't exceed 40% of EBITDA. [this becomes 30% for tax years beginning after 2023].
- Denied deductions can generally be carried forward up to 20 years.
- If your client is capital intensive, they could be caught.

Immediate CCA Expensing

- CCPC may claim 100% CCA on "designated immediate expensing property (DIEP)" acquired after April 18 2021.
- Individuals and eligible Canadian Partnerships can claim 100% CCA on DIEP acquired by Dec 31 2021
- The immediate CCA expensing rules was part of a Notice of Ways and Means Motion released on April 27 2022.
- DIEP generally are new depreciable property, other than property in CCA classes 1 to 6, 14.1, 17, 47, 49 and 51. Max limit: $1.5M for associated group per tax year
- CPA Canada's announcement:
  - *"In a communication to us, the CRA stated that since final draft legislation was released, taxpayers can include immediate expensing in the calculation of their capital cost allowance (CCA) deduction.* ***However, adjustment requests to recognize immediate expensing for returns that have already been filed cannot be processed until after Royal Assent has been received****."*

Budget 2022 – April 7, 2022

- Some highlights:
  - Ban on foreign investment in Canadian housing
  - Boutique tax credits
  - Anti-house flipping rule
  - New trust reporting rules – already discussed
  - New alternative minimum tax

What’s NOT in the 2022 Federal Budget

- No personal tax rate increases
  - Notwithstanding NDP’s 2021 election policy platform to raise personal rate by 2%.
- No corporate tax rate increases (except for certain financial institutions)
- No capital gains inclusion rate increases
  - Despite predictions and rumours, CG inclusion rate remains 50%.
- No introduction of a new “wealth” tax (*but there is the promise of a ‘new’ AMT…*)
- No amendments to Principal Residence Exemption
- No Bill C-208 amendments
  - History of this saga.
  - Another consultation asking for submissions from stakeholders no later than June 17, 2022.
  - New draft legislation to come fall of 2022.

Ban on Foreign Investment in Canadian Housing

- "*To make sure that housing is owned by Canadians instead of foreign investors, Budget 2022 announces the government's intention to propose 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*."
- New Act - *Prohibition on the Purchase of Residential Property by Non-Canadians Act* - has now received Royal Assent in June 2022 to take effect January 1, 2023 – December 31, 2024 - https://laws-lois.justice.gc.ca/eng/acts/P-25.2/page-1.html

More Boutique Tax Credits

- *Tax-Free First Home Savings Account (FHSA)*
  - New registered account to help individuals save for their first home;
  - Contributions to an FHSA would be 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;
  - The government will release its proposals for other design elements in the near future.

More Boutique Tax Credits

- *Home Buyers' Tax Credit (HBTC)*
  - Budget 2022 proposes to double the HBTC amount to $10,000;
  - 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.

More Boutique Tax Credits

- *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; and
  - This measure would apply for the 2023 and subsequent taxation years, in respect of work performed and paid for and/or goods acquired on or after January 1, 2023.

More Boutique Tax Credits

- *Home Accessibility Tax Credit*
  - 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;
  - Budget 2022 proposes to increase the annual expense limit of the Home Accessibility Tax Credit to $20,000 Budget 2022 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

- New deeming rule under subsection 12(12) "*to ensure profits from flipping residential real estate are always subject to full taxation*".
- Proposed: profits arising from dispositions of residential property (including a rental property) owned for less than 12 months deemed to be business income. Not capital gain. No principal residence exemption.
- Proposed rule will not apply if disposition is in relation to a "life event".

Residential Property Flipping Rule (Cont'd)

- Life events:
  - Death: of the taxpayer or a related person.
  - Household addition: due to, or in anticipation of, a related person joining the taxpayer's household or the taxpayer joining a related person's household.
  - Separation: due to the breakdown of a marriage or common-law partnership
  - Personal safety: due to a threat to the personal safety of the taxpayer or a related person
  - Disability or illness: due to a taxpayer or a related person suffering from a serious disability or illness.
  - Employment change: for the taxpayer or their spouse or common-law partner to work at a new location or due to an involuntary termination of employment. New home must be at least 40 km closer to the new work location.
  - Insolvency: due to insolvency or to avoid insolvency.
  - Involuntary disposition: a disposition against someone's will, e.g. expropriation, natural disaster.

Residential Property Flipping Rule (Cont'd)

- An unnecessary amendment.
- Existing tools in ITA, and personal tax returns have required PRE disclosure since 2016.
- Arbitrary test will likely drive undesirable behaviour.
- How will "life event" be policed by CRA?
- Kenneth Keung and Kim G C Moody podcast about these new rules here - https://moodysprivateclient.com/podcasts/episode-025-residential-property-flipping-proposal/

Increasing Taxable Capital Threshold for Small Business Tax Rate

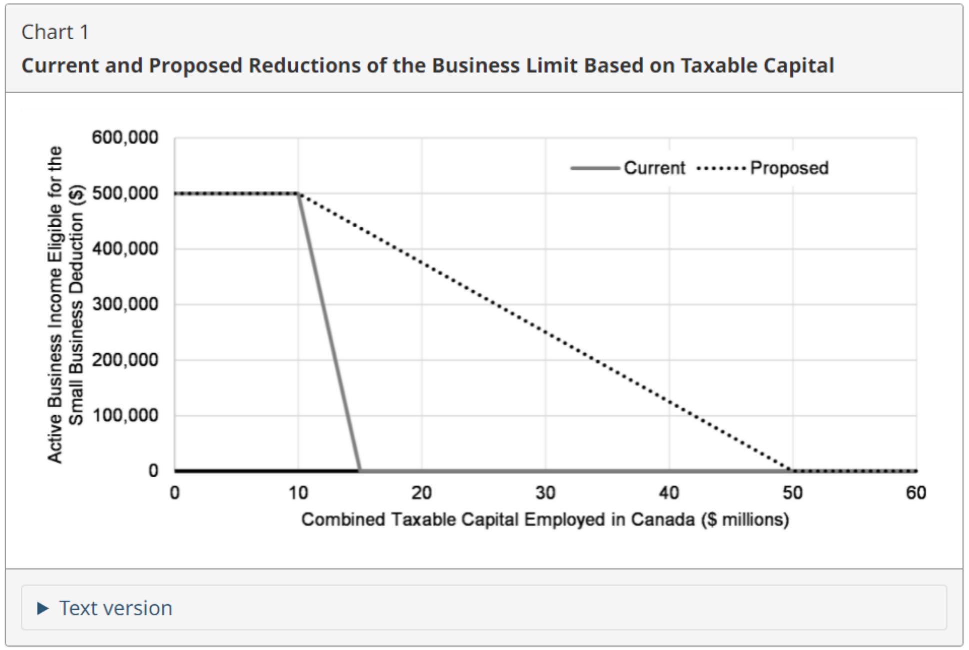
Current rules

- ITA 125(5.1): two $500,000 small business limit grinds for associated group:
  - Taxable capital over $10,000,000
  - Passive income over $50,000
- Taxable capital grind formula: 0.225% x (taxable capital - $10M) / $11,250.
  - Therefore, at $15M, small business limit is ground to nil.
- A disincentive against business expansion. One of our professionals (Brad Severin) was part of a significant lobby effort to change this.

Increasing Taxable Capital Threshold for Small Business Tax Rate

Proposed amendment, effective tax years begin or after April 7,2022

- Formula will be amended to slow the grind, expanding upper threshold to $50M



Increasing Taxable Capital Threshold for Small Business Tax Rate

- For tax years that begin on or after April 7 2022, the grind formula:
  - **0.225% x (taxable capital - $10M) / $90,000**
- Note that the $50K passive income grind to small business limit remains unchanged (full grind when passive income reaches $150K).
- Expanded trust disclosure rules may catch family businesses who are unaware they are associated.
  – e.g. a Holdco controlled by a discretionary family trust is associated with any corporations controlled by the trust's beneficiaries.

New Substantive CCPC Rules

Current rules

- CCPC earning “aggregate investment income” (AII) subject to refundable tax regime.
- AII includes income from property (interest, foreign dividend, rental, etc), and taxable capital gain.
- Corporate tax rate on CCPC earning AII in Alberta is 46.7%:
  - Federal tax rate of 38.7%

○ Basic corporate rate	38%
○ Provincial abatement	(10%)
○ Additional refundable tax	10.7%
	38.7%

  - Provincial rate of 8%

New Substantive CCPC Rules (Cont'd)

Current rules

- Immediate corporate tax on AII of 46.7%.
- Addition to NERDTOH of 30.7%. But NERDTOH refund requires payment of highly taxed non-eligible taxable dividends.
- Capital gain 50% non-taxable portion adds to CDA.
- Result of refundable tax regime: prevention of tax deferral when compared to investing personally.

New Substantive CCPC Rules (Cont'd)

Current rules

- Only CCPC's are subject to refundable tax regime.
- Requirements of CCPC definition in ITA 125(7) include:
  - "Canadian corporation", <u>AND</u>
  - Corporation not controlled, directly or indirectly, by a non-resident person, taking into account rights that may be exercised in the future [ITA 251(5)(b)]
- Therefore, refundable tax regime can be avoided by, e.g.:
  - Earning investment income in a Canadian-controlled foreign incorporated or continued company, typically in a non-tax treaty country in order to avoid treaty tie-breaker rule: e.g. BVI, Cayman, Bahamas.
  - Giving an option or other binding right to a non-resident entity for voting control of Canadian corporation, sometimes as part of an actual sale to a non-resident buyer.

New Substantive CCPC Rules (Cont'd)

Proposed rules

- According to Budget, taxpayers are "*manipulating the status of their corporations*" to avoid qualifying as a CCPC to achieve tax-deferral advantage on investment income.
- CRA is pursuing many of these, but Government is proposing a legislative fix because these challenges are "*time-consuming and costly*".
- The fix – a new definition in ITA 248(1):
  - *"Substantive CCPC" means a private corporation (other than a Canadian-controlled private corporation) that at any time in a taxation year*
    - a) *is controlled, directly or indirectly in any manner whatever, by one or more Canadian resident individuals, or*
    - b) *would, if each share of the capital stock of a corporation that is owned by a Canadian resident individual were owned by a particular individual, be controlled by the particular individual.*"

New Substantive CCPC Rules (Cont'd)

Effective for tax years that ends on or after April 7, 2022:

– Substantive CCPCs' AII will be subject to refundable federal Part I tax of 38.7% (plus provincial tax);

– 30.67% of AII goes into NERDTOH, just like a CCPC.

– 80% of AII earned by a Substantive CCPC adds to low-rate income pool (LRIP). Corporation cannot pay eligible dividend until LRIP paid out as non-eligible taxable dividends;

Very narrow grandfathering for transactions entered into before April 7 2022 - 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 must have been entered into before April 7, 2022.

New Substantive CCPC Rules (Cont’d)

- Accompanying anti-avoidance rule proposed to deem a corporation to be a Substantive CCPC if it is reasonable to consider that one of the purposes of any transaction or series was to cause the corporation not to be a Substantive CCPC.
- In summary, Substantive CCPC’s going forward will be taxed similarly as CCPC for investment income and taxable capital gain, but with higher administrative costs to comply with foreign laws.
  - Substantive CCPC will suffer from some tax disadvantages compared to CCPC, e.g. will it have ability to flow out eligible dividend received when its AII adds to LRIP.

New Substantive CCPC Rules (Cont'd)

- What to do now if your client has a substantive CCPC? Three basic options:
  1. Do nothing.
  2. Transfer assets out of substantive CCPC. This is generally the simplest. Downside: to the extent the assets have appreciated there will be capital gain triggered and dividend taxation (but this accomplishes effect of a surplus strip to the extent of gains triggered).
  3. Continue the foreign corporation back to a Canadian corporation. Should generally achieve exit of non-CCPC back to a normal CCPC without triggering any gains or dividends; will have deemed year end on status change. [If non-CCPC status accomplished by having a non-resident hold rights to acquire voting shares, may require more planning].

Modification of FAPI and Taxable Surplus Dividend Regime

Current rules

- Investment income earned by a controlled foreign affiliate (CFA) is reported by Canadian shareholder as foreign accrual property income (FAPI).
- ITA 91(4) deduction = foreign accrual tax (FAT) x relevant tax factor (RTF).
- For a corporate shareholder, RFT is 4. In any other cases, RTF is 1.9.
- RTF of 4 is to test whether foreign tax of at least 25% has been paid – rationale being that approximates Canadian federal + provincial corporate tax.
- RTF of 1.9 is to test whether foreign tax of at least 52.6% has been paid – rationale being that approximates Canadian federal + provincial personal tax.

Modification of FAPI and Taxable Surplus Dividend Regime(Cont'd)

- Perceived mischief: an individual achieves tax deferral by moving investments into a CFA. Provided 25% foreign corporate income tax is paid on the investment income, no further Canadian taxation until amounts repatriated back by Canadian corporation into Canadian individual hands.
- Compare to: Canadian investing inside a CCPC - 46.7% immediate tax in Alberta [50.2% in Ontario].

Modification of FAPI and Taxable Surplus Dividend Regime(Cont’d)

Proposed Rules

- RTF will become 1.9 even for corporate shareholders.
- To attempt integration, the following s.113 dividend deduction will be added to CDA of a CCPC:
  - amount of dividend deduction with respect to dividend paid out of taxable surplus (representing amount of foreign accrual tax-sheltered FAPI less FAT), less withholding tax paid;
  - amount of dividend deduction with respect to dividend paid out of hybrid surplus, less withholding tax paid;
  - Amount of withholding tax deduction claimed less withholding tax paid.
- Such dividends (as well as pre-acquisition surplus dividend) will no longer be added to GRIP.
- Measures apply to tax years that begin on or after April 7, 2022.
- Note that this equally impacts foreign active business income that falls outside of “exempt surplus” and treated as “taxable surplus”.

Proposed Rule Example: FAPI rental income of USCo sub of Canco

Table 1: Canadian and U.S. income tax, before repatriation to Canco

USCo's rental income	$100.00
U.S. income tax paid	$26.00
Computation of Canco's taxable income for 2013	
FAPI of USCo	$100.00
Participating percentage	100%
Income inclusion - s.91(1)	$100.00
Foreign accrual tax applicable	$26.00
RTF	1.9
FAT deduction - s.91(4)	$49.40
Net income inclusion	$50.60
Combined federal and Ontario corporate tax rate on AII	50.2%
Canadian corporate income tax on FAPI	$25.40
Combined Canadian and U.S. income tax	**$51.40**
Global effective tax rate - no repatriation	**51.4%**

Proposed Rule Example: FAPI rental income of USCo sub of Canco

Table 2(a) - Canco's 2013 income with respect to FAPI and USCo dividend	
FAPI income - s.91(1)	$100.00
Foreign dividend income - s.90(1)	$74.00
Less: s.91(4) FAT deduction	-$49.40
Less: s.113(1)(b) UFTA deduction	-$23.40
Less: s.91(5) deduction for previously taxed FAPI	-$50.60
Less: s.113(1)(c) withholding tax deduction	-$7.03
Net income inclusion as AII	$43.57
AII tax rate, combined federal and ON	50%
Corporate income tax before NERDTOH refund	$21.87

Proposed Rule Example: FAPI rental income of USCo sub of Canco

Table 2(b) - Canco's tax attributes	
NERDTOH (30.67% of AII)*	$13.36
Net addition to CDA:	
S.113(1)(b) deduction	$23.40
S. 113(1)(c) deduction	$7.03
Less s.113(1)(c)(i)(A) withholding tax	-$3.70
	$26.73

Table 2(c) - Dividend distributions from Canco	
Canco's available funds for distribution:	
Dividend received from USCo	$74.00
Less: U.S. withholding tax	-$3.70
Less: Canadian corporate tax before NERDTOH refund	-$21.87
Add: NERDTOH refund	$13.36
	$61.79
Distribution to individuals to consist of:	
Capital dividend from CDA	$26.73
Remainder as non-eligible taxable dividend	$35.06
Combined federal and ON effective rate on non-eligible	
taxable dividend	47.74%
Personal income tax on non-eligible taxable dividend	$16.74

Proposed Rule Example: FAPI rental income of USCo sub of Canco

Global tax burden on full distribution	
U.S. corporate income tax	$26.00
U.S. withholding tax	$3.70
Canadian corporate income tax, after NERDTOH refund	$8.51
Canadian personal income tax on taxable dividend	$16.74
Global tax burden	$54.95
Global effective tax rate on full distribution	54.95%

Takeaway re FAPI and Taxable Surplus Dividend Regime

- Practitioners could have largely ignored FAPI for U.S. investments until now. This certainly can no longer be the case, since almost all FAPI income will be taxable going forward.
- For foreign active business income earned by foreign affiliates, it is now imperative that central management and control of the foreign affiliates are exercised within the same jurisdiction as their treaty residency. Otherwise, dividend from the affiliate is "taxable surplus" dividend, which is now taxable in the Canadian corporate shareholder unless foreign corporate tax exceeded 52.6%.
- On top of all this, expanded T1134 disclosure.

A “New” Minimum Tax Regime

- Commitment to a “new minimum tax regime” that will “*go further towards ensuring that all wealthy Canadian pay their fair share of tax”.*
- Particular criticism on individual earning $400K or more but pays 15% federal tax or less.
- No details on what a new minimum tax will look like.
- 15% sounds low, but how much actually is tax on different types of income for someone earning $400K?
  - We ran some numbers of federal income tax, for someone earning $400K, with no special deductions or credits.

A "New" Minimum Tax Regime (Cont'd)

Type of income – $400,000	Estimated federal income tax	Effective tax rate
Employment income	$109,000	27.3%
Non-eligible dividend income	$87,700	21.9%
Eligible dividend income	$76,700	19.1%
Capital gain	$43,900	11.0%

A "New" Minimum Tax Regime (Cont'd)

- People paying 15% or less is typically earning capital gain, especially if there is LCGE being claimed.
- But current AMT already addresses LCGE. What more would a new minimum tax do? Our guess:
  - Tinker with existing AMT regime and increase the amount of AMT when preferential treatment such as LCGE is claimed.
  - Cause AMT to arise when an individual claims "too much" interest and financing expenses, claims "too much" foreign tax credits on foreign sourced income, or "too much" donation tax credits (although there already are various legislative limits on donations).
  - But how much is "too much"?

Other Tax Measures Announced in Budget 2022

- *Additional Taxes on Large Financial Institutions* – the Budget proposes (1) a one-time Canada Recovery Dividend, which is a one-time 15% tax on banks, and (2) additional 1.5% to the corporate tax rate for large banks. Very poor policy. What's next? Technology companies? Oil and gas companies?
- *Employee Ownership Trusts* – the Budget announces that it will create a new dedicated type of trust – the Employee Ownership Trust – to support and encourage employee ownership of a business. Consultations will continue and no further details were released.
- *Government to Review the SR&ED Program* – The SR&ED Program will be reviewed to ensure that it targets research, development, and the development of intellectual property beneficial to Canada. The proposed review will also consider the application of a "patent box" regime.
- *GST/HST on Assignment Sales* – Budget 2022 proposes to amend the Excise Tax Act to make all assignment sales in respect of newly constructed or substantially renovated residential housing taxable for GST/HST purposes.

Other Tax Measures Announced in Budget 2022

- *Elimination of Flow-Through Shares for Oil, Gas and Coal Activities* – the government strikes a blow against oil & gas and coal companies who seek financing through flow-through share issuances by eliminating the "flow-through share regime".
- *New 30% Critical Minerals Exploration Tax Credit* – the Budget provides an opportunity for investors in critical minerals to realize a 30% investor tax credit under the proposed Critical Minerals Exploration Tax Credit.
- *Expansion of the GAAR to Tax Attributes* – the Budget proposes to overturn the *Wild* case by legislating that a "tax benefit" now includes increase or preservation of tax attributes. As a result, GAAR can now apply to abusive tax avoidance transactions where only tax attributes (e.g., PUC, CDA, losses, etc.) are created or preserved. The government proposes to implement this retroactively so that historical transactions are also subject to this amendment to the extent they haven't yet been issued a GAAR notice of determination before the Budget date.

2022 GAAR Consultation

- On August 9, 2022, Finance released a consultation paper regarding possible changes to the General Anti-Avoidance Rule (“GAAR”).
- Three requirements must be met for GAAR to apply:
  - There must be a tax-benefit stemming from a transaction or series of transactions.
  - The transaction(s) must be an “avoidance transaction” - a transaction from which a tax benefit directly or indirectly results, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.
  - The avoidance transaction must result in a misuse or abuse of the Act.
- Finance has flagged five issues with current GAAR legislation and has suggested solutions to address them. We will discuss three of the five issues.

2022 GAAR Consultation

- Finance has flagged five issues with current GAAR legislation and has suggested solutions to address them. We will discuss three of the five issues.
  - Issue 1: Despite its broad definition, a “tax benefit” has not been found in every appropriate case.
  - Issue 2: GAAR fails in the context of “mixed-purpose transactions” (transactions that result in a tax-benefit but are not avoidance transactions because there was a primary non-tax purpose).
  - Issue 3: It is difficult at times to determine the object, spirit, and purpose of provisions under the Act, and therefore it is also hard to determine whether misuse or abuse has occurred.
  - Issue 4: GAAR does not sufficiently consider the economic substance of transactions.
  - Issue 5: GAAR does not have a sufficient deterrent effect on abusive tax planning.

2022 GAAR Consultation

- Issue: "*The GAAR fails to prevent abusive tax avoidance when a tax benefit is achieved in the context of a transaction with a primarily non-tax purpose. As a result, a transaction with significant tax planning objectives may be exempt from the GAAR, even where that transaction results in abusive tax avoidance*."
- Proposed solutions: Expand the scope of what constitutes an avoidance transaction by:
  - providing an interpretive rule to specify what is not a "bona fide" (non-tax) purpose;
  - extending the definition of "transaction" to include a choice; and
    - Currently a transaction includes an arrangement or event, but not the choice to effect a transaction in a particular way.
  - lowering the threshold under the purpose test

2022 GAAR Consultation

- Issue: "*The GAAR does not sufficiently take into consideration the economic substance of transactions*."
- Proposed solution: Add an explicit economic substance rule. To do so, must address three issues.
  - Need to define economic substance.
  - Economic substance rule needs to be integrated into GAAR analysis.
  - Determine consequence for lack of economic substance.
    - Automatically deem a transaction to be abusive?
    - Place burden of establishing lack of misuse / abuse on the taxpayer for transactions lacking economic substance?

2022 GAAR Consultation

- Issue: “*The GAAR does not have a sufficient deterrent effect on abusive tax planning*.”
  - Very generally, the application of GAAR precludes levying of penalties under the Act. When GAAR applies, the effect is typically to put the taxpayer back in the position they would have been in had it not been for the tax planning arrangement.
  - Therefore, main deterrent effect now is interest owing on taxes due to GAAR reassessment.
- Proposed solutions being considered:
  - introducing a penalty based on a percentage of the tax benefit;
  - increasing the interest rate on taxes in dispute under a GAAR assessment; and
  - extending the reassessment period for GAAR assessments by additional three years.

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