CALU Special Report: Federal budget 2022

Ottawa, ON – April 8, 2022 – Finance Minister Chrystia Freeland tabled the Liberal government's 2022 budget yesterday. Budget 2022, *A Plan to Grow Our Economy and Make Life More Affordable,* was a departure from the era of massive stimulus spending for COVID-19 measures, while attempting to maintain key Liberal tax and social policy themes and introducing several new initiatives to reflect current challenges such as housing and defence. This *CALU Special Report* highlights proposed government initiatives and tax proposals of greatest interest to our members and their clients. We extend our thanks to Kevin Wark and Angela Ross, CALU's tax advisors, for their work in preparing this summary.

Highlights of tax proposals

- Several new initiatives to support first time home buyers while preventing certain foreign entities and persons from purchasing Canadian residential properties for two years
- The introduction of a new dental plan for "lower" income taxpayers
- Changes to the disbursement quota rules for registered charities
- Increased taxes on banks and life insurance companies
- Greater access to the small business deduction for larger Canadian-controlled private corporations (CCPCs)
- Changes to the general anti-avoidance rules to expand its application
- Measures to remove tax advantages on investment income earned by certain private corporations
- Additional consultations relating to section 84.1 and the intergenerational transfer of shares in private corporations
- The launch of a Strategic Policy Review to assess the effectiveness of government programs with the goal of achieving $6 billion in savings over a five-year period

However, Budget 2022 does not propose any new changes in the following areas:

- Personal or corporate tax rates
- Taxation of capital gains, dividends, interest or the principal residence exemption
- Taxation of group insurance, exempt life insurance, corporate owned insurance or the treatment of life insurance in the definition of the capital dividend account
- A national pharmacare program
- Long-term care initiatives

Introduction

On April 7, 2022, Finance Minister Freeland tabled her second federal budget (Budget 2022), titled *A Plan to Grow Our Economy and Make Life More Affordable.* It maintains a number of themes from prior Liberal budgets including support for environmental initiatives and indigenous communities, improving the public healthcare system, growing the post-pandemic economy and addressing "aggressive" tax planning strategies. However, several new story lines have emerged including new initiatives designed to make housing more "affordable" as well as an increased focus on defense spending in response to Russia's invasion of the Ukraine. Unfortunately, the one issue that is currently uppermost in the minds of some Canadians, the spectre of uncontrolled inflation, appears to have been left to the Bank of Canada to deal with through interest rate hikes and tightening of monetary policy. This *CALU Special Report* reviews the policy frameworks underlying the budget and provides information about tax proposals of greatest interest to CALU members.

Major budget themes

As noted, Budget 2022 expands on the following key themes that underpin the Government's current and future priorities. The three highlighted themes (*) are reviewed in more detail in this *Special Report*.

1. **Making housing more affordable***
2. Growing a strong, resilient economy
3. Reducing pollution while growing the economy
4. Job creation for the middle class
5. Enhancing Canada's national defence system
6. **Creating a stronger health care system***
7. Moving forward with reconciliation
8. Building safe and inclusive communities
9. **Tax fairness combined with effective government***

What's not in this budget

No major tax rate increases

As noted in the Highlights section above, there are no substantive tax rate changes in Budget 2022 that will have an overly negative effect on CALU members and most of their clients. But with continued deficits and inflationary pressures that will inevitably lead to interest rate hikes, we remain concerned with the potential for significant tax increases in the future. The CALU Tax Policy Committee has been focused on this issue over the

past year and is advocating for the government to address the growing deficit through a combination of spending restraint and targeted tax increases that will have the least impact on economic growth.

Business tax measures

Follow-up to Bill C-208

As members are aware, section 84.1 of the Income Tax Act (the Act) contains rules designed to prevent business owners from converting dividends into lower-taxed capital gains through non-arm's length sales transactions—a practice referred to as "surplus stripping." Bill C-208, which received Royal Assent on June 29, 2021, introduced an exception to the rules in section 84.1 in order to facilitate intergenerational business transfers of qualifying small business corporation shares. However, Finance Canada expressed concerns that the exception may unintentionally permit surplus stripping without requiring that a genuine intergenerational business transfer takes place and announced plans to amend section 84.1 to address these concerns. No amendments have been released to date, and in a subsequent submission to Finance Canada CALU recommended that further discussions be held with stakeholders before implementing any such changes.

We are therefore pleased to see that Budget 2022 has announced a new consultation process for stakeholders to share their views as to how the existing rules can be strengthened to protect the integrity of the tax system while continuing to facilitate genuine intergenerational business transfers. It is important to note that in a conference call for tax professionals following the release of the Budget, Finance Canada officials once again confirmed that any amendment to section 84.1 would not be retroactive in effect.

Comments are due by June 17, 2022, and CALU will consider further submissions on this important issue. The government plans to introduce legislation in the fall of 2022 after the conclusion of the consultation process.

Increasing access to the small business deduction

Under the current tax rules, up to $500,000 of the active business income of a small business corporation benefits from a reduced rate of income tax, but the income cap is reduced once the taxable capital employed in Canada of the corporation and associated corporations exceeds $10 million and is reduced to nil once the taxable capital hits $15 million (a reduction of $0.10 for each $1.00 of taxable capital in excess of $10 million).[1]

Budget 2022 proposes to increase this taxable capital range so that the income cap is reduced to nil only when the taxable capital employed in Canada reaches $50 million (a reduction of $0.0125 for each $1.00 of taxable capital in excess of $10 million). As illustrated in the budget material, a small business corporation with taxable capital of $30 million would therefore be entitled to a reduced rate of tax on up to $250,000 of active business income compared to $0 today.

The proposed change will apply to tax years that begin on or after the budget day.

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[1] There is also a reduction when the corporation, in combination with associated corporations, earns investment income in excess of $50,000 and access to the small business deduction is reduced to nil when investment income reaches $150,000.

Substantive Canadian-controlled private corporations (CCPCs)

With the CRA aggressively challenging so-called “non-CCPC planning”, it is not a huge surprise that the budget proposes amendments that will treat a “substantive CCPC” as a CCPC for the purposes of the determination of its taxes payable.

The “non-CCPC planning” structured a private corporation (ultimately controlled by Canadian resident individuals) so that it would not meet the requirements to be a CCPC. The goal was for passive investment income earned by the non-CCPC to be taxed at regular corporate tax rates instead of the refundable tax rates applicable to CCPCs (cutting the tax payable by the corporation almost in half). While additional tax is payable when distributions are paid to the shareholders (generally level-setting the tax on the underlying income), until that happened there was a material deferral of tax in the non-CCPC. Attaining non-CCPC status can be accomplished in a number of ways including: (1) continuing or incorporating a private corporation under a foreign corporate law, and (2) having control or options to acquire control in the hands of a non-resident.

Budget 2022 proposes to extend the tax rates and rules for investment income earned by a CCPC to “substantive CCPCs”. Specifically, substantive CCPCs will be subject to the refundable corporate tax rates on investment income and such income will be included in determining the corporation’s “low rate income pool” so that distributions to the shareholders cannot be designated as eligible dividends. In other words, the tax benefits achieved in the “non-CCPC planning” will disappear. For all other purposes of the Act, a substantive CCPC will continue to be treated as a non-CCPC, including the extension by 1 year of the notice of reassessment period for the corporation as compared to a CCPC.

In general, a substantive CCPC will be a private corporation resident in Canada (other than a CCPC) that is ultimately controlled (in law or in fact) by Canadian-resident individuals. The rules will include an extended definition of control that will aggregate the shares owned, directly or indirectly, by Canadian resident individuals (regardless of their relationship).

The proposal will apply to tax years that end on or after the budget day except where the tax year of a corporation ends because of an acquisition of control as a result of the sale of the corporation, but only so long as the purchase and sale agreement was entered into before the budget day and the sale is completed before the end of 2022.

Investment income in controlled foreign affiliates

Where a CCPC holds a controlled foreign affiliate that is resident in a taxing jurisdiction such as the U.S., a tax deferral advantage is attained as a result of the current foreign accrual property income (FAPI) rules. This is because the amount of deduction permitted in calculating the FAPI income inclusion (being a rate factor of the foreign tax payable on the income) is higher for a corporation as compared to other taxpayers such as individuals. In addition, the FAPI income could be included in the CCPCs “general rate income pool” allowing for the payment of lower-taxed eligible dividends.

The budget proposes targeted amendments to ensure a CCPC and a substantive CCPC can no longer benefit from lower corporate tax rates on investment income earned in a controlled foreign affiliate. Specifically, it will reduce the FAPI deduction for foreign tax that can be claimed by a CCPC and substantive CCPC to the amount

that can be claimed by an individual. As a result, a full deduction in computing FAPI will only occur when the foreign tax on the income is at least 52.63 per cent. Integration of this income will be achieved with changes to the capital dividend account, rather than through the general rate income pool. In particular, there will be additions to the capital dividend account that represents the after-tax income that was subject to tax at the highest personal income tax rate in the corporation.

This proposal will apply to tax years that begin on or after the budget day.

Flow-through shares for oil, gas and coal

Fulfilling a commitment in the Liberal party's 2021 election platform, Budget 2022 proposes to eliminate the flow-through share regime for oil, gas and coal projects so that the expenses of these projects can no longer be "flowed-through" to its shareholders.

The proposal will apply to flow-through share agreements entered into after March 31, 2023.

Additional taxes on banks and life insurers

Canada Recovery Dividend

Budget 2022 proposes to introduce the so-called Canada Recovery Dividend (CRD). The CRD is a one-time 15 per cent tax on bank and life insurer groups. A group would include a bank or life insurer and any other financial institution that is related to the bank or life insurer. The CRD will be determined based on a corporation's taxable income for taxation years ending in 2021 and apply on taxable income over $1 billion. Bank and life insurer groups subject to the CRD would be permitted to allocate the $1 billion taxable income exemption by agreement amongst group members. The CRD liability will be imposed for the 2022 taxation year and payable in equal amounts over five years

Additional tax on banks and life insurers

Budget 2022 also proposes to introduce an additional tax of 1.5 per cent on the taxable income for members of bank and life insurer groups (determined in the same manner as the CRD). Bank and life insurer groups subject to the additional tax will be permitted to allocate a $100 million taxable income exemption by agreement amongst group members. The proposed additional tax will apply to taxation years that end after Budget Day.

It is expected these two taxes will raise $6.1 billion over five years, with the 1.5 per cent additional tax on bank and life insurance groups expected to raise $445 million thereafter.

International Financial Reporting Standards for insurance contracts (IFRS 17)

IFRS 17, the new accounting standards for life insurance contracts, will substantially change financial reporting for all Canadian insurers effective January 1, 2023. Generally accepted accounting principles (GAAP) typically serve as the basis for computing a corporation's income for tax purposes. However, with the introduction of a new IFRS 17 reserve, known as the contract service margin (CSM), a large portion of the profits earned on underwritten insurance contracts will be deferred and gradually released into income over the estimated life of the insurance contracts.

The CSM arises primarily for insurance contracts greater than one year. If deductible for tax purposes, the CSM would lead to an undue income tax deferral. Previously the government issued a news release (May 2021 Release) which announced that it intended to generally support the use of IFRS 17 accounting for income tax purposes. However, adjustments would be made to recognize underwriting profits as taxable income so that it remains aligned with economic activities. More specifically, the CSM would not be considered a deductible reserve for tax purposes. Following extensive consultations with the insurance industry, Budget 2022 proposes to maintain the policy intent described in the May 2021 Release, but will make certain relieving modifications, as well as consequential changes to protect the minimum tax base for life insurers. It is estimated that this measure will increase federal revenues by $2.35 billion over the next five years. Relieving transitional rules and consequential changes to protect the minimum tax base are also being proposed.

Personal tax measures

Housing measures

Budget 2022 contains a number of tax measures designed to assist first time home buyers as well as curb speculators and foreign ownership of Canadian residential housing, as outlined below.

Tax-Free First Home Savings Account

Budget 2022 proposes to create the Tax-Free First Home Savings Account (FHSA), a new registered account to help individuals save for their first home. It is similar to an RRSP as contributions to an FHSA will be deductible and income earned in an FHSA will not be subject to tax. However, as an additional tax benefit, qualifying withdrawals from an FHSA made to purchase a first home will be non-taxable.

While not all qualification requirements to own a FHSA have been finalized, the Budget papers indicate that the plan holder:

- Must be a resident of Canada and at least 18 years of age
- Not have lived in a home that they owned at any time in the year the account is opened, or during the preceding four calendar years (a “qualifying first home”)
- Would be limited to making non-taxable withdrawals in respect of the purchase of a single property in their lifetime

There will be a lifetime limit on contributions of $40,000, subject to an annual contribution limit of $8,000. The full annual contribution limit would be available starting in 2023. However, unused annual contribution room cannot be carried forward to future years (use it or lose it).

As noted, withdrawals from a FHSA to make a qualifying first home purchase will not be subject to tax. However, withdrawals for any other purpose will be taxable. In addition, once an individual has made a non-taxable withdrawal to purchase a home, they will be required to close their FHSAs within a year from the first withdrawal and would not be eligible to open another FHSA.

To provide greater flexibility, an individual can transfer funds from an FHSA to an RRSP or a RRIF. These transfers will not result in taxes being payable, but those amounts will be taxed when withdrawn from the RRSP or RRIF in the usual manner. Transfers will also not reduce, or be limited by, the individual's available RRSP room – in effect this represents an increase of the plan holder's RRSP contribution room.

Unlike a TFSA, withdrawals and transfers from an FHSA cannot be replenished in future years. As well, if the plan holder has not used the funds in their FHSA for a qualifying first home purchase within 15 years of first opening an FHSA, their FHSA will have to be closed. Once again, these funds can be transferred into an RRSP or RRIF, or otherwise will be received on a taxable basis.

Individuals will also be allowed to transfer funds from an RRSP to an FHSA on a tax-free basis, subject to the $40,000 lifetime and $8,000 annual contribution limits. This potentially allows access to RRSP funds on a tax-free basis for a qualifying first home purchase. While such transfers cannot be "replaced" by future tax-deductible contributions to an RRSP; however, those amounts could be transferred back to the RRSP in the event those funds are not used to purchase a qualifying home.

It is important to note that the home buyers' plan (HBP), which allows individuals to withdraw up to $35,000 from an RRSP to purchase or build a home without having to pay tax on the withdrawal (so long as it is repaid within the specified timeframe) will continue to be available. However, an individual will not be permitted to make both an FHSA withdrawal and an HBP withdrawal in respect of the same qualifying home purchase.

The government plans to work with financial institutions to have the infrastructure in place for individuals to be able to open an FHSA and start contributing in the 2023 calendar year.

Home Buyers' Tax Credit

Under existing legislation, first-time home buyers who acquire a qualifying home will be eligible to receive up to $750 in tax relief (federally) by claiming the First-Time Home Buyers' Tax Credit (HBTC). While this is a *non-refundable credit,* any unused portion of the HBTC may be claimed by an individual's spouse or common-law partner. A qualifying home is one that the individual or individual's spouse or common-law partner intends to occupy as their principal residence no later than one year after its acquisition. An individual is a first-time home buyer if neither the individual nor the individual's spouse or common-law partner owned and lived in another home in the calendar year of the home purchase or in any of the four preceding calendar years.

Budget 2022 proposes to double the HBTC amount to $10,000, which will provide up to $1,500 in tax relief to eligible home buyers. Spouses or common-law partners would continue to be able to split the value of the credit as long as the combined total does not exceed $1,500 in tax relief. This measure would apply to acquisitions of a qualifying home made on or after January 1, 2022.

Multigenerational Home Renovation Tax Credit and Home Accessibility Tax Credit

The Budget proposes to introduce a new Multigenerational Home Renovation Tax Credit and increase the annual expense limit of the Home Accessibility Tax Credit.

The Multigenerational Home Renovation Tax Credit will apply to qualifying renovation expenses to create a secondary dwelling unit in a home so that an eligible person (senior or disabled adult) can live with a related person. The refundable tax credit will be 15 per cent of the lesser of the expenses and $50,000. The credit can

be claimed by any one or a combination of the eligible person, the spouse or common-law partner of the eligible person, and the related person, but the total expenses claimed by all cannot exceed $50,000. Only one qualifying renovation can be claimed in respect of an eligible person for their lifetime. The credit will apply for the 2023 and subsequent years in respect of work performed, and goods acquired, on or after January 1, 2023.

The annual expense limit for the Home Accessibility Tax Credit is proposed to be increased from $10,000 to $20,000. This is non-refundable tax credit equal to 15 per cent of the lesser of the qualified expenses and $20,000 for the renovation or alteration of a home of a senior or disabled person. The increase will apply to expenses incurred in 2022 and subsequent years.

Anti-flipping rule

As outlined in the Liberal party’s 2021 election platform, Budget 2022 introduces a “residential property flipping rule”. As discussed in the Budget, property flipping involves purchasing real estate with the intention of reselling the property within a short period of time to realize a profit. Gains from such activity should be fully taxable as business income, and not eligible for the 50 per cent capital gains inclusion rate or the principal residence exemption. However, there are concerns that individuals engaged in flipping residential real estate may not be properly reporting their profits as business income and benefiting from lower or no taxation on the related gains.

Budget 2022 is therefore proposing to introduce a new deeming rule to ensure profits from flipping residential real estate are always subject to full taxation. Specifically, profits arising from dispositions of residential property (including a rental property) that is owned for less than 12 months will be deemed to be business income.

However, the new deeming rule will not apply if the disposition of property arises from one of a number of specified events including the death of the owner or related person, breakdown in a marriage or common-law relationship, a householder addition (e.g., the birth or adoption of a child or the care of an elderly parent) or insolvency. Additional “life events” which may give rise to an exception to the proposed deeming rules are outlined in the budget. The measure would apply in respect of residential properties sold on or after January 1, 2023.

Ban on foreign investment in Canadian housing

There have been significant concerns at the municipal, provincial and federal levels regarding ownership of residential property by non-resident non-Canadians and the impact on affordable housing, particularly in urban locations. These concerns have to date been addressed by imposing “anti-speculation” taxes and increased property transfer taxes on foreign purchasers. Budget 2022 significantly ramps things up by proposing restrictions that would prohibit foreign commercial enterprises and people who are not Canadian citizens or permanent residents from acquiring non-recreational, residential property in Canada for a period of two years.

Exemptions are planned for refugees and people who have been authorized to come to Canada under emergency travel while fleeing international crises, international students on the path to permanent residency as well as individuals on work permits who are residing in Canada.

Non-resident non-Canadians who currently own homes that are being underused or left vacant will become subject to the Underused Housing Tax once it is in effect.

Minimum tax for high income earners

To tackle the perceived significant use of deductions and tax credits by wealthy Canadians to reduce their taxes payable, and as first announced in the Liberal party's 2021 election platform, Budget 2022 announces that the government will examine a possible new minimum tax regime to ensure wealthy Canadians pay their fair share of tax. Details on a proposed approach will be released in the 2022 fall economic and fiscal update.

Increase to registered charity disbursement quota

As announced in the 2021 federal budget, over the past year the government held a consultation on raising the minimum amount a registered charity must grant annually, known as the disbursement quota (DQ). Submissions were made by a number of special interest groups and input was sought from the Advisory Committee on the Charitable Sector. It was therefore no surprise that the Budget proposes an increase in the DQ, although the amount of the increase was not as high as some predicted.

The budget proposes a graduated DQ rate of:

- 3.5 per cent of the registered charity's property not used directly in charitable activities or administration up to $1 million, and
- 5 per cent of the registered charity's property not used directly in charitable activities or administration in excess of $1 million.

In addition, amendments to the Act will be made to clarify that administration and management expenses will not be qualifying expenses to satisfy the DQ. Where a charity cannot meet the DQ, the CRA will have the discretion to provide relief and allow the CRA to publicly disclose information relating to such a decision. The budget also proposes removing the accumulation of property rule which allows a charity to apply to the CRA for permission to accumulate property for a specific purpose which would then not be included in calculating the DQ.

The proposals will apply to charities for their fiscal years beginning on or after January 1, 2023 except that the removal of the accumulation of property rule will not apply to accumulated property subject to an application submitted prior to January 1, 2023.

New reporting requirements for RRSPs and RRIFs

Financial institutions are currently required to annually report contributions and withdrawals from each RRSP and RRIF that they administer to the CRA. However, unlike TFSAs, financial institutions are not required to file a more comprehensive annual information return in respect of each RRSP and RRIF which includes the fair market value of property held in the account.

Due to concerns that RRSPs and RRIFs may hold assets that are not qualified investments under the Act, Budget 2022 proposes to require financial institutions to annually report the total fair market value, determined at the end of the calendar year, of property held in each RRSP and RRIF that they administer. This information will

assist the CRA in its review of RRSPs and RRIFs with higher fund balances to determine compliance with the qualified investment rules.

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

Other announcements and measures of interest

Expansion of the general anti-avoidance rule

The budget proposes amendments to the general anti-avoidance rule (the GAAR) so that it can apply to a series of transactions that affects tax attributes even where those attributes have not yet become relevant in the computation of tax.

This proposal is in response to the Federal Court of Appeal decision in *1245989 Albert Ltd. v. Canada* (sometimes referred to as *Wild v. Canada*) (2018 FCA 114) which held that the GAAR did not apply to a transaction that resulted in an increase in a tax attribute that has not yet been used to reduce taxes payable. Members will recall that the reasoning of this decision was recently applied by the Tax Court of Canada in *Rogers Enterprises (2015) Inc. v. The Queen* (2020 TCC 92) where certain transactions were implemented to split the ownership and beneficiary of life insurance policies which maximized the capital dividend account created after the death of the life insured. Because the "excess" capital dividend account (the increase in a tax attribute) had not yet been used to pay a tax-free capital dividend to an individual shareholder, the Tax Court of Canada concluded there was no tax benefit on which it could apply the GAAR.

The proposal will apply to notices of determination (like a notice of assessment or reassessment) issued by the CRA on or after the Budget Day. However, the Budget stated that notices of determination issued by the CRA before the Budget Day, where all rights of objection and appeal were exhausted before the Budget Day, would remain binding.

The government also announced that it intends to release in the near future a broader consultation paper on modernizing the GAAR with a consultation period running through the summer of 2022 and legislative proposals by the end of 2022.

Ownership transparency

In Budget 2021, the government announced funding to support the implementation of a publicly accessible corporate beneficial ownership registry by 2025. To counter the continued use of Canadian corporations to conceal the true ownership of assets, Budget 2022 proposes to accelerate the creation of such a registry so that it is accessible by the end of 2023. This will be a public and searchable beneficial ownership registry that will cover corporations governed under the *Canada Business Corporations Act* and will be scalable to allow access to data held by provinces and territories that agree to participate in this national registry.

In addition, the government will work with the provinces and territories to advance a national approach to a publicly accessible beneficial ownership registry for real property.

Prior measures

In addition to these proposed tax measures, we anticipate that the following additional tax legislative proposals from prior budgets will be enacted in 2022:

- Measures to implement enhanced reporting requirements for certain trusts to provide additional information on an annual basis
- Limitations in interest deductibility
- A new luxury tax on certain vehicles, boats and aircraft
- Expanded mandatory reporting rules for aggressive tax transactions including new notifiable transaction rules

Budget 2022 does not contain any new tax measures relating to the following areas:

- Tax treatment of exempt life insurance policies
- Rules governing the life insurance proceeds credit to the capital dividend account
- Individual or corporate tax rates
- Tax treatment of capital gains
- Taxation of group life and health benefits
- Modifications to the tax on split income (TOSI) or passive investment rules

CALU will continue to monitor and report on the implementation of the budget measures and will make submissions to Finance Canada on those proposals of importance to our members.

About CALU

The Conference for Advanced Life Underwriting (CALU) is Canada's professional association for leaders in the life insurance and financial advisory industry. We provide our 600+ members with high-quality education and with opportunities to connect, stay informed and share ideas on how to enhance the financial well-being of Canadians.

Advocacy is an important part of our mandate. Along with our partner organization, Advocis, we speak for more than 17,000 insurance and financial advisors in every part of Canada to grow and preserve the financial well-being of Canadians and family businesses.

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