AIRD BERLIS

Highlights of the 2022 Federal Budget

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On April 7, 2022 ("**Budget Day**"), Finance Minister Chrystia Freeland delivered Canada's budget for 2022 ("**Budget 2022**"). Budget 2022 continues the trend established in Budget 2021 by adding significant spending initiatives, closing additional perceived tax loopholes and continuing to implement international tax measures.

Budget 2022 proposes a number of new tax measures of note, including the following which are described in more detail below:

- rules to ensure investment income earned by private corporations that are substantively Canadian-controlled private corporations ("**CCPC**") are subject to the same refundable tax regime as CCPCs;
- amendments addressing "foreign accrual property income" of a CCPC;
- international tax measures that build upon measures already implemented or proposed in connection with the base erosion and profit shifting action plan ("**BEPS Action Plan**") by moving forward with domestic rules that will impose a 15% minimum tax on certain large multinational groups;
- an amendment to the General Anti-Avoidance Rule to deal with tax attributes;
- a new critical mineral exploration tax credit;
- amendments to the flow-through share rules for oil, gas and coal activities;
- hedging and short-selling by Canadian Financial Institutions;
- taxing real estate "flipping" as business income; and
- amendments to the annual disbursement quotas for charities.

Budget 2022 also introduces the following significant measures:

- a temporary Canada Recovery Dividend, under which banking and life insurers' groups – as determined under Part VI of the *Income Tax Act* (Canada) (the "**ITA**") – will pay a one-time 15% tax on taxable income above $1 billion for the 2021 tax year;
- a proposal to permanently increase the corporate income tax rate by 1.5 percentage points on the taxable income of banking and life insurance groups (as determined under Part VI of the ITA) above $100 million, such that the overall federal corporate income tax rate above this income threshold will increase from 15% to 16.5%;
- a number of sales and excise tax measures, including most notably taxing the assignments of agreements of purchase and sale for newly constructed (or substantially renovated) residential real estate; and
- a proposal to build on the previous $2.2 billion of new resources provided to the Canada Revenue Agency ("**CRA**") since Budget 2016, with an additional $1.2 billion over the next five years. This investment would be used to further expand the CRA's audit and enforcement capabilities, with a particular focus on expanded audits of larger entities and non-residents engaged in "aggressive tax planning."

BUSINESS INCOME TAX MEASURES

“Substantive” CCPCs

Budget 2022 contains measures to target the manipulation of a corporation’s status as a CCPC for the purposes of avoiding refundable tax on investment income. A CCPC is a corporation that is incorporated pursuant to the laws of a Canadian jurisdiction that is not controlled by a public corporation, non-residents, or some combination of public corporations and non-residents. When a CCPC earns income from property or a “specified investments business,” or realizes a taxable capital gain, the CCPC is subject to refundable tax on its “aggregate investment income.” Certain amounts are refunded upon payment by the CCPC of taxable dividends.

Some taxpayers have engaged in tax planning (“**Non-CCPC Planning**”) to take advantage of the fact that Canadian-resident corporations that are not CCPCs are not subject to the refundable tax regime. Non-CCPC Planning may involve steps taken by the owners of a CCPC to cause the corporation not to qualify as a CCPC. Such planning may be effected prior to the realization of a capital gain by the corporation, or as part of pre-sale planning in connection with the sale of the shares of the corporation. These steps often include migrating a corporation to another jurisdiction so that it is deemed not to be incorporated in a Canadian jurisdiction and, therefore, cannot qualify as a CCPC, or by shifting voting control of the corporation to non-residents. Once the corporation has lost CCPC status, the corporation is no longer subject to refundable tax on its investment income or taxable capital gains.

Budget 2022 introduces the concept of a “substantive CCPC” to nullify the benefits of Non-CCPC Planning. A proposed amendment to subsection 248(1) of the ITA defines a “substantive CCPC” as a corporation (other than a CCPC) that at any time in a taxation year:

1. is controlled, directly or indirectly in any manner whatever, by one or more Canadian resident individuals; or

2. 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.

Budget 2022 also introduces an anti-avoidance rule to accompany the new substantive CCPC definition. Proposed subsection 248(43) of the ITA provides that a non-CCPC that does not otherwise qualify as a substantive CCPC is deemed to be a substantive CCPC if it is reasonable to consider that one of the purposes of any transaction or series of transactions was to cause the corporation not to be a substantive CCPC.

Where a corporation is a substantive CCPC, such corporation would be subject to the same tax treatment on its investment income (including taxable capital gains) as would a conventional CCPC. Under the proposed amendments, a corporation will be a substantive CCPC if it is controlled in fact by Canadian resident individuals, or where shares that would result in control are owned by Canadian resident individuals. Under this definition, for example, the proposed amendments would cause a corporation to be a substantive CCPC in circumstances where the corporation would have been a CCPC but for the fact that a non-resident or public corporation has a right to acquire its shares. In each case, the corporation would be subject to refundable tax and the resulting profit would be credited to its “low rate income pool” (i.e., the investment income, including taxable capital gains, could not be distributed as an eligible dividend subject to the enhanced dividend tax credit). As a consequence, simply migrating a corporation to a foreign jurisdiction or vesting voting control of that corporation in non-residents would no longer avoid the refundable tax on investment income. Moreover, any attempts to circumvent the definition of “substantive CCPC” could be caught by the anti-avoidance rule in proposed subsection 248(43) of the ITA.

Budget 2022 also indicated that the new “substantive CCPC” regime would contain an auxiliary measure to extend the reassessment period for corporate taxpayers who receive dividends from substantive CCPCs by one year and are consequentially assessed a Part IV tax liability.

It should be noted that Finance's proposals indicate that a "substantive CCPC" would only be considered a CCPC for the purposes of determining its liability for refundable tax and the calculation of its "low rate income pool."

The "substantive CCPC" rules would apply for taxation years that end on or after Budget Day, except for a taxation year that ends after Budget Day as a consequence of an acquisition of control caused by a sale to an arm's length purchaser of all or substantially all of the shares of a corporation that is completed in 2022 under an agreement in writing entered into before Budget Day.

FAPI of a CCPC/Substantive CCPC

Budget 2022 proposes to eliminate an advantage enjoyed by CCPCs (both conventional and substantive) and their shareholders that earn investment income through controlled foreign affiliates ("**CFAs**"). Where the CFA of a Canadian resident corporation earns "foreign accrual property income" ("**FAPI**"), the Canadian resident corporation's participating share of the FAPI is included in the Canadian resident corporation's income on an accrual basis. Where the CFA is subject to foreign tax on that FAPI, to avoid double taxation, the ITA permits the Canadian resident corporation to claim an offsetting deduction in respect of that foreign tax. The amount of the deduction which can be claimed is four times the amount of foreign tax paid by the CFA. Accordingly, a CCPC can effectively earn investment income without being subject to the additional refundable tax by earning that income in a CFA that is subject to foreign tax at a rate of 25% or more. Moreover, if a CCPC receives dividends paid out of FAPI (taxable surplus) that was subject to foreign tax, the CCPC will be entitled to add an amount to its "general rate income pool" ("GRIP"). Eligible dividends can be paid out of GRIP. A CCPC earning investment income in Canada is not entitled to add anything to GRIP in respect of that investment income.

Budget 2022 proposes to eliminate the deferral advantage for CCPCs (and substantive CCPCs) by limiting the deduction in respect of foreign tax to 1.9 times (which is the factor for individuals), rather than four times. Substantially more foreign tax would have to be paid to shelter investment income earned by a CFA of a CCPC.

Budget 2022 also proposes to exclude from GRIP of a CCPC amounts related to dividends paid out of hybrid surplus or taxable surplus so that investment income earned through a foreign affiliate will not generate GRIP.

Budget 2022 also proposes welcome measures to ensure that integration works for CCPCs with foreign affiliates. A CCPC or substantive CCPC will be able to add an amount to its capital dividend account that approximates the portion of the after-tax income of a foreign affiliate of the CCPC distributed to the CCPC to the extent that income was subject to a notional tax rate of 52.63% or more. Amounts added to the capital dividend account will also include: (i) dividends paid by a foreign affiliate to a CCPC out of hybrid surplus (less the withholding tax paid) and (ii) the amount of an inter-corporate dividend deduction claimed with respect to a dividend paid out of taxable surplus as well as other non-FAPI amounts included in taxable surplus that were subject to sufficient foreign tax, as determined based on the relevant tax factor of 1.9.

These measures would apply to taxation years that begin on or after Budget Day.

Application of the General Anti-Avoidance Rule to Tax Attributes

Budget 2022 proposes to expand the scope of the general anti-avoidance rule ("**GAAR**") so that it applies to transactions that affect tax attributes that have not yet been used in the computation of tax.

This proposal is apparently in response to the Federal Court of Appeal decision in *Perry Wild v Canada*, 2018 FCA 114, which involved transactions that significantly increased paid-up capital and the adjusted cost base of shares on a tax-free basis using the lifetime capital gains exemption. Inthat case, the Federal Court of Appeal held that, although the transactions created the potential for a tax-free distribution in the future, that potential had not yet been realized and there was accordingly no "tax benefit."

Budget 2022 proposes to expand the definition of "tax benefit" to include a reduction, increase or preservation of an amount that could at a subsequent time be relevant in computing tax or other amounts

payable under the ITA, and other corresponding amendments. The supplementary information attached to Budget 2022 states that determinations made before Budget Day, where the rights of objection and appeal in respect of the determination were exhausted before Budget Day, would remain binding on taxpayers and the CRA and that these measures would apply to notices of determination issued on or after Budget Day.

Small Business Deduction

CCPCs may benefit from the "small business deduction," which is a reduced corporate income tax rate (currently 12.2% in Ontario), as opposed to the general corporate income tax rate (currently 26.5% in Ontario). The small business deduction applies on up to $500,000 per year of qualifying active business income (i.e., the "business limit") of a CCPC and the business limit is shared among associated CCPCs.

The business limit is reduced on a straight-line basis when:

1. the combined taxable capital employed in Canada of the CCPC and its associated corporations is between $10 million and $15 million; or

2. the combined "adjusted aggregate investment income" of the CCPC and its associated corporations is between $50,000 and $150,000.

Budget 2022 proposes to extend the range referred to in paragraph (1), above, such that the new range would be $10 million to $50 million. This amendment would allow more medium-sized CCPCs to benefit from the small business deduction and would increase the amount of qualifying active business income that can be eligible for the small business deduction.

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

Critical Mineral Exploration Tax Credit

The flow-through share rules in the ITA permit corporations, the principal business of which is exploration, mining or mineral processing, to renounce Canadian exploration expenses ("**CEE**") and Canadian development expenses to investors. Investors are treated as if they had incurred the expenses directly and can deduct such expenses in computing taxable income. In the case of CEE, 100% of the renounced CEE is deductible to the investor. An individual (other than a trust) who invests in flow-through shares can receive an additional tax benefit – a 15% non-refundable Mineral Exploration Tax Credit ("**METC**") on certain CEE defined as flow-through mining expenditures.

Budget 2022 proposes a new 30% Critical Mineral Exploration Tax Credit ("**CMETC**") which would apply in respect of exploration expenditures for certain specified minerals. The list of specified minerals includes copper, nickel, lithium, cobalt, graphite, rare earth elements and uranium, among others. These minerals are used to produce batteries and permanent magnets which are used in zero-emission vehicles and in the production of clean technology and semiconductors.

Eligible expenses would only qualify for the proposed CMETC, not for the METC as well. Eligibility for the CMETC will require certification from a qualified person that the expenditures to be renounced will arise from an exploration project that primarily targets the specified minerals.

The proposed CMETC would apply to expenditures renounced under eligible flow-through share agreements entered into after Budget Day and on or before March 31, 2027.

Flow-Through Shares for Oil, Gas and Coal Activities

Budget 2022 proposes to amend the flow-through share rules so that expenditures on oil, gas and coal exploration and development can no longer be renounced to an investor.

This change would apply for expenditures renounced under flow-through share agreements entered into after March 31, 2023.

INTERNATIONAL TAX REFORM & PILLAR TWO

Implementation of Global Minimum Tax

Budget 2022 builds upon measures already implemented or proposed in connection with the BEPS Action Plan developed by the Organisation for Economic Co-operation and Development ("**OECD**") by announcing its intention to move forward with proposals to implement rules to establish a minimum 15% tax applicable to multinational enterprises ("**MNEs**") with annual revenues of €750 million or more, as more particularly described in the second pillar (or "**Pillar Two**") of the inclusive framework on BEPS for international tax reform agreed to by OECD member countries on October 8, 2021. Previously implemented measures include minimum standards in tax treaties, proposals limiting deduction of interest and financing charges, rules to address hybrid mismatch arrangements, enhanced disclosure and reporting, and a domestic digital services tax in the event that a multilateral convention implementing an international framework for the allocation of profit has not come into force.

Pillar Two is intended to be implemented through changes to each member country's domestic tax laws. To this end, the inclusive framework includes detailed model rules ("**ModelRules**"), published on December 20, 2021, as well as commentary providing guidance on their interpretation and operation, published on March 14, 2022. Member countries are to implement Pillar Two in a way that is consistent with the outcomes provided for under the Model Rules and related commentary.

Under Pillar Two, a subject MNE is generally required to calculate the effective tax rate on its profits in each jurisdiction in which it operates. The basic premise of Pillar Two is that if the effective tax rate for a particular jurisdiction is below 15%, subject MNEs will be subject to a "top-up tax" that brings the effective tax rate on the profits in the particular jurisdiction up to the 15% minimum rate.

The objectives of Pillar Two are achieved via two basic charging rules for the top-up tax: (1) an income inclusion rule, and (2) an undertaxed profits rule. If the country in which the ultimate parent of the MNE is located has adopted the income inclusion rule, that country is entitled to impose the top-up tax on the ultimate parent entity. If that jurisdiction has not adopted the income inclusion rule, then the right to apply the top-up tax shifts to the jurisdiction of the highest-tier intermediate entity within the group that has adopted the income inclusion rule. If neither of the jurisdictions of the ultimate parent or any intermediate entity has adopted the income inclusion rule, the jurisdiction(s) in which the MNE operates may then levy the top-up tax if it has adopted the undertaxed profits rule. Pillar Two also contemplates a treaty-based subject-to-tax rule that would allow a developing country to impose a higher rate of withholding tax than might be applicable under a treaty if the payment is subject to tax in the payee country at a nominal rate below 9%. Budget 2022 notes, however, that this rule is not expected to impact Canada.

Budget 2022 anticipates that draft legislation implementing the Pillar Two proposals will be released for public consultation (no timeline has been given) and that the income inclusion rule and domestic minimum top-up tax would come into effect in 2023 (as of a date to be fixed). The undertaxed profits rules would come into effect no earlier than 2024.

Consultation on Pillar Two

In order to allow the Government to implement Pillar Two in accordance with the intended timeline, Budget 2022 is launching a public consultation on the implementation in Canada of the Model Rules and a domestic minimum top-up tax.

Budget 2022 refers taxpayers to the full text of the Model Rules on the OECD website and includes a series of general and specific questions related to the implementation of Pillar Two that Finance is particularly interested in. The general questions posed by Finance relate to the interaction of the Model Rules with the ITA, which administrative and enforcement provisions of the ITA should or should not be made applicable, suggestions regarding the general design of the domestic top-up tax in Canada, and whether there are any particular issues and uncertainties with how a domestic top-up tax is treated. Finance poses a number of specific questions in Budget 2022 in relation to each chapter (one through ten) of the Model Rules. Budget 2022 notes that Finance is not seeking views on the major design aspects of the Model Rules or broader policy considerations. Interested parties should review the Model Rules together with the general and specific questions posed in Budget 2022.

This preliminary consultation will be open until July 7, 2022, and interested parties are invited to send written representations to Finance as directed in Budget 2022.

Exchange of Information on the Digital Economy

In recent years, the digital economy has transformed the way business is conducted. The rise of the gig and the sharing economies have allowed many people to carry on business, often on a part-time or temporary basis. These businesses are generally carried on through online platforms that facilitate business activities such as short-term home rentals, food delivery, and ride sharing. Canada's income tax system is a system of self reporting. Many taxpayers engaged in the gig and sharing economies do not appreciate their tax obligations and such transactions are not visible to tax authorities such as the CRA.

To address these concerns, the OECD has developed model rules to require digital platform operators to collect and report information to tax administrations to ensure that such income can be properly taxed. Other jurisdictions such as the U.K., the EU and Australia have announced their intention to implement the model rules. The OECD model rules are designed to reduce the administrative burden of such reporting by requiring the platform to report the information of those persons offering a service or selling a product through the platform to only one jurisdiction, the jurisdiction of the platform. The tax administration in that jurisdiction would then share the information with the tax administrator in the country in which the partner sellers/service providers reside.

Budget 2022 proposes to implement the OECD model rules in Canada. The proposal will require "reporting platform operators" to determine the jurisdiction of residence of their "reportable sellers" for "relevant activities" and to report such information to the CRA. Reporting platform operators are entities that are engaged in contracting directly or indirectly with sellers to provide the software that runs a platform for sellers to be connected to other users or collecting compensation for the relevant activities facilitated through the platform. Providers of software that exclusively facilitate payment processing, the mere listing or advertising, or the transfer of users to another platform are generally excluded. This measure would apply to platform operators resident in Canada, or platform operators not resident in Canada or a partner jurisdiction and that facilitate relevant activities by sellers resident in Canada or the rental of real property located in Canada. Platform operators whose total compensation in the previous year is less than €1 million can elect to be excluded from reporting.

Relevant activities are sales of goods and "relevant services." Relevant services are personal services (for example, tutoring, manual labour or delivery services), rental of real property or rental of a means of transportation. A reportable seller is generally a user who is registered on a platform to provide relevant services or sell goods. There are some exceptions including those who sell goods and make fewer than 30 sales per year totalling €2,000 or less.

Reporting platform operators will need to complete due diligence procedures to identify reportable sellers and their jurisdiction of residence. For the first year in which a reporting operator becomes a reporting operator, the due diligence procedures must be completed by December 31 of the second calendar year in which the reporting operator is subject to the rules.

The measure will apply to calendar years beginning after 2023. This means that the first reporting would be due December 31, 2024, and the first exchange of information will take place in early 2025 with respect to the 2024 calendar year.

Interest Coupon Stripping

Part XIII of the ITA generally imposes a 25% withholding tax on interest paid or credited by a Canadian resident to a non-arm's length non-resident. If the lender is resident in a treaty jurisdiction, the tax treaty will generally reduce the withholding tax rate to either 10% or 15%. The tax treaty with the U.S. generally reduces the withholding tax rate to nil.

To avoid the Part XIII withholding tax on interest paid or credited to a non-arm's length non-resident lender, some non-resident lenders will sell their right to receive future interest payments (interest coupons) to a purchaser who is either not subject to withholding tax or subject to withholding tax at a lower rate. The non-resident lender generally retains the right to receive the repayment of the principal amount of the loan.

An amendment was made in 2011 to address a particular interest coupon stripping arrangement; however, there are other arrangements that the 2011 amendment failed to catch.

Budget 2022 proposes an amendment to the withholding tax rules to ensure that the total withholding tax paid under an interest coupon stripping arrangement is the same as it would have been if the arrangement had not been entered into and instead the interest payments had been made to the non-resident lender.

In general, where a Canadian-resident borrower owes an amount to a non-resident person with whom the Canadian-resident borrower does not deal at arm's length (the "**non-resident lender**"), pays an amount of interest in respect of that amount owing to another person, and the tax payable under Part XIII in respect of the interest payment is less than it would have been if the interest payment had been made to the non-resident lender, for purposes of Part XIII, the Canadian-resident borrower will be deemed to have also paid an amount of interest to the non-resident lender sufficient to impose on the non-resident lender enough Part XIII tax to reverse the reduction of Part XIII tax.

There is an exception for interest paid on debt issued as part of an offering lawfully distributed to the public if, in general, the interest payments were not part of a series of transactions one of the main purposes of which was to avoid or reduce Part XIII withholding tax.

In general, this measure applies to interest that accrues on or after Budget Date. However, it will not apply to interest that accrues prior to April 7, 2023, if the underlying debt was incurred before Budget Day, the sale of the right to receive future interest payments occurred before Budget Day and the interest coupon holder deals at arm's length with the non-resident lender.

Hedging and Short Selling by Canadian Financial Institutions

The ITA generally requires taxpayers to include in computing income all dividends received in a year but permits a Canadian corporation that receives a dividend from another Canadian corporation to deduct the amount of such dividend. Known as the dividend received deduction ("**DRD**"), this regime avoids taxing the same amount of income in more than one corporation. The ITA contains rules intended to deny the DRD where the dividend recipient does not have economic exposure to the share.

The ITA also contains favourable rules dealing with the taxation of securities lending arrangements ("**SLA**"), which are transactions that facilitate the lending of securities, usually to fill a short position. The SLA rules provide that dividend compensation payments made by a borrower of shares to a lender are very generally deductible to the borrower and treated as a dividend on the share to the lender. Registered securities dealers are entitled to deduct only 2/3 of a dividend compensation payment.

The government has been concerned that certain taxpayers in financial institution groups were engaging in transactions that gave rise to unintended tax benefits by exploiting both the DRD and the deductibility of dividend compensation payments while eliminating the group's economic exposure on the subject shares. For example, a Canadian bank owns shares of a Canadian corporation and a related registered securities dealer would borrow identical shares and sell them short (eliminating the economic exposure). The bank would get the DRD for the dividend and the securities dealer would also get the 2/3 deduction for the dividend compensation payment to the lender of the shares. A similar strategy might involve the registered securities dealer going long on the shares and short the identical shares. It would get the DRD for the shares it held and a 2/3 deduction for the dividend compensation payment made on the borrowed shares. The government was concerned that this created an "artificial deduction" under the arrangement equal to 2/3 of the amount of the dividend.

Budget 2022 proposes to amend the ITA to deny the DRD to a taxpayer for dividends received on a share of a Canadian corporation where:

1. a non-arm's length registered securities dealer enters into a transaction that it knew or ought to have known would hedge the taxpayer's exposure; and

2. the taxpayer is a registered securities dealer and it has eliminated all or substantially all of its exposure to the shares.

Where the proposal results in the denial of the DRD, the registered securities dealer will be entitled to a full deduction for the dividend compensation payment.

The proposed amendments will apply to dividends received and dividend compensation payments made on or after Budget Day unless the relevant hedging transactions or related securities lending arrangements were in place before Budget Day, in which case the proposed amendments will apply to dividends received and related compensation payments made after September 2022.

PERSONAL INCOME TAX MEASURES

Housing

For first-time home buyers, Budget 2022 introduces the Tax-Free First Home Savings Account ("**FHSA**"). Contributions to an FHSA would be deductible, and both income earned in an FHSA and qualifying withdrawals made to purchase a first home would be non-taxable. Each eligible individual would be subject to an annual contribution limit of $8,000 as well as a lifetime contribution limit of $40,000. Budget 2022 would also increase the maximum value of the Home Buyers' Tax Credit from $750 to $1,500. The Government intends to implement the FHSA in 2023. Draft legislation is not yet available.

For existing homeowners, Budget 2022 introduces the Multigenerational Home Renovation Tax Credit, which provides tax relief for individuals who create a secondary dwelling unit within their existing home to permit a related senior or person with a disability to live there. The maximum value of the credit would be $7,500. This measure is intended to take effect on January 1, 2023. Budget 2022 also increases the maximum value of the existing Home Accessibility Tax Credit from $1,500 to $3,000 effective for expenses incurred in the 2022 and subsequent taxation years.

Budget 2022 also takes aim at the "flipping" of residential property, with a new rule that would deem profits arising from the disposition of a residential property to be business income if the property was owned for less than 12 months. Where the new rule applies, the Principal Residence Exemption would not be available. The rule would not apply to dispositions in relation to certain qualifying life events (for example, death, changes in family composition, disability, certain changes in employment, etc.). This measure is intended to apply to residential properties sold on or after January 1, 2023.

Annual Disbursement Quota for Charities

Charities in Canada are required to spend a minimum amount each year on their charitable programmes or grants to other charities. The amount, known as the "disbursement quota" ("**DQ**"), is determined based on the value of a charity's assets that are not used for charitable activities (averaged over the prior 24 months). The intention of the DQ is to ensure charities use a significant portion of their resources for charitable purposes. The current DQ is 3.5% (reduced from 4.5% in 2004 to account for lower rates of return on investments at that time).

The government held public consultations in the late summer-fall of 2021 to seek feedback on issues relating to the DQ, including whether the DQ should be increased to provide additional funding for charities (particularly in the context of the pandemic) and if so, to what level, as well as whether it was desirable to increase the DQ to a level that would force foundations to encroach on capital in order to meet their DQs.

Budget 2022 proposes to increase the DQ to 5% for the portion of assets not used in charitable activities that exceeds $1,000,000; the government believes this will achieve the goal of increasing expenditures by charities overall while accommodating smaller charities that may not have investment returns that are achievable by larger charities. Charities will continue to be able to request a reduction to their DQ and Budget 2022 proposes to simplify the process while ensuring improved transparency. These measures would apply to charities in respect of fiscal periods beginning on or after January 1, 2023.

Charitable Partnerships

Charities that wish to carry out charitable activities overseas must either do so themselves, make grants to other "qualified donees" (which include Canadian registered charities and certain foreign entities such as the UN, as well as certain foreign universities and foreign charities), or maintain control and direction over the activity of an intermediary in the foreign jurisdiction. The requirements imposed on charities seeking to provide aid outside Canada can be unclear if not unduly onerous; Budget 2022 proposes to streamline these rules and allow Canadian charities to make disbursements to organizations that are not qualified

donees, provided the disbursements further the Canadian charity's charitable purposes and the Canadian charity ensures the funds are applied to charitable purposes by the recipient foreign organization. Budget 2022 sets out proposed accountability requirements for charities wishing to make grants to foreign organizations. The proposed rules and requirements will apply upon Royal Assent.

Medical Expense Tax Credit for Surrogacy and Other Expenses

Budget 2022 proposes to expand the Medical Expense Tax Credit to include certain medical expenses incurred in connection with the use of surrogates and/or donors of reproductive material. In addition, reimbursements paid by a taxpayer to a surrogate will now be eligible for the tax credit, provided they are in respect of expenses that would generally qualify under the tax credit. These measures will apply to expenses incurred in the 2022 and subsequent taxation years.

SALES AND EXCISE TAX MEASURES

Budget 2022 introduces two changes to the *Excise Tax Act*:

1. An expansion of entities that may be entitled to benefit from the enhanced 83% hospital rebate for GST/HST incurred in respect of inputs used in their exempt supplies. To be eligible for the enhanced 83% hospital rebate, a charity or non-profit entity must deliver the health-care service with the active involvement of, or on the recommendation of, either a physician or a nurse practitioner. Hence, the expanded hospital rebate would no longer distinguish between doctors and nurse practitioners, and it would recognize the ever-increasing role and prominence of nurse practitioners in administering hospital-like care in non-hospital settings. This new measure will apply for all rebate claim periods ending after Budget Day in respect of tax paid or payable after Budget Day.

2. A new rule which deems assignment sales of new homes or condominium units to be unconditionally subject to GST/HST, in respect of any amounts payable by the assignee over and above any deposit recoveries. As an example, if a purchaser under an agreement of purchase and sale for a newly constructed home or condominium unit (the "**assignor**") paid the builder $100,000 in cumulative deposits for that new home or unit, and that assignor wishes to assign the purchase agreement to a new purchaser (the "**assignee**") for consideration equal to $100,000 in "deposit recoveries" plus an assignment fee of $250,000, the assignor will be obligated to charge and collect GST/HST on the $250,000 assignment fee (and not on the $100,000 amount explicitly related to "deposit recoveries"). However, if the assignor is a non-resident of Canada, then the assignee will be obligated to self-assess that GST/HST instead. This new regime will apply for all assignments completed on or after May 7, 2022. Any assignments consummated before May 7, 2022, will still be governed by the current regime, which allows certain assignments to be made exempt from GST/HST if the circumstances warrant (for example, if the assignor originally entered into the agreement of purchase and sale to live in the home but was subsequently required to assign the agreement to the assignee due to changed life circumstances).

Budget 2022 also introduces comprehensive legislative provisions that govern the taxation of vaping products under the *Excise Act, 2001*. The new federal excise duty framework for vaping products will come into force on October 1, 2022.

In addition, Budget 2022 introduces technical amendments to the *Excise Act, 2001* governing the cannabis excise duty framework, in addition to a myriad of technical amendments that will come into force on Royal Assent to the enabling legislation. A detailed review of these legislative provisions is beyond the scope of this update.

OTHER MEASURES

Budget 2022 also proposes the following measures:

- a review of the scientific research and experimental development (SR&ED) program with a view to ensuring that it is effective in encouraging R&D that benefits Canada, and to explore opportunities to modernize and simplify it;
- considering, and seeking views on, the suitability of adopting a patent box regime;

- the creation of an employee ownership trust – a new dedicated type of trust under the ITA – to support employee ownership of a business and facilitate the transition of privately owned business to employees;
- the establishment of an investment tax credit of up to 30%, focused on net-zero technologies, battery storage solutions and clean hydrogen;
- a refundable investment tax credit for businesses that incur eligible carbon capture, utilization, and storage expenses, starting in 2022, that permanently store capture CO_2 through an eligible use;
- accelerating by two years the government's commitment to amend the *Canada Business Corporations Act* to implement a public and searchable beneficial ownership registry to be accessible before the end of 2023;
- a renewed commitment to examine a new minimum tax regime so as to ensure that all "wealthy" Canadians pay their "fair share;" details to be released in the 2022 fall economic statement;
- the release of a broader consultation paper on modernizing the GAAR, with a consultation period running through 2022, and with legislative proposals to be tabled by the end of 2022; and
- a review to assess whether the tax system is providing adequate support to investments in growing businesses. The review will include an examination of the rollover for small business investments. This measure allows investors in small businesses to defer tax on capital gains.

If you have any questions about Budget 2022, please contact any member of our Tax Group.

This communication offers general comments on legal developments of concern to business organizations and individuals and is not intended to provide legal advice. Readers should seek professional legal advice on the particular issues that concern them.

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