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TaxNewsFlash

Canada

2022 Federal Budget — Tax Changes on the Table

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Canada's Deputy Prime Minister and Finance Minister Chrystia Freeland will deliver Canada's 2022 federal budget on April 7, 2022. Although the government has signalled that this year's budget may largely focus on themes such as affordability, housing and income inequality, any specific details on what measures may be under consideration are kept under wraps until the budget is released. However, when preparing this year's federal budget, it's likely that the government will draw heavily from the 2022 pre-budget report from the House of Commons Standing Committee on Finance (Finance Committee), as well as measures from its 2021 election platform. There may be additional indications about what's to come in the government's recent public announcements.

As these documents and comments will likely form the basis of the government's 2022 federal budget, a close analysis may provide some preliminary clues about what may be in store this year. It's also possible that the upcoming budget may include some proposals based on the NDP's policy priorities. The government announced on March 22, 2022 that the parties reached an agreement where the NDP would provide the support needed to pass the budget measures under a minority government in exchange for advancing some NDP proposals. Among other possible measures, the government may be considering a new 15% minimum tax on high-net-worth individuals, changes to increase the corporate income tax rate on certain banks and insurance companies to 18% (from 15%) on all earnings over $1 billion and may also provide further details on a previously announced carbon capture, storage and utilization credit.

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

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

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

Possible tax changes — 2022 federal budget

In considering the Finance Committee's recommendations, the government's 2021 election platform and other recent announcements, Finance may take a broad approach and consider changes across Canada's tax system. Specifically, Finance could announce measures affecting the following areas:

- Business tax
- International tax
- Tax transparency
- Innovation
- Personal tax
- Housing
- Climate-related tax measures
- COVID-19 support
- Indirect tax
- Tax administration
- Other personal income measures
- Tax system review.

Business tax

Corporate tax rate increases for certain entities

The budget may propose measures to fulfill the government's 2021 election platform promise to raise the corporate income tax rate on banks and insurance companies to 18% (from 15%) on all earnings over $1 billion.

The budget may also include certain related measures affecting entities who made strong profits during the pandemic. The 2022 pre-budget report recommends that Finance implement an "excess profit tax" focused on corporate pandemic windfalls, while the government's 2021 election platform also promises to require banks and insurance companies with earnings over $1 billion to pay a temporary Canada Recovery Dividend to the government.

KPMG observation
The government recently acknowledged that it will prioritize plans to move forward in the near term on tax changes for financial institutions as part of its recent agreement with the NDP. Soon after the agreement was announced, the NDP further called on the government to include measures in the 2022 federal budget to introduce a 3% surtax on banks and insurance companies on profits over $1 billion and expand it to profitable big oil companies and "big box" stores.

Real estate

The budget may propose changes to the tax rules for large corporate owners of residential real estate (such as real estate investment trusts). The government's 2021 election platform pledged to review the tax treatment of these entities. In addition, the platform promises to require landlords to disclose the rent received pre- and post-renovation on their tax filings and implement a proportional surtax on excessive increases.

KPMG observation
As part of the 2022 pre-budget report, the NDP submitted a supplementary opinion that recommended that Finance eliminate the preferential tax treatment for real estate investment trusts.

General anti-avoidance rule

The budget may propose changes to the general anti-avoidance rule (GAAR) regime. Following its previous comments in the 2020 Fall Economic Update and the 2021 federal budget, the government pledged to "modernize" the GAAR regime in its 2021 election platform to focus on economic substance and restrict the ability of federally regulated entities, including financial institutions such as banks and insurance companies, to use tiered structures as a form of corporate tax planning that flow Canadian-derived profits through entities in low-tax jurisdictions to reduce taxes in Canada. The 2022 pre-budget report advises Finance to immediately proceed with its GAAR consultation.

International accounting rules for insurance contracts

The budget could include changes to address the international accounting rules for insurance contracts that are scheduled to become effective in 2023. In the summer of 2021, Finance held a public consultation on how to maintain the current alignment between the taxation of profits and the timing of income earning activities, as well as any other potential taxation issues that could arise as the new accounting standard, known as IFRS 17, is implemented. For details, see *TaxNewsFlash-Canada* 2021-31, "Insurers — Have Your Say on New Accounting Standards".

Other measures

The 2022 pre-budget report also recommends business tax changes to:

- Introduce a tax credit to incentivize businesses to make investments in cybersecurity and data protection
- Invest in Quebec's existing pharmaceutical infrastructure by enhancing tax credits and/or subsidies for modernizing or expanding manufacturing facilities in Quebec
- Consider implementing a rural development tax credit similar to the Atlantic Investment Tax Credit to other regions, notably North Shore in Quebec.

KPMG observation
The pre-budget report also recommends that Finance ensure the continuation of the tax-deferral program, however it's not clear which specific program this refers to.

International tax

Tax and the digitalization of the economy

Finance may further comment on the OECD/G20 Inclusive Framework two-pillar approach to address challenges of tax and the digitalization of the economy in this year's budget. Canada and 135 other countries and jurisdictions of the OECD/G20 Inclusive Framework have now agreed on several key aspects of a framework intended to reform the international tax system, in accordance with the government's 2021 election platform promise to move forward on this approach. The 2022 pre-budget report urges Finance to follow through on these commitments to ensure that all sectors, including "web giants", pay their fair share of Canadian profits.

For details on this approach, which focuses on the allocation of taxing rights including nexus issues (Pillar One), and a minimum 15% global corporate income tax rate (Pillar Two), see *TaxNewsFlash-Canada* 2022-13, "OECD Pillar Two — KPMG Analysis Available Now" and *TaxNewsFlash-Canada* 2022-07, "OECD Consultation — Tax Base Calculations under Pillar One".

Other measures

The 2022 pre-budget report recommends changes to "make it impossible" for companies to repatriate tax-free dividends from "tax havens".

There are several tax proposals from the 2021 federal budget and other announcements that have not yet been released as draft legislation. The government may provide more information on proposals to:

- Introduce rules to address hybrid mismatch arrangements starting as early as July 1, 2022
- Launch a public consultation on Canada's transfer pricing rules.

Tax transparency

Publicly accessible beneficial ownership registry

The 2022 pre-budget report recommends the federal government undertake a broad review of how it could significantly increase the amount, detail, quality and timeliness of information publicly available on the financial conditions of individuals, corporations and trusts, including ownership, assets, income and taxes paid.

KPMG observation
The government stated that, as part of its agreement with the NDP, it will prioritize plans to implement a publicly accessible beneficial ownership registry by the end of 2023 (previously, the registry was proposed to be established by 2025).

Other measures

The 2022 pre-budget report also recommends that Finance consider changes to continue to improve corporate transparency and make public the country-by-country financial reports of large transnational corporations.

Innovation

In its 2022 pre-budget report, the Finance Committee recommends Finance consider changes to promote innovation including to:

- Introduce a production modernization tax credit to adopt existing technologies and significantly improve business productivity as a complement to the Scientific Research and Experimental Development (SR&ED) tax credit
- Bolster intellectual property generation in Canada by allowing IP-related costs to be recognized as eligible SR&ED expenses for income tax purposes
- Modernize the Accelerated Investment Incentive to include advanced technology asset classes such as software, machine learning and artificial intelligence.

In addition, the government pledged in its 2021 election platform to reform the SR&ED Program by aligning eligible expenses to current innovation and providing additional support for companies based on risk.

Personal tax

Minimum tax

The budget may propose a minimum tax rule of 15% for individuals who qualify for the top tax bracket. The government promised to introduce this change in its 2021 election platform, in order to remove excessive use of deductions and credits.

KPMG observation
It is not yet clear how this potential minimum tax would interact with existing Alternative Minimum Tax.

Intergenerational transfers

The budget could include new changes to the rules concerning the intergenerational transfer of shares of a small business or family farm or fishing corporation that were introduced in 2021. Finance previously indicated that it intends to bring forward draft legislative amendments for consultation to ensure that these rules facilitate genuine intergenerational transfers. In addition, the pre-budget report recommends that Finance hold consultations on any amendments to these rules. For further details of potential amendments, see *TaxNewsFlash-Canada* 2021-41, "New Intergenerational Transfer Rules — More Changes Coming".

Other changes

The government's 2021 election platform also promised personal tax changes to:

- Allow certain health professionals establishing a practice to deduct up to $15,000 over their first three years of practice
- Expand the Canada Worker's Benefit
- Establish an expert panel to provide recommendations for establishing an Aging at Home Benefit
- Amend Canada's tax credit system including changes to:
  - Expand the Canada Caregiver Credit into a refundable, tax-free benefit
  - Increase the Home Accessibility Tax Credit to $20,000 (from $10,000) to provide up to an additional $1,500
  - Expand the Medical Expense Tax Credit to include costs reimbursed to a surrogate mother for IVF expenses

- Introduce a Labour Mobility Tax Credit to allow those in construction trades to deduct up to $4,000 in eligible travel and temporary relocation expenses

- Introduce a Career Extension Tax Credit for seniors 65 and over who earn a minimum of $5,000 of working income (maximum credit available of $1,650)

- Undertake a review of access to the Disability Tax Credit, CPP-Disability and other federal benefits and programs.

- Introduce a 15% tax credit to cover the cost of home appliance repairs performed by technicians (up to $500).

The government may also provide more information on its 2021 federal budget announcement that it intends to consult with stakeholders on how workers and owners of private businesses in Canada could benefit from the use of employee ownership trusts.

In addition, the pre-budget report recommends that Finance consider changes to:

- Examine additional ways for the federal government to reduce wealth and income inequality through the tax system

- Eliminate the capital gains tax on donations of shares in private corporations or real property to charities

- Introduce a tax credit for experienced workers

- Create a skilled trades workforce mobility tax deduction to allow skilled trades workers to deduct work-related travel costs when these costs are not covered by their employer

- Increase the Canada Workers Benefit and expand it to people with no employment income

- Make the caregiver tax credit refundable

- Increase the maximum weekly earnings threshold for caregiving benefits

- Substantially invest in the base amount for the Canada child benefit

- Speed up the design and implementation of the new federal disability benefit

- Create a federal disability benefit for children

- Review the limits, conditions and tax implications of converting RRSPs to RRIFs to ensure that experienced workers who wish to continue working or return to the workforce are not penalized.

Housing

Underused housing tax

The budget may propose further adjustments to the underused housing tax (UHT), the annual 1% tax on non-resident owned residential real estate in Canada that is considered to be vacant or underused. Although this tax has not yet been enacted, Finance noted in the 2021 Fall Federal Economic Update that it plans to introduce an exemption for certain vacation/recreational properties, which would apply to an owner's interest in a residential property for a calendar year if the property is located in certain non-urban areas and is personally used by the owner (or the owner's spouse or common-law partner) for at least four weeks in the calendar year. For details, see *TaxNewsFlash-Canada* 2021-62, "Highlights of the 2021 Federal Fall Economic Update".

In its 2021 election platform, the government also pledged to expand the 1% underused housing tax to include foreign-owned vacant land within large urban areas.

Other changes

The government's 2021 election platform also promised housing-related changes to:

- Establish an "anti-flipping" tax that would require properties to be held for at least 12 months to qualify for the principal residence exemption, subject to certain exceptions
- Introduce a tax-free First Home Savings Account to allow Canadians under 40 to save up to $40,000 toward their first home and withdraw it tax-free, with no requirement to repay
- Increase the First-Time Home Buyers Tax Credit to $10,000 (from $5,000)
- Introduce a Multigenerational Home Renovation tax credit of 15% on up to $50,000 in renovation costs for families to add a secondary unit to their home for immediate or extended family members.

Climate-related measures

CCUS investment tax credit

The budget could provide additional detail on a carbon capture, utilization, and storage (CCUS) investment tax credit, which was announced in the 2021 federal budget. Finance commented at the 2021 Fall Federal Economic Update that it would provide further details on this measure in the 2022 federal budget.

Other measures

The government made some additional climate-related promises in its 2021 election platform, including that it would:

- Continue to put a rising price on pollution
- Consider applying Border Carbon Adjustments on imports of steel, cement, aluminum and other emissions-intensive industries, in collaboration on the development of an approach with the U.S. and the EU
- Eliminate fossil fuel subsidies by 2023
- Develop additional investment tax credits for renewable energy and battery storage solutions
- Increase the Mineral Exploration Tax Credit for certain minerals essential to manufacturing of clean technologies, such as batteries
- Introduce an investment tax credit of up to 30% for a range of clean technologies including low carbon and net-zero technologies
- Eliminate flow through shares for oil, gas and coal projects.

COVID-19 support

The 2022 pre-budget report recommends changes to Canada's COVID-19 support programs, including to:

- Implement a Canada Emergency Response Benefit repayment amnesty for everyone living below or near the low-income level
- Allow commercial tenants to receive the Canada Emergency Rent Subsidy (CERS) for all months that they have been eligible for it since the start of the pandemic and for which they were unable to receive Canada Emergency Commercial Rent Assistance (CECRA)
- Increase the loan forgiveness portion for all government-backed business loans and extend the Canada Emergency Business Account (CEBA) repayment deadline
- Allow small businesses that created their companies during the pandemic to access COVID-19 programs
- Provide better coverage for the aerospace industry through the Hardest-Hit Business Recovery Program

- Modify the Tourism and Hospitality Recovery Program to allow all seasonable businesses to access the program.

KPMG observation
As part of the Finance Committee's pre-budget report, the NDP submitted a supplementary opinion that recommends Finance expand the eligibility criteria of the Canada Worker Lockdown Benefit to include workers in hard-hit industries such as independent travel agents.

Indirect tax changes

The Finance Committee's 2022 pre-budget report recommends that the government consider indirect tax measures to:

- Adopt a progressive excise tax system, similar to the U.S. Craft Beverage Modernization and Tax Reform Act, to help small Canadian distillers (and other craft alcohol producers) compete in Canada and abroad

- Exclude aircraft from the manufacturing tax in the 2021 federal budget and delay its implementation until its impact on the industry can be more accurately assessed.

The government's 2021 election platform promises to move forward with a national tax on vaping products.

The government may also provide more information on its 2021 federal budget announcement that it intends to consider changes to modernize Canada's trade remedy system.

Tax administration

CRA funding

The 2022 pre-budget report recommends that Finance fund the CRA so that it is equipped to address "high-profile tax loopholes", while maintaining strong leadership at the OECD for a more ambitious and fairer application of the base erosion and profit shifting initiative for developing countries. This recommendation appears to follow the government's 2021 election pledge to significantly increase the resources of the CRA (up to $1 billion per year) to combat aggressive tax planning and tax avoidance.

Other measures

The Finance Committee's 2022 pre-budget report also recommends that the government consider measures to:

- Remove taxpayer signature requirements for the T183, “Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return” and RC71, “Statement of Discounting Transaction” consistent with Finance’s 2022 legislative proposals
- Expedite permanent approval for e-signature use on all remaining forms that are necessary to meet tax filing requirements
- Initiate discussions with the Quebec government to reach a practical and innovative agreement on the matter of a single tax return
- Consider how federal and provincial governments could more effectively deliver benefits through the CRA’s tax and benefit system infrastructure, including the introduction of free automatic tax filing.

Other personal income measures

In its 2021 election platform, the government promised to make certain reforms to the Employment Insurance (EI) system. The 2022 pre-budget report also recommends specific changes to:

- Support the modernization of Employment Insurance (EI) through dialogue with stakeholders in the labour market
- Increase flexibility in the EI program and recognize the uniqueness of the construction labour force
- Develop a comprehensive plan on how to better integrate the self-employed into the EI system
- Extend the EI benefit period to a maximum of 52 weeks for caregivers who must leave work temporarily to care for a family member
- Contribute on an ongoing basis to EI and make improvements such as a higher replacement rate or a minimum amount on what the unemployed receive such as the $500 per week provided under the Canada Emergency Response Benefit and the Canadian Recovery Benefit and a lower threshold for hours of entry into the Employment Insurance program.

In addition, the 2022 pre-budget report recommends certain changes to Old Age Security including to:

- Increase Old Age Security benefits by 10% for all seniors eligible for the program
- Extend the Old Age Security benefits of deceased individuals by three months for the surviving spouse

- Revise the Old Age Security indexing method to account for wage growth in Canada.

The 2022 pre-budget report also advises Finance to consider increasing the Guaranteed Income Supplement by at least $50 per month for all seniors.

Tax system review

The budget may announce a broad review of the tax system, focused on addressing income inequality issues, and in particular wealthy individuals and large corporations. Specifically, the Finance Committee's 2022 pre-budget report recommends changes to:

- Undertake a public review to identify "loopholes and other tax avoidance mechanisms" that particularly benefit high incomes, wealthy individuals and large corporations and make recommendations to eliminate or restrict these

- Address growing income inequality and generate revenue for poverty reduction programing by eliminating "tax loopholes, closing tax havens, taxing extreme wealth, and implementing excess profit tax focused on corporate pandemic windfalls"

- Conduct a systematic review of tax and budget measures to redirect efforts and funding away from less effective measures and toward the most effective and efficient policy instruments.

Federal expenditure review

Finance could also consider changes based on a review of existing federal tax expenditures in the 2022 federal budget. The 2022 pre-budget report recommends that the government undertake a public review to identify expenditures that particularly benefit high incomes, wealthy individuals and large corporations and make recommendations to eliminate or restrict these expenditures.

Finance releases an annual report of federal tax expenditures that covers tax credits and a wide range of other targeted tax measures such as preferential tax rates, exemptions, deductions and deferrals that are aimed at reducing taxation for specific groups or to achieve certain public policy objectives. These measures are often considered a form of government spending because they reduce the tax revenue the government would otherwise receive.

Certain large expenditures, such as pension plans and RRSPs are probably unlikely to be targeted, and the media has reported Finance Minister Chrystia Freeland's comments signaling that Finance does not intend to make changes to the principal residence exemption or capital gains tax in this year's budget. However, it's possible that Finance may look to eliminate some less prominent expenditures as part of its efforts to address growing income inequality.

We can help

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

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