TaxNewsFlash
Canada

2020 Federal Budget — Tax Changes on the Table

March 11, 2020
No. 2020-09

Finance Minister Bill Morneau will deliver Canada's 2020 federal budget on March 30, 2020. Although the government has signalled that this year's budget will focus on climate change and the environment, any details on what measures may be under consideration are kept under wraps until the budget is released. However, when preparing this year's federal budget, it's likely that the government will draw heavily on its 2019 election platform and a recent report from the House of Commons Standing Committee on Finance (Finance Committee), which was presented to Parliament on February 28, 2020. The government is also expected to propose financial measures related to the recent COVID-19 outbreak.

As these documents will likely form the basis of the new government's budget, a close analysis of the included tax proposals and recommendations may provide some preliminary clues about what may be in store this year. Among other possible measures, the government may be considering changes to limit corporate interest deductions, institute a 10% tax on luxury items and cut corporate taxes in half for qualifying green businesses. As in previous years, the Finance Committee also recommends a comprehensive review of the Canadian tax system.

In addition, the government could consider creating financial incentives for individuals to invest in accredited climate-conscious products, and implement a "Netflix tax" on foreign media content companies, as suggested by other recent government reports. Finance has also indicated that it intends to announce further measures related to the stock option cap that it originally proposed in the 2019 federal budget, but later delayed.

Catch KPMG's same-day budget coverage
Whatever tax changes are announced in this year's budget, your KPMG adviser can help you understand their effect on your personal finances or business affairs, and point

out ways to ease their impact or recognize new opportunities. You can also get highlights from our special budget edition of *TaxNewsFlash-Canada* — expected to be available on budget day from your KPMG adviser and on our website.

Complete tax-sensitive transactions before budget day
As with any budget, the government may make unexpected announcements that could affect your personal or business tax situation. Since federal budgets often propose measures that take effect on budget day, your best defense against adverse tax changes is to complete or close all tax-sensitive transactions before budget day, providing that doing so makes sense from an investment and business perspective.

Business tax changes

Corporate interest deduction

This year's federal budget could include measures to limit the amount of interest that companies can deduct. This potential change, which was outlined in the government's election platform and a related Parliamentary Budget Officer (PBO) costing report released in September 2019, could limit interest deductions for corporations with net interest expenses of more than $250,000 (see *TaxNewsFlash-Canada* 2019-43, "Post-2019 Election — Possible Tax Changes"). According to the PBO, the rules would limit interest deductions to 30% of the corporation's income before interest, taxes, depreciation and amortization (EBITDA) in computing its income. However, if the corporation is part of a corporate group, it could deduct interest over the 30% threshold up to the worldwide group ratio of total net third-party interest expense to EBITDA. According to the PBO cost estimate, this change would allow companies to carry back denied interest deductions three years, or carry deductions forward 20 years. This potential measure could also limit hybrid debt mismatch arrangements, which are cross-border transactions that exploit differences in tax laws in two or more jurisdictions.

For the purposes of its cost estimate, the PBO indicates that it assumed the policy changes do not apply to Canadian-controlled private corporations (CCPCs) with less than $10 million in assets and less than $500,000 in active business income, and CCPCs with less than $250,000 in net interest payments (interest payments minus interest revenues). It is not clear whether the PBO's assumptions in costing this platform promise was part of the government's proposal.

KPMG observation
During the 2019 fall election, both the Liberals and the NDP made similar promises to close corporate tax loopholes and costed the potential revenues that could be raised by implementing measures to limit certain corporate interest deductions, and to limit hybrid debt mismatch arrangements. Both these measures correspond with the OECD's recommendation to adopt interest limitation and hybrid mismatch rules. However, the PBO's revenue estimates for the Liberal's and NDP's 2019 election platform corporate

tax proposals contain limited details and, in the case of the anti-hybrid measures, simply assume that Canada would fully implement the OECD's hybrid mismatch recommendations. No further details have been provided on these possible measures.

In September 2019, when the PBO costed this measure based on the above assumptions, it projected the revised interest expense limitation rules would generate $1.64 billion in 2020-21 and $1.5 billion in 2021-22, while implementing the hybrid mismatch rules would generate additional revenue of just under $100 million for each of these years.

Other countries around the world have implemented similar measures. For example, the United States enacted expanded interest expense limitations and hybrid mismatch rules as part of tax reform in 2017. The UK and EU members, among others, have also implemented similar rules. In each case, the new rules also have supplementary worldwide group ratios that provide higher interest expense limitations in certain cases and exemptions for certain industries.

Succession planning

The budget could also look to update the succession planning rules for family businesses and farms to facilitate intergenerational transfers. The Finance Committee recommended tax measures in this area and, during the 2019 federal election, the government promised to consider tax measures for intergenerational transfers of farms.

KPMG observation
Finance indicated in the 2019 federal budget that it was continuing to review the issue of intergenerational transfers. Previously, in a 2017 consultation paper, Finance described its concerns over the treatment of intergenerational transfers under the current rules. Currently, shareholders of corporations are ineligible for the lifetime capital gains exemption when they sell their qualified small business corporation shares to a corporation owned by their adult children, while shareholders who sell to an arm’s length corporation can use their lifetime capital gains exemption and not be subject to these rules. At that time, Finance stated it is difficult to identify genuine intergenerational transfers undertaken among family members, but it would continue to try and address the issue.

During the 2019 election, Canada’s other three opposition parties also promised to look at potential changes to the succession planning rules.

Active business income for small businesses

In its pre-budget report, the Finance Committee recommends that the government review the rules defining passive and active business income, including the five-employee rule for

small businesses. Specifically, the Finance Committee asks the government to consider introducing budget changes to clearly state that income earned by private campgrounds who employ less than five full-time employees year-round be considered as "active business income" for the purpose of determining their eligibility for the small business deduction.

KPMG observation
This recommendation, which has appeared in previous pre-budget Finance Committee reports, may have been included again this year in response to a recent Tax Court of Canada case.

Zero-emission technologies and products

The government's election platform included several possible climate change measures that could appear in this year's budget, including a promise to cut corporate taxes in half for businesses that develop technologies or manufacture products that have zero emissions. According to the accompanying PBO cost estimate, this potential corporate tax cut would phase-in over three years and reduce the income tax rate on small businesses to 4.5% (from 9%). The cut would also reduce the general corporate income tax rate to 7.5% (from 15%). According to the PBO, the cost of this proposed measure would be $14 million in 2020-21 and $33 million in 2021-22.

Similarly, the Finance Committee's pre-budget report also recommends that that the government consider proposing legislative changes to encourage more Canadians to transition to zero-emission vehicles and manufacturers to produce and sell a greater number of such vehicles.

KPMG observation
The government recently introduced related measures for zero-emission vehicles. In particular, the 2019 federal budget introduced a temporary enhanced first-year CCA rate of 100% for eligible zero-emission vehicles, and created two new qualifying CCA classes: Class 54 and Class 55. Both classes are restricted to automotive vehicles designed or adapted to be used on highways and streets. On March 2, 2020, Finance announced it will propose a temporary enhanced first-year capital cost allowance (CCA) rate of 100% for qualifying zero-emission off-road automotive vehicles and equipment. The enhanced rate will gradually be phased out beginning in 2024, until it eventually expires in 2028.

Green tech sector

In its report, the Finance Committee also recommends that the government should consider allowing green tech companies/start-ups to use flow-through shares to raise market capital. The Finance Committee also notes that this measure could also apply

beyond the green tech sector.

Oil and gas sector

The Finance Committee recommends that the government consider the use of fiscal tools, such as a flow-through share instrument to incentivize and facilitate capital investment for decommissioning inactive wells, facilities and pipelines (similar to the Canadian Exploration Expense). In addition, the Finance Committee states that businesses could use Qualified Environmental Trusts to set aside funds for the future remediation of oil and gas wells, similar to the current rules for mines.

Rural development

The Finance Committee also asks the government to consider introducing a tax credit for rural development in this year's budget. The Finance Committee notes that this credit could be similar to the Atlantic investment tax credit.

Personal tax changes

Luxury tax

One measure that could be included in this year's federal budget is a new luxury tax. This potential change, which was included in the government's 2019 election platform, is described as a new 10% tax on luxury cars, boats, and personal aircraft over $100,000 (excluding certain commercial uses).

KPMG observation
The PBO projected that this measure could generate approximately $600 million a year in revenue.

During the 2019 election, the NDP also promised to enact a luxury tax.

Vacant residential properties

The government may also consider changes to tax vacant residential properties owned by non-Canadians who do not live in Canada, as noted in the government's 2019 platform. This measure could impose a new annual tax of 1% of the property value of residential real-estate owned by non-resident foreign entities (individuals, corporations, partnerships and trusts), according to an associated PBO cost estimate. However, the government could also include exemptions for principal residences or properties that are occupied by a renter or by a non-arm's length person (i.e., a family member) for at least six months of the year.

KPMG observation
The PBO estimated that this measure could generate approximately $200 million a year in revenue.

Employee stock options

One measure likely to be included in the upcoming budget is a change to the tax treatment of employee stock options. Finance previously stated that its 2020 budget will provide more details on this change, including a new coming-into-force date, following recent delays to implement the new regime (see *TaxNewsFlash-Canada* 2019-60, "New Stock Option Rules Delayed"). As initially announced in the 2019 federal budget, these rules will essentially impose an annual $200,000 cap on certain employee stock options that qualify for the stock option deduction. However, Finance has indicated that stock options granted by Canadian-controlled private corporations (CCPCs) and certain "highly innovative, fast-growing companies" will be exempt from the new limit. Where, as a result of these new rules, the employee is not entitled to the stock option deduction, these rules would allow qualifying employers to claim a corporate tax deduction that equals the employee's stock option benefit.

KPMG observation
Finance said that it intends to announce the new effective date of the employee stock option rules in the budget. Finance also noted that it delayed the implementation of the rules because it was still reviewing the characteristics of companies that would be exempt from the change.

Incentives for investing in climate-conscious products

In addition to certain corporate measures targeting climate change, the Finance Committee also recommends that the government adopt recommendations outlined in a 2019 report by the Expert Panel on Sustainable Finance. In this report, the Panel suggested that the government provide a tax-based financial incentive for Canadians to invest in accredited climate-conscious products, such as green bonds, through their registered savings plans (such as RRSPs) or defined contribution (DC) pension plans. In its report, the Panel recommends providing a "super tax deduction" that would allow a taxable income deduction greater than 100% on eligible contributions to registered retail savings plans earmarked for accredited climate-conscious products, combined with an extended fixed dollar contribution limit available only for eligible investments.

In addition, the Panel says that the government should consider introducing time-limited fiscal incentives to offset issuers' cost concerns of setting up green bonds, including:

- Tax credits for bond investors in lieu of interest payments

- Tax exemptions for interest earned by investors on green bonds
- Enhanced interest deductibility (such as a 1.5x multiplier for interest paid by first-time green or transition bond issuers)
- Cost reimbursements for first-time issuers for a portion of the set-up cost for issuing a green or transition-linked facility.

The Panel also recommends examining whether federal fiscal incentives adequately support innovations aimed at substantial emissions reductions and climate resiliency measures at all stages of the oil and natural gas production and transmission chain. This examination would include a review of the Scientific Research and Experimental Development (SR&ED) program and the accelerated capital cost allowance provisions, as well as the potential for new net support.

Disability-related tax measures

The Finance Committee's report suggests that the government make several tax changes intended to benefit individuals living with disabilities in this year's budget. In addition to recommending that the government could simplify the tax system for people with physical disabilities and mental infirmities, the Finance Committee recommends changes to the federal Disability Tax Credit (DTC) to:

- Modify the eligibility criteria for Canada Pension Plan disability benefits and the DTC to include people with episodic disabilities
- Amend the DTC by reducing the hours needed to qualify and institute automatic qualification for all Canadians who require life sustaining therapy
- Make the DTC refundable
- Uncouple the eligibility for the DTC and the registered disability savings plan so that individuals who are denied the DTC do not have their registered disability savings plan government co-contributions clawed back.

Highlights of other election platform promises

Several other promised measures were included in the government's election platform, including changes to:

- Increase Old Age Security payments for seniors by 10% when they turn 75
- Increase the Canada Child Benefit by 15% for children under the age of one
- Double the Child Disability Benefit
- Make maternity and parental leave benefits tax-free

- Improve the Northern Resident Deduction by giving people living in the Northern Zone at least $1,200 in deductible travel costs, with $600 in deductible travel costs for people in the Intermediate Zone.

International tax changes

Digital taxation measures

The government's election platform and the Finance Committee report both note a potential change to ensure multinational tech companies pay corporate tax on the revenue they generate in Canada. In a related cost estimate by the PBO, this measure is described as a 3% tax on revenues of certain sectors of the digital economy, modelled after the "digital services tax" implemented by France in 2019. The tax would only apply to targeted advertising services and digital intermediation services where the worldwide revenues of the business are at least $1 billion and Canadian revenues are more than $40 million.

KPMG observation
All three of Canada's opposition parties also promised to introduce a similar 3% digital tax during the 2019 election campaign. However, since the election, some government officials have indicated that Canada should wait for the OECD to progress with its work on obtaining global consensus for a solution for taxation on the digital economy before moving ahead with any unilateral measures. As a result, it remains uncertain whether this measure will be considered for the upcoming budget.

The PBO costing for this proposal indicated that this measure could generate up to $540 million in 2020-21 and $600 million in 2021-22.

Anti-avoidance rules

During the election, the government promised to introduce changes to modernize anti-avoidance rules to stop large multinational companies from being able to shop for lower tax rates by constructing complex schemes between countries. No additional details were provided at that time.

Indirect tax changes

GST/HST on digital services

The 2020 federal budget could include new rules to apply GST/HST to digital services from foreign-based firms, a change that has been referred to by the media as a "Netflix Tax". The Broadcasting and Telecommunications Legislative Review Panel recently issued a report to recommend that foreign media content companies should have to collect and remit GST/HST. If this measure is proposed in the budget, non-resident suppliers of digital services and operators of electronic platforms would need to register for GST/HST and put systems in place to collect and remit GST/HST on all qualifying taxable supplies.

Similarly, the government's election platform also promised to ensure that international digital corporations collect and remit sales tax on products consumed in Canada, in line with OECD standards and Canadian digital corporations.

KPMG observation
Several provinces have recently instituted their own measures to require foreign and out-of-province sellers to register and collect provincial sales tax. British Columbia proposed this change in its 2020 budget (See *TaxNewsFlash-Canada* 2020-04, "Highlights of the 2020 British Columbia Budget"), following similar announcements in Quebec and Saskatchewan (see *TaxNewsFlash-Canada* 2019-02, "Businesses — Are You Meeting Saskatchewan PST Rules?" and *TaxNewsFlash-Canada* 2018-19, "Businesses Outside Quebec — Get Ready for New QST Rules").

Other changes

The Finance Committee report includes several indirect tax changes, including trade and customs measures, that could be included in the budget. Specifically, the Finance Committee recommends that the government consider changes to:

- Increase the federal tobacco tax
- Ensure that export duties under the Canada-United States-Mexico Agreement (CUSMA) imposed after a specific threshold on certain dairy products apply only to the exports of CUSMA signatories
- Further reduce internal barriers to free trade
- Eliminate transaction fees charged to businesses on GST and HST amounts paid by credit card
- Reduce the excise duty rates applicable to beer products at or below 3.5% alcohol by volume and exempt non-alcoholic beer products from excise duties.

Tax expenditure review

In preparing the 2020 federal budget, the government may also consider the results of Finance's annual report of federal tax expenditures. This report, released on February 27, 2020 covers tax credits and a wide range of other targeted tax measures such as preferential tax rates, exemptions, deductions and deferrals that are aimed at reducing taxation for specific groups or to achieve certain public policy objectives. These measures are often considered a form of government spending because they reduce the tax revenue the government would otherwise receive.

During the election, the current government promised to undertake a comprehensive review of government spending and tax expenditures, and could address large expenditures with forthcoming measures in the 2020 federal budget. Although pension

plans and RRSPs are probably unlikely to be targeted, other large expenditures such as the current 50% capital gains inclusion rate could be considered. According to the report, this expenditure costs the government more than $21 billion in revenue from personal and corporate taxpayers, which has led to some media speculation on whether the government could increase the capital gains inclusion rates. It's not yet clear whether the government is considering such a change, as it was not mentioned in either the government's election platform or the Finance Committee report.

KPMG observation
According to the federal fall economic update, the government's pledge to review government spending and tax expenditures could generate $1.5 billion in annual revenue, beginning in 2020-21. However, no further details were provided on this potential measure.

Administrative tax changes

Comprehensive review of the Canadian tax system

As in previous years, the Finance Committee has again called on the government to appoint an expert panel to undertake a public comprehensive review of the Canadian tax system. The Finance Committee's recommendation notes that the panel take a "made in Canada" approach that "closes corporate loopholes and strengthens the competitiveness of Canadian business, drives innovation, and reduces the administrative and compliance burden for all users of the tax system". The Finance Committee says that such a review could examine, among other possible issues:

- Succession of business
- Deductible interest payments, including foreign subsidies
- Profits transferred to foreign subsidiaries
- Taxation of large digital companies and corporations with no physical presence in Canada
- Capital cost allowance and other tax incentives
- Canada's tax information exchange agreements and tax treaties
- Tax regimes that distribute corporate profits using a formula that reflects real economic activity
- Tax evasion
- Corporate income taxes and GST/HST for short-term rental platform operators

- Disability-related tax measures
- Inflationary excise tax on alcohol
- Publishing CRA information on the number and value of tax deductions and rules.

Addressing compliance issues

The Finance Committee recommendations also include possible budget measures that would affect how the CRA approaches compliance issues. In particular, the report recommends that the government review the resources provided to the CRA to investigate "tax havens" and the related legislative measures for large businesses operating in Canada, and require the CRA to publish estimates of tax gaps every three years.

Beneficial ownership

In its election platform, the government promised to establish a national approach to beneficial ownership. Likewise, the Finance Committee also recommends that the government work with the provinces and territories to create a national public registry of the beneficial owners of corporations operating in Canada.

KPMG observation
This government's election pledge follows previous legislative measures to introduce new requirements for federally incorporated private corporations to maintain a register of individuals with significant control, effective June 13, 2019. More recently, the government launched a public consultation to explore options to make this information more readily available to law enforcement, tax and other competent authorities, potentially through the creation of a public register. In the 2018 federal budget, Finance also proposed to introduce new enhanced tax reporting requirements for certain trusts, applicable for the 2021 and later taxation years, although these measures have not been passed into law (see *TaxNewsFlash-Canada* 2018-06, "2018 Federal Budget Highlights").

Highlights of other potential measures

The Finance Committee also recommends several other measures affecting individuals and businesses. Specifically, the Finance Committee's view is that the government should consider measures to:

- Undertake a comprehensive review of the Employment Insurance system
- Increase the duration of EI sickness benefits to 50 weeks (from 15 weeks)
- Increase the Canada Pension Plan and Quebec Pension Plan survivor's benefits

- Review and update the Temporary Foreign Worker Program by reducing application fees, simplifying the process for workers submitting new applications and creating a path to permanent residence.

We can help

Your KPMG adviser can help you assess the effect of the tax changes in the upcoming federal budget on your personal finances or business affairs, and point out ways to realize any benefits or ease their impact. We can also keep you abreast of the progress of these proposals as they make their way into law.

---

kpmg.ca

Contact Us | KPMG in Canada Privacy Policy | KPMG On-Line Privacy Policy | Legal

Information is current to March 11, 2020. The information contained in this *TaxNewsFlash-Canada* is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.