KPMG

TaxNewsFlash

Canada

# 2021 Federal Budget Highlights

April 19, 2021
No. 2021-21

Canada's Deputy Prime Minister and Finance Minister Chrystia Freeland delivered the 2021 federal budget on April 19, 2021. The budget expects a deficit of $354.2 billion for 2020-21 and forecasts a deficit of $154.7 billion for 2021-2022.

This year’s budget announces significant new spending as part of Canada's post-pandemic economic recovery, including changes to transition to a greener economy. Although the budget does not change the federal personal or corporate tax rates, it does extend the Canada Emergency Wage Subsidy (CEWS), the Canada Emergency Rent Subsidy (CERS) and the Lockdown Support until September 25, 2021 and introduces a new Canada Recovery Hiring Program.

Among other tax measures, businesses may be interested in new interest expense limitations for certain Canadian corporations starting in 2023 and proposed anti-hybrid rules that may affect Canadian multinationals. In addition, the budget provides some long-awaited details of the digital services tax, which is scheduled to be effective for January 1, 2022. In addition to these tax measures, the budget also provides new supports for small business innovation, and $17.6 billion for green investments and jobs. Further, the government announced a range of funding and new initiatives to drive Canadian innovation and growth.

Other major announcements in the budget include a commitment to $30 billion over five years to create and sustain early learning and child-care programs, and additional funding for the Black entrepreneurship program. The budget also invests in a Black-led philanthropic endowment fund to help fight anti-Black racism and improve social and economic outcomes in Black communities.

As Canada has a minority government, these measures will require the support of another political party before they pass into law. Also note that the budget did not increase the capital gains inclusion rate, change the principal residence exemption, introduce a wealth tax or address intergenerational transfers of businesses. In addition, Finance did not announce comprehensive tax reform.

The highlights of the budget are as follows.

## COVID-19 relief changes

The budget extends the CEWS, CERS and Lockdown Support subsidy to September 25, 2021 (from June 5, 2021). In response to COVID-19, Canada introduced the CEWS as a temporary subsidy that is currently available from March 15, 2020 to June 5, 2021. This two-part subsidy consists of a "base" and a "top-up" amount, with a current subsidy rate of up to a maximum of 75% of eligible wages until June 5, 2021.

In October 2020, Canada also announced the CERS for qualifying tenants and property owners. This subsidy, which is also available until June 2021, subsidizes a percentage of eligible expenses incurred by entities that have suffered a specified revenue drop. Furthermore, the 25% Lockdown Support Subsidy assists those organizations temporarily shut down due to a mandatory public health order or whose business activities have been significantly restricted due to COVID-19.

### *CEWS*

The budget reduces the CEWS rates starting on July 4, 2021. Furthermore, employers must realize a revenue reduction of greater than 10% to qualify for the CEWS as of July 4, 2021. The maximum weekly benefit per employee for the combined base subsidy and top-up subsidy for a qualifying period will gradually decrease from $847 for the period from June 6 to July 3, 2021 to $226 for the period from August 20 to September 25, 2021.

The budget also requires public corporations to repay subsidies received for periods that begin after June 5, 2021 if the aggregate compensation for specified executives during the 2021 calendar year exceeds such compensation for the 2019 calendar year. Specified executives include those officers whose compensation is required to be disclosed in the organization's annual information circular under Canadian securities laws.

A separate wage subsidy structure will continue to apply to furloughed employees for the period from June 6 to August 28, 2021 to ensure the subsidy for these employees remains aligned with EI benefits.

The budget also introduces alternative baseline remuneration periods for furloughed and non-arm's length employees for the qualifying periods starting June 6, 2021.

### *CERS and Lockdown Support Subsidy*

The budget gradually phases out the CERS subsidy rates starting on July 4, 2021 to a maximum of 20% (from the current maximum of 65%) for the period from August 29 to

September 25, 2021. The budget extends the current 25% Lockdown Support subsidy until September 25, 2021.

As with the CEWS, effective July 4, 2021 employers must realize a revenue decline of greater than 10% to qualify for the CERS and Lockdown Support subsidy.

For purposes of the CERS, applicants must have a business number with the CRA. The budget introduces a deeming rule similar to the CEWS where an entity purchases business assets from an arm's-length purchaser and uses those assets to carry on a business. Specifically, the purchaser will be deemed to have a business account number, where the seller meets this requirement. This measure applies as of September 27, 2020 (i.e., the start of CERS).

### *Canada Recovery Hiring Program*

The budget introduces the Canada Recovery Hiring Program (CRHP), which provides a subsidy of up to 50% on the incremental remuneration paid to eligible employees between June 6 and November 20, 2021. An eligible employer can claim either the CRHP or the CEWS for a particular qualifying period, but not both.

The CRHP applies to Canadian controlled private corporations (CCPCs), individuals, non-profit organizations, registered charities and certain partnerships. Organizations that do not qualify for the CEWS and public for-profit corporations will not qualify for the CRHP. Furthermore, the CRHP does not apply to furloughed employees.

Employers must meet the same revenue reduction thresholds as under the CEWS program (i.e., greater than 10% reduction, effective July 4 through November 20, 2021).

Incremental remuneration for a qualifying period means the difference between the total eligible remuneration paid to qualifying employees for the qualifying period and the baseline period (being the period from March 14 to April 10, 2021), up to a maximum of $1,129 per week per employee.

The CRHP for a qualifying period is equal to the incremental revenue multiplied by the applicable hiring subsidy rate for that period. The hiring subsidy rates gradually decline to 20% for the period from October 24 to November 20, 2021 (from 50% for the period from June 6 to July 3, 2021).

Applications for the CRHP must be made no later than 180 days after the end of the qualifying period.

## Corporate tax changes

### *Interest deductibility limits*

The budget introduces an earnings-stripping rule to limit the net interest expense deduction to no more than a fixed ratio of 30% (40% in the first year of application) of “tax EBITDA” (i.e., earnings before interest, taxes, depreciation and amortization).

The limits are intended to apply in circumstances where excessive debt or interest deductions are created through, for example:

- Interest payments to related non-residents in low-tax jurisdictions
- The use of debt to finance investments that earn non-taxable income, or
- Having Canadian businesses bear a disproportionate burden of a multinational group’s third-party borrowings.

Tax EBITDA refers to the corporation’s taxable income before interest expense and income (including amounts economically equivalent to interest and other financing-related expenses and income), income tax, and deduction for depreciation and amortization for tax purposes. Income would exclude, among other things, dividends to the extent they qualify for the inter-corporate dividend deduction on amounts received from foreign affiliates. The interest expense excludes denied interest expense under the thin capitalization rule and interest between Canadian members of a corporate group.

The new rule applies to corporations, trusts, partnerships, and Canadian branches of non-resident taxpayers. The existing thin capitalization rule will continue to apply in conjunction with the new rule.

The budget notes that taxpayers may be able to carry back denied interest up to three years and forward up to 20 years, and that Canadian members of a group may be able to transfer the unused capacity to deduct interest to other Canadian members of the group. However, banks and life insurance companies may not transfer unused capacity to other members that are not regulated banking or insurance entities, subject to further consideration and comments from stakeholders.

The budget provides limited exemptions from the rule for the following taxpayers:

- CCPCs that have taxable capital employed in Canada of less than $15 million (together with any associated corporations), and
- Groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $250,000 or less.

The budget also includes a “group ratio” rule to allow a taxpayer to deduct interest in excess of the fixed ratio of tax EBITDA where the taxpayer can demonstrate that the ratio of net third-party interest to book EBIDTA of the consolidated group implies a higher deduction limit would be appropriate. Adjustments would be made for entities with negative book EBIDTA.

The rule will apply to taxation years beginning on or after January 1, 2023 for which the limit will be 40% of tax EBITDA, and for taxation years beginning on or after January 1, 2024, for which the limit will be 30% of tax EBITDA. Finance intends to release further details in the summer of 2021 for comment.

**KPMG observations**
The budget's new rules to limit the deduction of corporate interest expense are generally consistent with the OECD's 2015 recommendations in BEPS Action 4, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments*. By introducing these rules, Canada will join several other countries which have already introduced similar rules that limit the amount of interest an entity may deduct, based on EBITDA or EBIT, including the United States, the UK and countries across the EU.

### *Immediate expensing of eligible property for CCPCs*

The budget provides immediate expensing of certain properties acquired by a Canadian-Controlled Private Corporation (CCPC) that would otherwise qualify for capital cost allowance (CCA), up to a maximum of $1.5 million per taxation year.

Eligible property includes any capital property subject to the CCA rules, except for property that would be included in Classes 1 to 6, 14.1, 17, 47, 49 and 51.

The $1.5 million limit is prorated for short taxation years and is shared amongst associated members of a group of CCPCs. Any unused portion of the limit cannot be carried forward. CCPCs acquiring more than $1.5 million of eligible property in a taxation year may decide which CCA class the immediate expensing applies to, with any excess over $1.5 million subject to the normal CCA rules. Assets that are already eligible for enhanced deductions under the existing accelerated investment incentive rules, such as the full expensing for manufacturing and processing machinery and equipment and for clean energy equipment, do not reduce the maximum deduction available under this new immediate expensing proposal. Specifically, a CCPC may expense up to $1.5 million in addition to all other CCA claims under existing rules, as long as the total CCA deduction does not exceed the capital cost of the property.

Immediate expensing is restricted by any existing rules that would otherwise restrict a CCA deduction, such as rules related to limited partners, specified leasing properties, specified energy properties and rental properties. In addition, property that has been used, or acquired for use, for any purpose before it was acquired by the taxpayer is eligible for immediate expensing only if both of the following conditions are met:

- Neither the taxpayer nor a non-arm's length person previously owned the property, and

- The property has not been transferred to the taxpayer on a tax-deferred "rollover" basis.

Immediate expensing applies to eligible property acquired on or after April 19, 2021 and available for use before 2024.

### *Rate reduction for zero-emission technology manufacturers*

The budget temporarily reduces the small business tax rate to 4.5% (from 9%) and the general corporate tax rate to 7.5% (from 15%) on eligible zero-emission technology manufacturing and processing income (i.e., "eligible income"). Taxpayers subject to both rates can choose which rate is applicable to their eligible income (subject to the corporation's business limit). No changes to the dividend tax credit rates are proposed.

To qualify for the reduced rates, at least 10% of the taxpayer's gross revenue from all active business income carried on in Canada must be derived from eligible zero-emission technology manufacturing or processing activities ("eligible activities"). Eligible activities include, among others:

- Manufacturing of solar energy conversion equipment, such as solar thermal collectors, photovoltaic solar arrays and bespoke supporting structures or frames, but excluding passive solar heating equipment (e.g., a masonry wall installed to absorb solar energy)

- Manufacturing of wind energy conversion equipment, such as wind turbine towers, nacelles and rotor blades

- Manufacturing of zero-emission vehicles (i.e., plug-in hybrid vehicles with a battery capacity of at least seven kilowatt-hours, electric vehicles and hydrogen-powered vehicles) and the conversion of vehicles into zero-emission vehicles

- Manufacturing of batteries and fuel cells for zero-emission vehicles

- Manufacturing of electric vehicle charging systems and hydrogen refuelling stations for vehicles

- Manufacturing of equipment used for the production of hydrogen by electrolysis of water, and

- Production of hydrogen by electrolysis of water.

For each of the activities described above, eligible activities include the manufacturing of components or sub-assemblies only if such equipment is purpose-built or designed exclusively to form an integral part of the relevant system. For example, manufacturing of wind turbine rotor blades may be an eligible activity, but manufacturing of general use tires, fasteners, wiring, transformers, paint, piping or concrete is not.

Eligible activities exclude all activities that do not qualify as manufacturing or processing for the purposes of the capital cost allowance rules.

A taxpayer's eligible income is equal to its "adjusted business income" multiplied by the proportion of its total labour and capital costs that are used in eligible activities. The budget bases the definition of "adjusted business income", as well as the method used to determine labour and capital costs, on similar existing rules used in calculating manufacturing and processing profits. In addition, all of a taxpayer's labour and capital costs would be deemed to be labour and capital costs that are used in eligible activities if all or substantially all of its labour and capital costs are related to eligible activities. Finance will accept stakeholder comments on this allocation method until June 18, 2021.

The reduced tax rates apply to taxation years beginning after 2021. The reduced rates are gradually phased out starting in taxation years that begin in 2029, and are fully phased out for taxation years that begin after 2031.

### *Capital Cost Allowance for clean energy equipment*

The budget expands Capital Cost Allowance Classes 43.1 (30%) and 43.2 (50%) to include:

- Pumped hydroelectric storage equipment
- Electricity generation equipment that uses physical barriers or dam-like structures to harness the kinetic energy of flowing water or wave or tidal energy
- Active solar heating systems, ground source heat pump systems, and geothermal energy systems that are used to heat water for a swimming pool
- Equipment used to produce solid and liquid fuels (e.g., wood pellets and renewable diesel) from specified waste material or carbon dioxide
- A broader range of equipment used for the production of hydrogen by electrolysis of water, and
- Equipment used to dispense hydrogen for use in hydrogen-powered automotive equipment and vehicles.

Under certain conditions, additions to these classes are eligible for immediate expensing under the existing accelerated investment incentive rules. The accelerated CCA is only available on the expanded list of assets if, at the time the property becomes available for use, the requirements of all Canadian environmental laws, by-laws and regulations applicable in respect of the property are met.

The budget also changes the eligibility criteria for certain types of equipment:

- Fossil-fuelled cogeneration systems are removed from classes 43.1 and 43.2
- Fossil-fuelled enhanced combined cycle systems are removed from classes 43.1 and 43.2
- Specified waste-fuelled electrical generation systems are removed from classes 43.1 and 43.2 if more than one quarter of their total fuel energy input is from fossil fuels, determined on an annualized basis. The budget also introduces a heat rate threshold on certain eligible systems with an electrical capacity greater than 3 megawatts.
- Specified waste-fuelled heat production equipment for which more than one quarter of the total fuel energy input is from fossil fuels on an annualized basis are removed from classes 43.1 and 43.2, and
- Producer gas generating equipment for which more than one quarter of the total fuel energy input is from fossil fuels on an annualized basis are removed from classes 43.1 and 43.2.

The expansion of Classes 43.1 and 43.2 apply in respect of property that is acquired and that becomes available for use on or after April 19, 2021, where it has not been used or acquired for use for any purpose before April 19, 2021. The removal of certain property from eligibility for Classes 43.1 and 43.2, as well as the application of the new heat rate threshold for, apply in respect of property that becomes available for use after 2024.

### *Tax incentive for carbon capture, utilization and storage*

The budget introduces an investment tax credit (ITC) for investments made in carbon capture, utilization and storage (CCUS) projects. The budget announces a 90-day consultation period with CCUS stakeholders, after which the specific details of the ITC will be released, including the amount of this incentive. The ITC is intended for direct air capture projects but is not available for enhanced oil recovery projects. This tax measure is currently scheduled to come into effect some time in 2022.

### *Avoidance of tax debts*

The budget introduces measures to prevent taxpayers from avoiding tax debts and provides a related penalty for promoters. Currently, the tax debt avoidance rule deems a transferee to be jointly and severally liable for a taxpayer's tax debts in certain circumstances where the taxpayer transferred their assets to a non-arm's length transferee for insufficient consideration. Some taxpayers have attempted to circumvent this rule by stripping the transferor's assets using a complex series of transactions.

The budget extends the circumstances where the tax debt avoidance rule will apply. Specifically, if certain conditions are met, the tax debt avoidance rule could apply to:

- Deem a tax debt to arise before the end of the taxation year in which a transfer of property occurs

- Deem a transferor and transferee otherwise dealing at arm's length not to deal with each other at arm's length, or

- Consider the overall result of the series rather than simply using the values at the time of the transfer in determining the value of the property transferred and the consideration received.

The budget also introduces a penalty for planners and promoters of tax debt avoidance schemes equal to the lesser of:

- 50% of the tax that they attempt to avoid, and

- $100,000 plus the promoter's or planner's compensation for the scheme.

These measures apply to transfers of property that occur on or after April 19, 2021.

### *Mandatory disclosure rules*

The budget announces a consultation on certain proposals to enhance Canada's mandatory disclosure rules to implement recommendations from Action Item 12 of the OECD's Base Erosion and Profit Shifting Project.

*Reportable and notifiable transactions*

The budget proposes changes to the existing reportable transactions rules so that only one generic hallmark needs to be present in order for a transaction to be reportable (in contrast to the current rules which require two of three generic hallmarks to be present). In addition, the budget amends the definition of an "avoidance transaction" for purposes of these rules to include a transaction where it can reasonably be concluded that one of the main purposes of entering into the transaction is to obtain a tax benefit.

A taxpayer who enters into a reportable transaction, or another person who enters into such a transaction to procure a benefit for the taxpayer would be required to report the transaction to CRA within 45 days of the earlier of the day the taxpayer (or the other person) becomes contractually obligated to enter into the transaction and the date the transaction is entered into by the taxpayer (or the other person).

Promoters and advisors (and certain non-arm's length persons who are entitled to receive a fee with respect to the transaction) would be required to report a scheme that, if implemented, would be a reportable transaction within the same time limits. However, an exception to the reporting requirement would be available for certain advisors where solicitor-client privilege applies.

The budget proposes a category of specific hallmarks known as "notifiable transactions" that would include both transactions that the CRA has found to be abusive as well as transactions identified as transactions of interest. The CRA would have the authority to designate, with the concurrence of Finance, a transaction as a notifiable transaction. A taxpayer who enters into a notifiable transaction (or a series of transactions that is substantially similar to a notifiable transaction), or another person who enters into such a transaction or series in order to procure a tax benefit for the taxpayer, would be required to report the transaction or series in prescribed form to CRA within 45 days of the earlier of:

- The day the taxpayer (or the other person) becomes contractually obligated to enter into the transaction or series, and
- The day on which the transaction or series is entered into by the taxpayer (or other person).

Promoters or advisors (and certain non-arm's length persons who are entitled to receive a fee with respect to the transaction) who offer such schemes would also be subject to similar reporting requirements, with an exception available for certain advisors to the extent solicitor-client privilege applies.

The proposed penalty for taxpayers (or another person who enters into a transaction to procure a tax benefit for the taxpayer) in respect of each failure to report a reportable transaction or notifiable transaction is $500 per week, up to the greater of $25,000 and 25% of the tax benefit, or for corporations with assets of $50 million or more a penalty of $2,000 per week, up to the greater of $100,000 and 25% of the tax benefit. In addition, the proposed penalty for advisors and promoters (and certain non-arm's length persons who are entitled to a fee with respect to the transaction) in respect of each failure to report a reportable or notifiable transaction is the total of:

- 100% 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.

If a person enters into a reportable or notifiable transaction for the benefit of another person and is a person entitled to a fee who does not deal at arm's length with an advisor or promoter, the person would be subject only to the greater of the penalties above.

*Uncertain tax treatments*

In addition, the budget proposes that an uncertain tax positions regime be implemented in Canada that would require specified corporate taxpayers to report particular uncertain tax treatments to the CRA. The budget states that the regime would be similar to the United States uncertain tax positions rule, where a corporation meeting certain conditions must report when it has taken a tax position on a U.S. income tax return and either the corporation or a related party has recorded a reserve with respect to that tax position in its audited financial statements.

Reporting would be required where:

- The corporation is required to file a Canadian tax return (i.e., the corporation is Canadian-resident or non-resident with a taxable presence in Canada)
- The corporation has at least $50 million in assets at the end of its financial year coinciding with the taxation year (or its last financial year), determined using the carrying value of assets on the company's balance sheet prepared in accordance with GAAP
- The corporation, or a related corporation, has audited financial statements prepared in accordance with IFRS or other country-specific GAAP relevant for domestic public companies, and
- Uncertainty in respect of the corporation's Canadian income tax is reflected in those audited financial statements.

A Canadian public corporation and a corporation controlled by a Canadian public corporation meeting the asset threshold will be subject to this reporting regime, on the basis that Canadian GAAP requires audited financial statements of public corporations to be prepared in accordance with IFRS. A private corporation meeting the asset threshold is also expected to be subject to the reporting regime if it or a related corporation has audited financial statements prepared in accordance with IFRS. A Canadian corporation controlled by a non-resident corporation may also be subject to the reporting regime where, for example, a reserve with respect to an uncertain tax position has been recorded in its audited financial statements prepared in accordance with another country-specific GAAP.

For each reportable uncertain tax treatment, a corporation would be required to report certain prescribed information (e.g., quantum of taxes at issue), a concise description of the relevant facts, the tax treatment taken and whether the uncertainty relates to a permanent or temporary difference in tax. The reporting would be due at the same time as the corporation's Canadian income tax return.

The proposed penalty for failure by a corporation to report each particular uncertain tax treatment is $2,000 per week, up to a maximum of $100,000.

*Reassessment period*

The budget proposes that where a taxpayer has a reporting requirement in respect of a transaction relevant to the income tax return for a taxation year, the normal reassessment period would not commence in respect of the transaction until the taxpayer has complied with the reporting requirement. In other words, a reassessment of a taxation year in respect of a particular transaction would not become statute-barred if the taxpayer does not comply with the mandatory disclosure reporting requirement in respect of the transaction.

Finance intends to release draft legislation on these proposed measures and additional information soon and invites stakeholders to provide feedback by September 3, 2021.

Amendments made as a result of this consultation would come into effect for taxation years beginning after 2021 and to the extent a proposed measure applies to transactions, the amendments would apply to transactions entered into on or after January 1, 2022. However, penalties would not apply to transactions occurring prior to the date on which the legislation receives Royal Assent.

### *Extension for film and video tax credits*

The budget extends the timelines for the Canadian Film or Video Tax Credits (CPTC) and the Film or Video Production Services Tax Credit (PSTC) by 12 months. The CPTC and PSTC are refundable tax credits on certain qualified expenditures.

Affected taxpayers should file a waiver with the CRA and the Canadian Audiovisual Certification Office for the 12-month extension. These measures apply to productions for which the taxpayers incurred eligible expenditures in their taxation years ending in 2020 or 2021.

### *General anti-avoidance rule*

The budget announces that the government will take steps to modernize the general anti-avoidance rule, as previously announced in the 2020 Fall Economic Statement.

## **Personal tax changes**

### *Tax treatment of COVID-19 benefit amounts*

The budget provides individuals the option to claim a deduction for the repayment of a federal COVID-19 benefit in the year of receipt rather than the year of repayment. Federal COVID-19 benefits include the Canada Emergency Response Benefit (CERB), Employment Insurance Emergency Response Benefit, Canada Emergency Student Benefit (CESB), Canada Recovery Benefit (CRB), Canada Recovery Sickness Benefit (CRSB) and Canada Recovery Caregiving Benefit (CRCB). This option is available for benefits repaid before 2023.

The budget also requires non-resident persons who received federal COVID-19 benefits and similar provincial or territorial benefits to include these benefits in taxable income.

### *Taxes applicable to registered investments*

The budget prorates the tax under Part X.2 of the *Income Tax Act* based on the proportion of shares (or units) of a registered investment held by investors subject to the qualified investment rules. This measure applies to Part X.2 tax in respect of months after 2020. The measure also applies to taxpayers whose tax liability under Part X.2 in respect of months before 2021 has not been finally determined by the CRA as of April 19, 2021.

### *Canada Workers Benefit*

The budget increases the Canada Workers Benefit to 27% (from 26%) for income over $3,000. This benefit provides individuals and families with a tax credit up to a maximum of $1,395 for single individuals without dependents, or $2,403 for families, couples and single parents. The budget also increases the phase-out threshold as follows:

- To $22,944 (from $13,194) for single individuals
- To $26,177 (from $17,522) for families.

In addition, the budget increases the phase-out rate to 15% (from 12%), which means when a household reaches the threshold, the benefit is reduced by 15% of adjusted net income until it is eliminated.

The budget also increases the reduction threshold of a Canada Workers Benefit supplement for individuals eligible for the Disability Tax Credit. The budget increases the threshold to $32,244 (from $24,815) for single individuals without dependents, and $42,197 (from $37,548) for families, and states that the phase out rate for the supplement is 7.5% for each individual in a couple where both individuals receive the supplement, and 15% otherwise.

The budget also introduces a “secondary earner exemption” to allow a spouse or partner with the lower working income to exclude up to $14,000 of their working income in the computation of their adjusted net income, for the purpose of the Canada Workers Benefit phase-out.

These measures apply to the 2021 and subsequent taxation years.

### *Northern Resident Deductions*

The budget expands the travel component of the Northern Resident Deductions to allow taxpayers the option to claim up to $1,200 across eligible trips, or the amount of employer-provided travel benefit that the taxpayer received for that travel. Individuals who reside in the prescribed Northern Zone may claim 100% of eligible travel expenses (up to $1,200) and individuals who reside in prescribed Intermediate zone may claim 50% of eligible travel expenses (up to $600). This measure applies to the 2021 and subsequent taxation years.

### *Postdoctoral fellowship income*

The budget allows taxpayers to include postdoctoral fellowship income in “earned income” when determining an individual’s contribution limit for a registered retirement savings plan (RRSP). This measure will apply in the 2021 and subsequent taxation years. In addition, a taxpayer can submit a request in writing to the CRA to adjust their RRSP room for postdoctoral fellowship income received in the 2011 to 2020 taxation years.

### *Fixing contribution errors in defined contribution pension plans*

The budget proposes to allow pension plan administrators to make additional contributions to an employee's defined contribution pension plan account to compensate for an under-contribution, and to refund the contributor (employer or employee) to correct an over-contribution error. This measure applies to errors made in any of the preceding five years, subject to a dollar limit.

Plan administrators will be required to file a prescribed form for each affected employee, rather than amend T4 slips for prior years. Additional contributions to correct for under-contributions would reduce the employee's registered retirement savings plan (RRSP) contribution room for the taxation year following the year in which the retroactive contribution is made.

This measure applies for 2021 and subsequent taxation years.

### *Tax on unproductive use of Canadian housing by foreign non-resident owners*

The budget introduces a new 1% tax on the value of non-resident, non-Canadian owned residential real estate considered to be vacant or underused. This tax will be levied annually beginning in 2022.

The budget also requires all owners of residential property in Canada (other than Canadian citizens or permanent residents of Canada) to file an annual declaration for the prior calendar year with the CRA for each Canadian residential property they own, beginning in 2023. In their declaration, an owner will be required to report information such as the address, and the value and the owner's interest in a property. The owner may also be eligible to claim in their declaration an exemption from tax on the property for the year, for instance, where the property is leased to qualified tenants for a minimum period in a calendar year. Failure to file a declaration on a property for a calendar year as and when required could result in the loss of any available exemptions on the property for the calendar year. Penalties and interest would also apply and the assessment period would be unlimited.

The budget states that the government will release a backgrounder to provide stakeholders with an opportunity to comment on further parameters of the proposed tax such as the definition of residential property, the value on which the tax would apply, how the tax would apply where a property is owned by multiple individuals and/or non-individuals, potential exemptions and compliance and enforcement mechanisms. The consultation will also consider whether, how and when the proposed tax would apply in smaller, resort and tourism communities.

### *Disability Tax Credit*

The budget expands the Disability Tax Credit by revising the list of mental functions used to assess the credit, and reducing the minimum required frequency of therapy to two times a week (from three times). However, the budget still requires that individuals must receive therapy for an average of at least 14 hours a week.

In addition, the budget adjusts the list of eligible activities used to determine time spent on life-sustaining therapy to:

- Allow reasonable time to determine dietary intake and physical exertion (as part of the therapy), where this information is necessary in determining the daily dosage of medication

- Clarify that appointments to receive therapy or determine the daily dosage of medication is not excluded (based on the exclusion of time for medical appointments)

- Provide that medically required recuperation is not excluded (based on the exclusion of time for recuperation after therapy)

- Allow reasonable time spent on activities that are directly related to determining the amount of a compound that can be safely consumed to be considered part of the therapy, where therapy requires daily consumption of a medical food or formula to limit intake of a compound.

The budget also allows an individual to include the time reasonably required by another person to assist in performing or supervising therapy, where that individual is incapable of performing their therapy independently due to their disability.

These proposed changes apply to the 2021 and subsequent taxation years for DTC certificates filed with the CRA on or after Royal Assent.

### *Increasing Old Age Security for Canadians 75 and over*

The budget enhances Old Age Security (OAS) benefits by introducing a one-time $500 payment and then a 10% increase to regular, ongoing OAS payments. The enhancements apply to OAS pensioners who will be age 75 or over as of June 2022. The lump sum payment will go out in August 2021 while the 10% increase is effective July 1, 2022.

### *Canada Recovery Benefit and EI*

The budget extends the Canada Recovery Benefit (CRB) for an additional 12 weeks, to a maximum of 50 weeks. The CRB currently provides income support to employed and self-employed individuals who are not entitled to Employment Insurance (EI) until September 25, 2021.

The budget notes that $500 will be paid for the first four additional qualifying weeks, decreasing to $300 per week for the remaining eight weeks. New claimants after July 17, 2021 will also receive $300 per week.

The budget also extends the Canada Recovery Caregiving Benefit by an additional four weeks, to a maximum of 42 weeks at a rate of $500 per week.

Additional amendments extend the CRB, as well as other sickness and caregiving and EI benefits until November 20, 2021.

The budget also outlines changes to make EI more accessible by:

- Maintaining uniform access to EI benefits across all regions
- Ensuring all insurable hours and employment are included in determining a claimant's eligibility
- Simplifying the rules related to severance and vacation pay, and
- Extending the temporary enhancements to the Work-Sharing program.

The budget notes that additional consultations will also be held on future, long-term reforms to EI.

### *Establishing a $15 Federal minimum wage*

The budget proposes to introduce a federal minimum wage of $15 per hour, rising with inflation. The wage would apply to the federally regulated private sector. Where provincial or territorial minimum wages are higher, the higher rate would apply.

### *Registration and revocation rules for charities*

The budget allows the CRA to suspend the authority of a registered charity to issue official donation receipts for one year or to revoke its registration where a false statement amounting to culpable conduct was made for the purpose of maintaining its registration.

The budget also allows the CRA to immediately revoke the registration of a charity or other qualified donee, upon being listed as a terrorist entity under the *Criminal Code.* Further, current or past members of such entities will be considered to be "ineligible individuals" under this change.

These measures will apply on Royal Assent.

## International tax changes

### *Hybrid mismatch arrangements*

The budget introduces hybrid mismatch arrangement rules by implementing the OECD's BEPS Action 2 recommendations as adapted for the Canadian income tax context. Hybrid mismatch arrangements are generally cross-border arrangements that result in mismatches in the tax treatment of payments across different countries due to differences in the income tax treatment of hybrid entities or hybrid instruments.

The budget refers to the following forms of hybrid arrangements addressed by the BEPS Action 2 recommendations:

- Deduction/non-inclusion mismatches where payments are deductible in one country without corresponding inclusion within a reasonable time in ordinary income (i.e., income subject to income tax at the recipient's full tax rate without exemption, exclusion, deduction, credit or similar tax relief) in the other country

- Double deduction mismatches where the same expense is deductible in two or more countries

- Imported mismatches where a payment deductible in one country is included in the recipient's income in a second country, but that income is offset by a deduction under a hybrid mismatch arrangement between the recipient and an entity resident in a third country

- Branch mismatch arrangements.

The budget provides an outline of the main proposed rules:

- Canadian resident payors will not be permitted to deduct payments made under hybrid mismatch arrangements to the extent the payments are deductible in another country or are not included in the ordinary income of a non-resident recipient

- Payments made by a non-resident under hybrid mismatch arrangements that are deductible in a foreign country will not also be deductible by a Canadian resident and, if the payments are received by a Canadian resident, the payments must be included in the Canadian resident's income without any offsetting deduction for certain dividends received from foreign affiliates

The budget notes that the rules will not include a purpose test, but that they will be mechanical in nature. To ensure coordination with similar rules in other countries, there will also be ordering rules consistent with the Action 2 recommendations. Further, the rules will generally apply to payments between related parties and payments under certain arrangements between unrelated parties designed to produce a mismatch.

The government will implement the proposed rules in two separate legislative packages. The first package, intended to neutralize deduction/non-inclusion mismatches resulting from payments in respect of financial instruments, will be released for comment later in 2021, and will apply as of July 1, 2022. The second package, containing the remaining rules, will be released for comment after 2021, and will apply no earlier than 2023.

The budget advises that rules to implement the remaining Action 2 recommendations, such as those addressing imported mismatches, branch mismatches and reverse hybrids, will be introduced to the extent relevant and appropriate in the Canadian context.

### *Transfer pricing rules consultation*

The budget announces a consultation on Canada's transfer pricing rules to discourage the inappropriate shifting of income out of Canada which could artificially reduce corporations' taxes owed in Canada. Finance intends to release a consultation paper later in 2021 to collect stakeholder feedback on potential reforms to Canada's transfer pricing rules.

## Indirect tax changes

### *Digital services tax*

The budget introduces a new 3% digital services tax (DST) on certain revenue streams of certain large businesses effective January 1, 2022. The new DST applies to certain revenues from online business models including:

- Online marketplaces
- Social media
- Online advertising
- User data.

The new DST generally applies to businesses that meet both of the following thresholds:

- Global groups revenues from all sources of €750 million or more in the previous calendar year
- In-scope revenue related to Canadian users of more than $20 million in the particular calendar year (the new DST would only apply to in-scope revenue over that $20 million threshold).

The DST liability would not be eligible for a credit against Canadian income tax payable, but could be deductible in computing taxable income in certain circumstances. The budget notes that the new DST would apply based on the calendar year (instead of the fiscal year).

The budget only contains highlights of the new DST proposal, but does not include draft legislation. The government invites stakeholder comments by June 18, 2021.

**KPMG observations**
The new digital services tax announced in the budget is a temporary measure that will be repealed once international consensus is reached on how to tax large multinationals

in a digitalized economy. Recent U.S. statements to drop a “safe harbour” demand and support a global minimum tax may help clear the way for an international consensus to be reached soon. The OECD and Inclusive Framework of over 135 countries (including Canada) are working towards achieving global consensus on the OECD’s two-pillar approach to address tax challenges arising from the digitalization of the economy by mid-2021. These changes are intended to ensure that certain multinational enterprises pay tax in countries where they have consumer-facing activities but do not have a physical presence and that the profits of internationally operating businesses are subject to a minimum rate of tax.

### *GST/HST measures related to e-commerce*

The budget amends the proposed GST/HST measures related to e-commerce supplies originally announced in the 2020 fall economic statement. Under these changes:

- Platform operators and third-party supplier will be jointly and severally liable for the collection and remittance of GST/HST in cases where false details were provided by the third-party supplier to the platform operator

- Platform operators will have limited liability in cases where they did not collect and remit GST/HST where they reasonably relied on information provided by third-party suppliers

- Suppliers registered under the proposed simplified method may be able to deduct amounts related to GST/HST and bad debts, and certain provincial HST point-of-sale rebates

- Platform operators and suppliers must not include zero-rated supplies in the calculation of the proposed $30,000 thresholds used to determine the registration obligations under the proposed simplified method

- The CRA will have the authority to register suppliers and platform operators believed to be required to be registered under the proposed simplified registration rules.

The budget notes that the CRA can exercise discretion in the 12-month transition period of these proposed GST/HST measures starting July 1, 2021, where certain businesses and platform operators show that they have taken reasonable measures to comply with the proposed measures but could not meet all the related obligations.

### *Tax on luxury goods*

The budget introduces a new tax on certain luxury goods, such as luxury vehicles, personal aircrafts and boats. For qualifying new luxury vehicles and personal aircrafts, the new tax is equal to the lesser of 10% of full value of the vehicle or the aircraft, or 20% of the value above $100,000. For qualifying boats over $250,000, the new tax is equal to the lesser of

10% of the full value of the boat or 20% of the value above $250,000. The applicable GST/HST on these luxury goods would apply on the final sale price, including the proposed new tax. The budget notes that Finance will release further details on this tax in the coming months. This new tax applies as of January 1, 2022.

### *Other GST/HST measures*

The budget introduces other GST/HST measures, including to:

- Increase the current thresholds related to the required details on supporting documentation for input tax credit (ITC) claims to $100 (from $30) and $500 (from $150), and to treat billing agents as intermediaries for ITC documentation purposes, effective April 20, 2021

- Modify the GST new housing rebate so that the rebate may be available if any one of the purchasers, or a relation of any of the purchasers, acquires the home for use as their primary place of residence (instead of all of the purchasers having to meet this test), effective for agreements of purchase and sale entered into after April 19, 2021 (special rules apply for owner-built homes)

- Amend the rebate of excise tax available to certain provinces by introducing a new joint election in cases where the vendor is claiming the rebate, effective on or after January 1, 2022.

### *Tobacco tax*

The budget increases the tobacco excise duty rate by $4 per carton of 200 cigarettes. The tobacco excise duty rates will also increase as follows:

- On cigarettes (per five cigarettes or fraction thereof) to $0.72725 (from $0.62725),

- On tobacco sticks (per stick) to $0.14545 (from $0.12545),

- On manufactured tobacco (per 50 grams or fraction thereof) to $9.09062 (from $7.84062), and

- On cigars $31.65673 (from $27.30379) per 1,000 cigars plus the greater of $0.11379 (from $0.09814) per cigar and 88% of the sale price or duty-paid value.

This measure applies on April 20, 2021.

### *Excise duty on vaping product*

The budget announces a consultation for a new excise duty system on vaping products. The budget invites comments from industry and stakeholders on these proposed measures by June 30, 2021. Under this new system, the new single flat duty rate would apply to vaping liquids, regardless of whether they contain nicotine, produced in Canada or imported intended for use in a vaping device in Canada. The budget also provides details on licensing, registration, excise stamping and reporting requirements.

### *Trade and customs changes*

The budget announces trade and customs measures to ensure imported goods are valued consistently between all importers by ensuring Canadian importers with ties to foreign suppliers value their goods based on the last sale for export to a purchaser in Canada (and not a previous foreign sale price).

The government also announced it intends to start consultation in summer 2021 with importers and exporters of emission intensive goods on whether Canada should participate in a program of Border Carbon Adjustments. The aim of this program is to ensure that if Border Carbon Adjustments from the country of export and the levy from the importing country do not match, any required adjustment to level the playing field would occur on the import.

The budget also announced the government will:

- Pursue reciprocal procurement policies to ensure that goods and services are only procured from countries that grant Canadian businesses a similar level of market access, to protect Canadian supply chains and ensure that Canada's trading relationships are mutually beneficial economic relationships

- Work with Export Development Canada to enhance supports to small and medium-sized exporters and to strengthen human rights considerations in export supports, including possible amendments to the *Export Development Act.*

## Administrative and other changes

### *Public corporate beneficial ownership registry*

The budget announces funding for a publicly accessible corporate beneficial ownership registry to be implemented by 2025. This announcement follows public consultations addressing the need for law enforcement, tax and other authorities to access accurate and current data on individuals who own and control corporations in order to combat money laundering, tax evasion and other financial crimes.

### *Audit authorities*

The budget provides CRA officials with the authority to require taxpayers to respond to all questions that CRA officials deem proper, in any form the CRA officials specify (i.e., orally or in writing), and to provide reasonable assistance for any purpose related to the administration or enforcement of the laws. This change will come into force on Royal Assent.

### *Electronic filing and certification of tax and information returns*

*Electronic correspondence*

The budget allows the CRA to send certain notices of assessments electronically without taxpayer consent. This measure applies to individuals who file their income tax return electronically or employ a tax preparation service that files their income tax return electronically. Taxpayers who paper-file their returns will continue to receive paper notices of assessment from the CRA. The budget also changes the default method of correspondence to electronic only for businesses that use the CRA's My Business Account. However, businesses can still choose to receive paper correspondence. These measures would come into force on Royal Assent of the enacting legislation.

*Information returns*

The budget allows information return issuers to provide T4A (Statement of Pension, Retirement, Annuity and Other Income) and T5 (Statement of Investment Income) information returns electronically, without requiring taxpayer authority and without having to issue a paper copy. This measure applies to information returns sent after 2021.

*Electronic filing thresholds*

For tax preparers, the budget lowers the electronic filing threshold to allow professional tax preparers to file electronically when they prepare more than five personal or corporate income tax returns per calendar year (instead of 10), or five trust income tax returns (previously not included). In addition, the budget reduces the number of personal and corporate income tax returns a tax preparer can paper-file per calendar year to a maximum of five of each type (from 10). For information return filers, the budget lowers the threshold for mandatory electronic filing of income tax information returns per calendar year to five returns (from 50) for each type of information return. As such, persons or partnerships that file more than five information returns of a particular type for a calendar year must file them electronically. These measures apply to calendar years after 2021.

For corporations and GST/HST registrants, the budget eliminates the mandatory electronic filing thresholds so that most corporations (under the Income Tax Act) GST/HST registrants (under the Excise Act) must file their returns electronically. This measure does not apply to charities or selected listed financial institutions. This measure applies to taxation years that begin after 2021 for corporations, and reporting periods that begin after 2021 for GST/HST registrants.

*Electronic payments*

The budget clarifies that payments required to be made at a financial institution include online payments. The budget also requires taxpayers to make electronic payments for remittances over $10,000. The budget also lowers the threshold for mandatory remittances to be made at a financial institution to $10,000 (from $50,000). This measure applies to payments made on or after January 1, 2022.

*Handwritten signatures*

The budget eliminates the requirement that signatures be in writing on the following prescribed forms (under the *Income Tax Act* and the *Tax Rebate Discounting Act*):

- T183, Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return
- T183CORP, Information Return for Corporations Filing Electronically
- T2200, Declaration of Conditions of Employment
- RC71, Statement of Discounting Transaction
- RC72, Notice of the Actual Amount of the Refund of Tax.

This measure would come into force on Royal Assent.

### *Climate Action Incentive payments*

The budget changes the annual Climate Action Incentive payment to quarterly payments made through the benefits system. The Climate Action Incentive payment is currently an annual refundable personal tax credit that is available in Alberta, Saskatchewan, Manitoba, and Ontario, where the federal pollution pricing backstop system applies. This change applies starting in 2022.

### *CRA funding*

The budget announces the following new funding for the CRA:

- $304.1 million over five years to increase audits of large businesses, to identify tax evasion involving trusts, and to modernize the CRA's process
- $230 million over five years to help collect outstanding taxes
- $41.7 million over three years to reduce processing time for personal income tax returns
- $43.9 million to accelerate ongoing e-payroll work with Digital Government and Employment and Social Development Canada (ESDC), and to develop the first phase of an e-payroll solution through the testing of prototype options for the implementation of a real-time e-payroll solution for the government

- $330.6 million over five years to invest in new technologies and tools to address cyber threats, and to ensure the CRA's workforce has the specialized skills to proactively monitor threats and safeguard Canadian data.

## Innovation and Digital Transformation

### *Investments in key sectors and clean tech*

The budget invests $2 billion in funding for life sciences, aerospace, automotive and agricultural sectors through the Strategic Innovation Fund. The budget also announces $5 billion in clean technologies, in addition to $3 billion previously announced in December 2020, with funding managed by the Net Zero Accelerator, an initiative to help decarbonize heavy industry and advance the development of new, clean technologies. In addition, the budget provides an additional $1 billion to support investments in clean technologies, and $319 million specifically for carbon capture, usage and storage research, development and commercialization.

**KPMG observations**
These measures complement the budget's 50% reduction of corporate and small business income tax rates for businesses that manufacture zero-emissions technologies.

The budget also announces:

- Funding for emerging technologies including genomics, and Artificial Intelligence (through the Pan Canadian Artificial Intelligence Strategy), and

- A new National Quantum Strategy to support research, business formation, commercialization and talent.

### *Support for small and medium-size business innovation*

The budget allocates $4 billion to help small and medium-size businesses digitize and take advantage of e-commerce opportunities. Funding of $1.4 billion will be managed through the newly created Canada Digital Adoption Program and the Business Development Bank of Canada will allocate $2.6 billion of these funds to help companies finance technology adoption.

Through the Venture Capital Catalyst Program, the budget provides additional funding for venture capital for start-ups, as well as expanded funding for research and assistance for an additional 2,500 small and medium-size businesses, through the Industrial Research Assistance Program.

### *Support for workforce transition*

The budget announces several initiatives to help Canadians workers transition to growing industries in the knowledge-based economy, including:

- $960 million over three years for the Sectoral Workforce Solutions Program to help design and deliver training relevant to the needs of business. This program is intended to connect 90,000 people with the training they need to access jobs in growing sectors such as health care and clean technologies

- $298 million over three years for the Skills for Success Program for training in skills for the knowledge economy, and

- $250 million over three years to Innovation, Science and Economic Development to upskill and redeploy workers to meet the needs of growing industries.

In addition, the budget amends the Canadian Labour Code to improve protection for gig workers, a growing force in the innovation economy.

## Previously announced tax changes

The budget confirms that Finance intends to proceed with certain previously announced measures, as modified by recent consultations and deliberations. These measures include:

- Legislative proposals released on March 3, 2021 in respect of “baseline remuneration” for the CEWS

- Legislative proposals released on February 24, 2021 in respect of the CEWS, the CERS and the Lockdown Support

- Legislative proposals released on January 19, 2021 in respect of temporary adjustments to the Child Care Expense and Disability Supports deductions

- Legislative proposals released on December 21, 2020 relating to temporary adjustments to the automobile standby charge to take into account COVID-19

- Legislative proposals released on December 16, 2020 extending timelines in respect of flow-through shares by 12 months

- Legislative proposals released on December 15, 2020 relating to capital cost allowance claims for purchases of zero-emission automotive equipment and vehicles

- The anti-avoidance rules consultation and the income tax measures announced in the 2020 fall economic statement in respect of:

    - Registered disability savings plans

  - Employee stock options
  - Patronage dividends paid in shares.

- Measures announced on November 30, 2020 in the fall economic statement regarding GST/HST relief on face masks and face shields
- Legislative proposals announced on November 27, 2020 to facilitate the conversion of Health and Welfare Trusts to Employee Life and Health Trusts
- Regulatory proposals announced on July 2, 2020 providing relief for Deferred Salary Leave Plans and Registered Pension Plans during the COVID-19 pandemic
- Legislative proposals released on April 17, 2020 to clarify support for Canadian journalism
- Income tax measure announced on December 20, 2019 to extend the maturation period of amateur athletes trusts maturing in 2019 to nine years (from eight years)
- The income tax measure announced on December 9, 2019 to increase the Basic Personal Amount to $15,000 by 2023
- The income tax measure announced on August 29, 2019 to clarify the definition of a shared-custody parent
- Legislative proposals released on July 30, 2019 to implement 2019 federal budget income tax measures in respect of:
  - Multi-unit residential properties
  - Permitting additional types of annuities under registered plans
  - Contributions to specified multi-employer pension plans for older members
  - Pensionable service under an individual pension plan
  - The allocation to redeemers methodology for mutual funds
  - Character conversion transactions
  - Electronic delivery of requirements for information
  - The transfer pricing rules
  - The foreign affiliate dumping rules
  - Cross-border share lending arrangements.

- Measures released on July 30, 2019 modifying previously enacted measures from the 2018 fall economic statement and the 2019 federal budget, in respect of:
  - The Accelerated Investment Incentive
  - The expensing of the cost of machinery and equipment used in the manufacturing or processing of goods and the cost of specified clean energy equipment
  - The expensing of the cost of certain zero-emission vehicles.
- Legislative proposals released on May 17, 2019 relating to GST/HST.
- Remaining regulatory proposals released on July 27, 2018 relating to GST/HST.
- The income tax measures announced in the 2018 federal budget to implement enhanced reporting requirements for certain trusts to provide additional information on an annual basis.
- Measures confirmed in the 2016 federal budget relating to the GST/HST joint venture election.

The budget also confirms the government's commitment to move forward with technical amendments to improve the certainty and integrity of the tax system.

## We can help

Your KPMG adviser can help you assess the effect of the tax changes in this year's 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.