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Federal Budget 2022: Tax Highlights

Authors: Elie Roth, R. Ian Crosbie, Christopher Anderson, Michael N. Kandev, Rhonda Rudick, Marie-Emmanuelle Vaillancourt, Julie Colden, Neal H. Armstrong, Ian Caines, Olivia Khazam, Ryan Wolfe, Darren M. Joblonkay, John J. Lennard, Cadie Yiu and Eytan Dishy

On April 7, 2022 (Budget Day), the Honourable Chrystia Freeland, Deputy Prime Minister of Canada and Minister of Finance, delivered the Liberal Party's federal budget (Budget 2022), the second budget since the start of the COVID-19 pandemic.

As part of the Trudeau government's plan to "grow our economy and make life more affordable," Budget 2022 contains over $15 billion in spending, including on housing and health initiatives. Budget 2022 also contains several measures aimed at making the tax system "more fair," closing what the government perceives as loopholes and increasing its ability to attack what it considers improper tax planning. Notably, there are no proposed changes to general corporate or personal tax *rates* or to the capital gains inclusion rate.

As Canadian individuals and corporations continue to recover from the economic impact of the ongoing pandemic, Budget 2022 includes a number of personal and corporate tax changes. On the personal front, several measures are targeted at improving access to housing, including the creation of a Tax-Free First Home Savings Account, a First-Time Homebuyers tax credit, a Multigenerational Home Renovation Tax Credit and a Home Accessibility Tax Credit. This is coupled with a residential property flipping rule whereby profits from flipping properties would not be eligible for the 50% capital gains inclusion rate or the principal residence exemption.

Budget 2022 also introduces changes for registered charities, following an announcement in Budget 2021 that the government was reviewing the disbursement quota. Budget 2022 increases the disbursement quota for registered charities, while expanding the ability of registered charities to donate to organizations that are not qualified donees under the *Income Tax Act* (Act).

Budget 2022 introduces a number of business income tax measures targeted at certain types of planning that the government considers aggressive (including by proposing rules to address hedging and short selling by financial institutions); extending the general anti-avoidance rule (GAAR) to tax attributes; removing certain tax advantages for entities that – although controlled by Canadians – do not meet the technical definition of "Canadian-controlled private corporation" (CCPC); and proposing rules that limit tax deferral opportunities using foreign entities.

From an international tax perspective, Budget 2022 reaffirms the government's support for the OECD's Pillar One and Pillar Two initiatives.

Budget 2022 proposes measures aimed at addressing climate change. These include the elimination of the flow-through share regime for the oil, gas and coal industries.

We discuss a number of these measures in greater detail below.

Business Income Tax Measures

Financial Institutions Tax Measures

New Financial Institutions Taxes

Budget 2022 proposes to announce two new tax measures on Canadian banks and insurance corporations:

- **Temporary Recovery Dividend.** Banks, life insurance corporations and related financial institutions will pay a one-time 15% tax on taxable income above $1 billion for the 2021 taxation year.
- **Permanent Tax Increase.** Banks, life insurance corporations and related financial institutions will be subject to an additional corporate income tax rate of 1.5% on taxable income above $100 million, increasing the federal tax rate from 15% to 16.5%.

These measures are expected to raise $6.1 billion over five years, with the permanent tax increase expected to raise $445 million per year. These proposals had been widely publicized and were expected to be implemented following the announcement of the NDP and Liberal government agreement in late March; the proposals were widely criticized by Canadian financial institutions as sending the wrong signal to the global investment community. Some reports indicated that these tax measures would be expanded and be imposed on other Canadian businesses, but Budget 2022 does not include any statements that a further expansion of the tax is being contemplated.

Hedging and Short Selling by Canadian Financial Institutions

Budget 2022 proposes amending the Act to close what the government has described as the "double-deduction loophole" utilized by some Canadian financial institutions engaged in certain tax-planning arrangements that give rise to an unintended tax benefit. The types of arrangements targeted include arrangements whereby one member of the Canadian financial institution's corporate group (typically a Canadian bank or a registered securities dealer) owns shares of another Canadian corporation (Canadian Shares), and a separate registered securities dealer in the Canadian financial institution's corporate group borrows identical shares under a securities lending arrangement to cover its short position. As a result of such an arrangement, the holder of the Canadian Shares can claim a dividend received deduction for the dividends received on the Canadian Shares, resulting in tax-free dividend income, and the registered securities dealer can deduct two-thirds of the amount of the dividend compensation payments made to the lender that reflect the same dividends paid on the shares. In the government's view, this arrangement generates a double-deduction loophole or an artificial tax deduction under the arrangement equal to two-thirds of the amount of dividend compensation payments made to the lender over the term of the arrangement.

Budget 2022 introduces specific legislation to address the use of these hedging and short-selling arrangements by proposing amendments to

- deny the dividend received deduction for dividends received by a taxpayer on Canadian Shares if a registered securities dealer (or a partnership whose partners are all registered securities dealers) that does not deal at arm's length with the taxpayer enters into transactions that hedges the taxpayer's economic exposure to the Canadian Shares, where the registered securities dealer knew or ought to have known that these transactions would have such an effect;
- deny the dividend received deduction for dividends received by a registered securities dealer on Canadian Shares that it holds if it eliminates all or substantially all of its economic exposure to the Canadian Shares by entering into certain hedging transactions; and
- provide that in the above situations, the registered securities dealer would be permitted to claim a full, rather than a two-thirds, deduction for a dividend compensation payment it makes under a securities lending arrangement.

The proposed amendments would apply to dividends and related dividend compensation payments that are paid, or become payable, on or after Budget Day, unless the relevant hedging transactions or related securities lending arrangement are in place before Budget Day, in which case such amendments would apply to dividends and related dividend compensation payments that are paid on or after October 1, 2022.

Limiting Aggressive Tax Avoidance by Financial Institutions

In addition to tax-related measures, Budget 2022 proposes certain legislative changes targeting aggressive tax avoidance by financial institutions. These measures propose to examine potential changes to the financial transaction approval process to limit the ability of federally regulated financial institutions to use corporate structures in tax havens to engage in aggressive tax avoidance by ensuring approval requirements for financial sector transactions apply regardless of how they are structured.

International Financial Reporting Standards for Insurance Contracts

On May 28, 2021, the government issued a news release announcing that it intends to generally support the use of IFRS 17 accounting for income tax purposes, with certain amendments made to recognize underwriting profits as taxable income. These new accounting standards for insurance contracts would introduce a new reserve, the contract service margin (CSM), on January 1, 2023, resulting in the deferral of certain profits earned on underwritten insurance contracts, which would be released into income over the estimated life of the contracts. Budget 2022 confirms that the CSM would not be considered a deductible reserve for tax purposes, but proposes a five-year transition period, in addition to a number of relieving modifications. These include the ability to deduct 10% of the CSM associated with life insurance contracts for tax purposes (in recognition of future non-attributable expenses that are included in deductible reserves at the inception of the contract under current rules) and provides for CSM associated with segregated funds to be fully deductible (on the basis that this income would continue to be recognized as earned annually in respect of investment management activities rendered to policyholders after inception of the contract). The non-deductible CSM would be included in the Part VI tax base, a capital-based minimum tax imposed on large financial institutions. In addition, deferred tax assets would no longer be deducted from the Part VI minimum tax base for life insurers.

RRSP Reporting

Financial institutions will be required to report the total fair market value of property held in each RRSP and RRIF they administer at the end of each calendar year to assist the CRA in administering RRSP and RRIF compliance.

Investment Tax Credit for Carbon Capture, Utilization and Storage

Budget 2022 proposes to introduce a refundable investment tax credit (CCUS Tax Credit) for carbon capture, utilization and storage (CCUS). The CCUS Tax Credit would be available to businesses that incur eligible expenses starting on January 1, 2022.

The CCUS Tax Credit would be available in respect of the cost of purchasing and installing eligible equipment used in an eligible CCUS project, so long as the equipment was part of a project whereby the captured carbon dioxide was used for an eligible purpose.

This measure would apply to eligible expenses incurred after 2021 and before 2041. The following credit rates would apply to eligible expenses incurred after 2021 through 2030:

- 60% for eligible capture equipment used in a direct air capture project;
- 50% for all other eligible capture equipment; and
- 37.5% for eligible transportation, storage and use equipment.

Lower credit rates would apply to eligible expenses incurred after 2030 through 2040.

Budget 2022 further proposes establishing new capital cost allowance (CCA) classes for eligible equipment and for certain intangible exploration expenses and development expenses associated with storing carbon dioxide.

Clean Technology Tax Incentives

Capital Cost Allowance for Clean Energy Equipment

CCA Classes 43.1 and 43.2 provide accelerated CCA rates (30% and 50%, respectively) for investments in specified clean energy generation and energy conservation equipment. Property in these classes that is acquired after November 20, 2018, and that becomes available for use before 2024 is eligible for immediate expensing and property that becomes available for use after 2023 and before 2028 is subject to a phase-out from these immediate expensing rules. In addition, if the majority of the tangible property in a project is eligible for inclusion in Class 43.1 or 43.2, certain intangible project startup expenses are treated as Canadian Renewable and Conservation Expenses, which can generally be deducted in full in the year incurred, carried forward indefinitely or transferred to investors using flow-through shares.

Budget 2022 proposes to expand eligibility under Classes 43.1 and 43.2 to include air-source heat pumps primarily used for space or water heating.

This expansion of Classes 43.1 and 43.2 would apply in respect of property that is acquired and that becomes available for use on or after Budget Day, if it has not been used or acquired for use for any purpose before Budget Day.

Rate Reduction for Zero-Emission Technology Manufacturers

Budget 2021 proposed a temporary measure to reduce corporate income tax rates for qualifying zero-emission technology manufacturers. Taxpayers would be able to apply reduced rates of 7.5% or 4.5% (depending on whether the income would otherwise be taxed at the 15% general corporate tax rate or at the 9% small business tax rate) on eligible zero-emission technology manufacturing and processing income. The reduced tax rates would apply to taxation years that begin after 2021, subject to a phase-out starting in taxation years that begin in 2029.

Budget 2022 proposes including the manufacturing of air-source heat pumps used for space or water heating as an eligible zero-emission technology manufacturing or processing activity.

Critical Mineral Exploration Tax Credit

Flow-through share agreements allow corporations to renounce or "flow through" specified expenses to investors, who can deduct the expenses in calculating their taxable income. The Mineral Exploration Tax Credit (METC) provides an additional income tax benefit for individuals who invest in mining flow-through shares. The METC is equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors. The METC facilitates the raising of equity to fund exploration by enabling companies to issue shares at a premium.

Budget 2022 proposes to introduce a new 30% Critical Mineral Exploration Tax Credit (CMETC) for specified minerals. It lists the specified minerals that would be eligible, which are generally used in the production of batteries and permanent magnets, both of which are used in zero-emission vehicles, or are necessary for the production and processing of advanced materials, clean technology or semi-conductors.

The 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 eliminate the flow-through share regime for oil, gas, and coal activities by no longer allowing oil, gas and coal exploration or development expenditures to be renounced to a flow-through share investor. This change would apply to expenditures renounced under flow-through share agreements entered into after March 31, 2023.

Small Business Deduction and Substantive CCPCs

Small Business Deduction

A small business that is a CCPC may benefit from a reduced federal corporate tax rate of 9% on the first $500,000 of qualifying active business income (the "business limit"). The business limit is reduced on a straight-line basis when combined taxable capital employed in Canada of the CCPC and associated corporations is between $10 million and $15 million.

In order to make the small business deduction available to medium sized corporations, Budget 2022 proposes to extend the range over which the business limit is reduced on a straight-line basis to between $10 million and $50 million.

Substantive CCPCs

A corporation that is a CCPC is required to pay tax on certain passive income, including interest income, taxable capital gains, rents and royalties, at a federal rate of 38.67%, as a result of the application of additional refundable tax and the denial of the general rate reduction. In contrast, a Canadian resident corporation that is not a CCPC (a "non-CCPC") is required to pay federal tax on such passive income at a rate of 15%. The combined federal and provincial tax rate on passive income is approximately 50% and 25% for CCPCs and non-CCPCs, respectively.

On February 4, 2022, the Department of Finance Canada released proposed legislative changes that require corporations that undertake transactions to change their status from a CCPC to a non-CCPC to obtain benefits related to the taxation of passive income would be required to report the transaction under the notifiable transaction rules (discussed below). Such transactions include continuing the corporation to a foreign jurisdiction where it continues to remain a resident in Canada, issuing special voting shares to a non-resident person or giving a non-resident person an option to acquire a majority of the voting shares of the corporation.

Budget 2022 introduces further substantive measures to address this type of planning by proposing to apply additional refundable tax on passive income earned by "substantive CCPCs." A substantive CCPC is defined as a private corporation resident in Canada where a Canadian resident individual controls (or multiple Canadian resident individuals collectively control), directly or indirectly in law or in fact, a sufficient number of shares to control the corporation. Significantly, the definition also includes a corporation that would have been a CCPC but for the fact that a non-resident or public corporation has a right to acquire its shares. In this regard, the substantive CCPC rules appear to apply to transactions where the shares of a CCPC are acquired by a non-resident or a public corporation under a binding agreement of purchase and sale and the corporation makes an designation under paragraph 111(4)(e) immediately prior to the closing date, to trigger a capital gain at non-CCPC tax rates ("111(4)(e) planning"), subject to a limited grandfathering rule for agreements of purchase and sale entered into prior to Budget Day and closed before the end of 2022.

The passive income earned by substantive CCPCs will be added to their low rate income pool (or LRIP), such that the corporation will be required to declare and pay non-eligible dividends (as opposed to more favorable eligible dividends) until its LRIP account is depleted. Similar to CCPCs, substantive CCPCs will also be entitled to receive a tax refund of 30.67% under subsection 129(1), in the year that the income is distributed in the form of a dividend.

It is noteworthy that, despite the nomenclature, substantive CCPCs are only taxed as CCPCs in one respect, namely their investment income and distributions thereof; they are not afforded any of the benefits of CCPC status, such as eligibility for the SBD, refundable investment tax credits or the abridged assessment period, to name just a few, and thus such entities constitute a novel, hybrid category of corporate taxpayer under the Act.

To reinforce these rules, Budget 2022 is introducing a rule to address particular arrangements or transactions where it is reasonable to consider that the particular arrangement, transaction or series of transactions was undertaken to avoid the anti-deferral rules applicable to substantive CCPCs.

The proposed rules will generally apply to taxation years that end on or after Budget Day. As noted, there is a grandfathering rule with respect to share sale transactions between arm's length parties that were entered prior to Budget Day and close before the end of 2022, such that the parties may engage in 111(4)(e) planning in respect thereof.

Tax on Foreign Accrual Property Income attributed to CCPCs

A Canadian resident shareholder of a controlled foreign affiliate is required to include in computing its income the foreign accrual property income (FAPI) of the controlled foreign affiliate. Where the Canadian resident shareholder is a corporation, it is entitled to claim a deduction in respect of its FAPI inclusion equal to four times the amount of foreign tax paid up to a rate of 25%. All other shareholders, including individuals, are entitled to claim a deduction equal to 1.9 times the amount of foreign tax paid, such that a foreign tax rate lower than 52.63% will result in net FAPI income inclusions for these taxpayers. In addition, the inclusion of certain amounts in respect of FAPI in a CCPC's "general rate income pool" entitles the CCPC to distribute FAPI in the form of eligible dividends, which are included at favorable tax rates to individual shareholders compared with non-eligible dividends.

Budget 2022 proposes to change the deduction a CCPC (or substantive CCPC) is entitled to claim in respect of FAPI that is required to be included in its income to 1.9 times the amount of foreign tax paid, to align the tax treatment with individuals. To ensure integration is achieved when a CCPC (or substantive CCPC) distributes amounts included as FAPI to an individual shareholder, an amount would be added to the corporation's capital dividend account that is approximately equal to the portion of the after-tax earnings repatriated to the corporation from its foreign affiliate to the extent such earnings had been subject to a notional tax rate of 52.63% and provide for corresponding changes to the general rate income pool of such a CCPC.

Changes to the General Anti-Avoidance Rule (GAAR)

The GAAR can apply to redetermine the tax consequences otherwise arising under the Act where a transaction or series of transactions contains an "avoidance transaction" and results directly or indirectly in a "tax benefit," but only in circumstances giving rise to a misuse or abuse of the provisions of the Act or of the Act as a whole.

The term "tax benefit" is defined in subsection 245(1) of the Act and generally refers to a reduction, avoidance or deferral of tax or other amount payable under the Act or an increase in a refund of tax or other amount under the Act. The definition has remained largely unchanged since the GAAR was first enacted in 1988, other than an amendment in 2004 to extend its scope to tax benefits achieved under an applicable tax treaty.

Budget 2022 proposes amending the definition of tax benefit to provide that the creation or preservation of tax attributes (or the reduction of unfavourable tax attributes) constitutes a tax benefit for the purposes of the GAAR. The effect of this amendment is to overrule the 2018 decision of the Federal Court of Appeal in *1245989 Alberta Ltd. v Canada (Attorney General)* (sub nom. *Wild v Canada*), which held that a series of transactions that increased the paid-up capital (PUC) of corporate shares did not result in a tax benefit because the PUC had not yet been utilized to effect a reduction in tax. Budget 2022 states that the limitation of the GAAR to circumstances in which a tax attribute has been utilized runs counter to the policy underlying the GAAR and the related determination rules, and reduces certainty for taxpayers and the CRA.

A corresponding amendment is also proposed to the definition of "tax consequences" in subsection 245(1), which is relevant for the purposes of determining the amounts that may be adjusted by the CRA where the GAAR applies.

These amended definitions apply to notices of determination issued by the CRA on or after Budget Day.

Intergenerational Business Transfers

The Act contains an anti-surplus stripping rule in section 84.1 directed at individuals converting dividends into capital gains (which are taxed at a lower effective tax rate). For example, where an individual sells shares of a Canadian corporation to another Canadian corporation with which the individual deals at non-arm's length, the individual may be deemed to realize a dividend on the transfer rather than a taxable capital gain and be precluded from claiming the lifetime capital gains exemption on shares of a qualified small business corporation, family farm or fishing corporation. Prior to the enactment of private member's Bill C-208 on June 29, 2021, this rule led to different tax consequences where an individual sold shares to an arm's-length purchaser corporation, in contrast to a sale to a corporation controlled by a family member. In light of this deterrent for intergenerational transfers of Canadian corporations, Bill C-208 introduced changes to section 84.1 to facilitate these transfers as well as to the reorganization rules in section 55 to facilitate intergenerational reorganizations. For example, the amendments excluded intergenerational transfers from the scope of section 84.1 where the purchaser corporation does not dispose of the purchased shares within 60 months and is controlled by the transferor's adult children or grandchildren. As Bill C-208 progressed through Parliament without technical input from the Department of Finance, there are perceived deficiencies in the amendments. In particular, Budget 2022 notes that there is no requirement that a "genuine" intergenerational business transfer occur. Budget 2022 does not set out criteria for a "genuine" intergenerational transfer and instead announces public consultation regarding amendment of the amended rules to facilitate intergenerational transfers while still maintaining the "integrity of the tax system," Comments are due by June 17, 2022, and the tabling of legislation in fall 2022 following consultation is contemplated.

International Tax Measures

International Tax Reform

Budget 2022 contains an update on Canada's implementation of the OECD-led Pillars International Tax Reform proposals.

Regarding Pillar One, which is intended to reallocate taxing rights over the profits of the largest and most profitable multinational enterprises (MNEs) to market countries, the government is actively working with its international partners to develop the model rules and the multilateral convention needed to establish the new multilateral tax framework for Amount A and bring it into effect. Budget 2022 also notes the government's back-up plan for a Digital Services Tax (DST), a draft of which was released in December 2021. The DST could be imposed as of January 1, 2024, if the multilateral convention implementing the Amount A tax framework has not come into force.

Regarding Pillar Two, which is intended to ensure that the profits of large MNEs are subject to an effective tax rate of at least 15%, regardless of where they are earned, Budget 2022 states Canada's intention to implement Pillar Two, in line with the model rules approved by the Inclusive Framework (the Model Rules), published on December 20, 2021, along with a domestic minimum top-up tax that would apply to Canadian entities of MNEs that are within scope. The latter will substitute financial statement income calculations for the rules of the Act that compute Canadian tax payable on Canadian source income of a Canadian multinational.

The government anticipates that draft legislation implementing Pillar Two would be publicly released for consultation and the Income Inclusion Rule (IIR), and domestic minimum top-up tax would come into effect in 2023 as of a date to be fixed; the back-stop Undertaxed Profits Rule (UTPR) would come into effect no earlier than 2024.

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 notes that the Model Rules are the product of extensive international negotiation and have been agreed to by Inclusive Framework members. A country's failure to adhere in its domestic implementing legislation to the common approach set out in the Model Rules runs the risk of the implementing country's IIR not being a "qualified" IIR under the Model Rules, leaving MNEs based in that country open to the application of other countries' UTPRs. In light of this, the principal purpose of the consultation is to ensure that the draft legislation incorporates any necessary adaptations of the Model Rules to the Canadian legal and income tax context, rather than to seek views on the major design aspects of the Model Rules or broader policy considerations.

Interest Coupon Stripping

Budget 2022 proposes an amendment to ensure that the interest withholding tax paid under an interest coupon stripping arrangement is the same as if the arrangement had not been undertaken.

While an amendment was made in 2011 to address an interest coupon stripping arrangement that was the subject of the Federal Court of Appeal decision in *Lehigh Cement Limited v Canada*, 2010 FCA 124, under Canada's pre-2008 interest withholding rules, it did not deal with two other variations of the arrangement. One such variation involves a U.S. resident coupon holder that benefits from nil withholding tax under the Canada-U.S. Tax Treaty. The second variation involves a Canadian resident coupon holder.

Under the amended rules, an interest coupon stripping arrangement would be considered to exist where a Canadian-resident borrower pays or credits to the coupon holder an amount of interest on a debt owed to a non-resident lender with whom the Canadian-resident borrower is not dealing at arm's length and the withholding tax that would be payable, if the particular amount were paid or credited to the non-resident lender, is greater than the withholding tax payable on the amount paid or credited to the interest coupon holder. Where an interest coupon stripping arrangement exists, the Canadian-resident borrower would be deemed, for the purposes of the interest withholding tax rules, to pay an amount of interest to the non-resident lender such that the withholding tax on the deemed interest payment equals such tax otherwise avoided as a result of the interest coupon stripping arrangement.

The proposed rules contain an exception for debt obligations issued as part of an offering that is lawfully distributed to the public in accordance with a prospectus, registration statement or similar document filed with and, where required by law, accepted for filing by a public authority. Finally, they include a specific anti-avoidance rule.

This measure would generally apply to interest paid or payable by a Canadian-resident borrower to an interest coupon holder to the extent that such interest accrued on or after Budget Day.

Personal Income Tax Measures

Housing Measures

Budget 2022 proposes various housing measures, mostly aimed at increasing access to residential property. Among these measures is the creation of a new tax-free "first home savings account" (FHSA). Contributions to a FHSA will be limited to $8,000 per annum (up to $40,000 in the aggregate) and will be fully deductible against income (similar to contributions to a RRSP and unlike contributions to a tax-free savings account (TFSA)). Income earned within the FHSA will not be subject to tax, and neither will amounts withdrawn to make a qualifying first home purchase (unlike RRSPs and similar to TFSAs). Budget 2022 also proposes to double the first-time home buyer's tax credit, up from $750 to a maximum of $1,500 where certain conditions are satisfied. New multigenerational home renovation and accessibility tax credits are also added.

Budget 2022 also aims at deterring speculative trading in the residential market by ensuring that "home flippers" are fully taxed on any profit realised on the sale of a residential property (as opposed to realizing a capital gain) where the property is held for less than 12 months, except where the sale can be explained by certain life circumstances, such as death, illness, insolvency or marital breakdown. As a consequence, home flippers would also be precluded from claiming the principal residence exemption on such sales.

The budget also proposes to apply GST/HST to assignment sales of agreements to purchase new (or substantially renovated) residential housing. This measure is effective for assignments agreed to on or after May 7, 2022. Previously, such assignments generally were exempted if the assigning individuals could demonstrate that they had originally entered into the purchase agreements for the primary purpose of closing and occupying the homes as a place of residence, rather than "flipping" the agreements for a profit.

Additional Minimum Tax

Budget 2022 includes an announcement that the Department of Finance will modernize the alternative minimum tax rules. These changes are expected to be announced as part of the fall economic update.

Registered Charities

Following a consultation process initially announced in last year's budget, Budget 2022 proposes to increase the disbursement quota (DQ) applicable to registered charities from 3.5% of the charity's property not used directly in charitable activities or administration to 5% in respect of such property that exceeds $1 million. This change is intended to increase expenditures by charities, without impacting smaller grant-making organizations with potentially lower investment returns. The Act will also be amended to clarify that expenditures for administration and management will not constitute qualifying expenditures for purposes of satisfying a charity's DQ. Proposed amendments would provide the CRA with broad discretion to grant a reduction in a charity's DQ obligation. These measures are proposed to apply in respect of a charity's fiscal periods beginning on or after January 1, 2023.

Budget 2022 also proposes amendments that are intended to allow a charity to make qualifying disbursements to organizations that are not qualified donees, such as to foreign charities or other intermediaries, provided that they are made in furtherance of its charitable objects and steps are taken to ensure that the funds are applied to charitable activities by the grantee. A number of mandatory accountability requirements would need to be satisfied by the charity to ensure that these conditions are met, including conducting pre-grant inquiries, entering into a written agreement in respect of the funding and its application, monitoring the grantee, and publicly disclosing the grants on its annual information return. These changes should provide greater flexibility to charities that conduct activities through an intermediary organization other than a qualified donee; the current rules require the charity to maintain control and direction over such activities such that they can be considered to be directly carried on by the charity itself. To protect against the risk that a charity could act as a conduit for donations to other organizations, the budget proposes to restrict registered charities from accepting gifts that are expressly or implicitly conditional on making a gift to a person other than a qualified donee.

Borrowing by Defined Benefit Pension Plans

Registered pension plans have long been subject to tight borrowing restrictions which generally limit them to (i) borrowing to invest in real property and (ii) certain short-term borrowing for a period not exceeding 90 days. Recently, those restrictions were relaxed during the COVID-19 pandemic in order to help pension plans manage liquidity concerns during a time of uncertainty, with plans being allowed to borrow money provided that it was repaid by the end of April 2022.

With the ending of the special COVID-era dispensation, Budget 2022 now proposes a longer-term change to the rules for defined benefit pension plans (other than individual pension plans). Starting on Budget Day, in addition to borrowing to invest in real property, such plans will be permitted to borrow up to an amount equal to the lesser of (i) 20% of plan net assets, and (ii) the amount by which 125% of the plan's actuarial liabilities exceed net assets. These limits would generally be recalculated on an annual basis, and apply at the time of each borrowing. Other pension plans (i.e., defined contribution plans and individual pension plans) would continue to be subject to the existing rules. The budget also does not amend the strict borrowing limitations imposed on investment corporation subsidiaries of pension plans.

While the rationale for the existing borrowing restrictions is not entirely clear, the fact that the new relief is limited to defined benefit plans that are not significantly overfunded is consistent with what we understand is the government's view that the restrictions should prevent pension plans from unduly increasing plan assets and returns for the benefit of pension beneficiaries.

We also note that while the change has been presented as increasing flexibility for pension plans, certain overfunded defined benefit plans may be worse off, since such plans will lose access to the short-term borrowing allowed under the existing regulations, while also being unable to borrow under the new rule (other than for real property investments).

Other Measures

As part of the government's ongoing efforts to improve corporate transparency, Budget 2022 proposes to amend the Canada Business Corporations Act to implement a publicly accessible beneficial ownership registry by the end of 2023.

Previously Announced Tax Measures

In addition to the new tax measures mentioned above, Budget 2022 announced that the government intends to proceed with the following key measures announced on February 4, 2022 (amongst others) following the completion of applicable public consultation periods:

Limits on Interest Deductibility

The draft legislation introduced a new regime to the Act intended to limit the deduction of interest and financing expenses for Canadian income tax purposes – the "excessive interest and financing expenses limitation" (EIFEL) rules. Under the proposed EIFEL rules, a deduction in respect of interest and financing expenses will be limited up to a fixed ratio of 30% (40% in the first year of application) of tax-adjusted EBITDA (i.e., any amount deducted in excess of this fixed ratio will be denied).

While fundamentally mechanical in application, the broader effects of the proposed EIFEL regime are not well understood. Due to the complexity of the rules, increased compliance costs for taxpayers is expected. Questions remain as to the underlying rationale for these rules, particularly in light of the government's intention to preserve the current thin capitalization rules. The Department of Finance will continue to accept submissions in respect of the proposed EIFEL rules until May 5, 2022.

Mandatory Disclosure Rules

The draft legislation includes the following three mandatory disclosure measures intended to provide the CRA with "timely, comprehensive and relevant information on aggressive tax planning strategies":

- A broadening of the existing rule requiring the disclosure of "reportable transactions." Pursuant to the proposed amendments, a reportable transaction will now only require one of the "hallmarks" of aggressive tax planning, and the definition of "avoidance transaction" for purposes of the mandatory disclosure rules will be expanded to include a transaction in which one of its main purposes (as opposed to the principal purpose) is to obtain a tax benefit.

- A new rule for the disclosure of "notifiable transactions." The Proposals contained a list of "sample" transactions the Minister of National Revenue intends to designate as requiring disclosure under the new notifiable transaction rules.
- A new rule requiring disclosure with respect to uncertain tax positions as reflected in the audited financial statements of a corporation.

Concerns have been raised in respect of various issues with these proposals, including, among other things, that they may result in a breach of solicitor-client privilege, the scope/application of the rules, the definition of "avoidance transaction," whether the sample notifiable transactions constitute the "designated" transactions alluded to by Finance, and the potentially excessive administrative burden for both taxpayers and tax authorities.

Tax Compliance Measures

The draft legislation authorizes the CRA to compel the attendance of a taxpayer at a place designated by the auditor to answer proper questions relating to the administration or enforcement of the Act. There are serious concerns with the proposals, namely that the proposed amendments afford auditors quasi-judicial powers, lack appropriate legal safeguards and could result in what has otherwise been an administrative process becoming a legal proceeding akin to an examination on discovery.

The draft legislation also introduces specific rules to broaden the circumstances in which a person can be held jointly and severally liable for another taxpayer's debts under the Act. In particular, the Proposals are intended to target complex schemes designed to circumvent the rules in section 160 of the Act that cause a transferee of property to be liable for tax debts of the transferor, and impose penalties on those who devise and/or promote such schemes.

Trust Reporting

The draft legislation in respect of certain reporting requirements for trusts constitutes a revision of draft legislation that was released in 2018. The Proposals, consequently, delay the application of the reporting requirements, but also propose new subsection 150(1.3), which effectively extends the proposed reporting requirements to bare trusts. Concerns have been raised that the extension of the reporting requirements to bare trusts will unnecessarily increase the compliance burden for taxpayers and is an ineffective method to obtain beneficial ownership information.

The consultation period for the mandatory disclosure rules, tax compliance measures and trust reporting measures ended on April 5, 2022.