TaxNewsFlash

Canada

2024 Federal Budget — Spotlight on Financial Services

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Companies in the financial services industry may be affected by new measures in the 2024 federal budget. In particular, the budget introduces several changes that may have an important effect on the reporting obligations of financial institutions, including banks, insurance companies and asset managers, such as:

- Crypto-Asset Reporting Framework and Common Reporting Standard.

In addition, several other 2024 federal budget measures are expected to affect asset management companies, who may want to review changes related to:

- Qualified investments
- Mutual fund corporations
- Synthetic equity arrangements
- Interest deductibility — Purpose-built rental housing
- Mineral Exploration Tax Credit flow-through shares
- Capital gains inclusion rate.

Budget measures affecting banks, insurance and asset management companies

Crypto-Asset Reporting Framework

The budget proposes to implement the Crypto-Asset Reporting Framework (CARF) developed by the Organization for Economic Co-operation and Development (OECD).

Under this change, crypto-asset service providers that are resident in Canada or carry on business in Canada will be required to annually report certain customer and crypto-asset information to the CRA, including the annual value of specified crypto-asset transactions such as exchanges and transfers of crypto-assets. Note that although central bank digital currencies and specified electronic money products are not considered reportable crypto-assets, they will be reportable under the amendments to the Common Reporting Standard.

In addition, crypto-asset service providers will be required to obtain and report certain information on each of their customers, including any natural persons who exercise control over corporate or other entity customers. Service providers will have to provide information for these customers including their name, address, date of birth, jurisdiction of residence, and taxpayer identification number.

Common Reporting Standard

The budget proposes to broaden the scope of the Common Reporting Standard (CRS) to include specified electronic money products and central bank digital currencies which are excluded from the CARF. In addition, financial institutions will be required to report additional information regarding financial accounts and account holders, and to strengthen their due diligence procedures.

The proposed CRS amendments also remove Labour-Sponsored Venture Capital Corporations (LSVCC) from the list of non-reporting financial institutions and treat a non-registered account held in an LSVCC as an excluded account, provided that annual contributions to the account do not exceed US$50,000. Also, the budget clarifies that the anti-avoidance provision of the CRS will apply when an individual or any entity enters into an arrangement or engages in a practice, if it can reasonably be considered that the primary purpose is to avoid an obligation of any person under the CRS.

The proposed CARF and the amendments to the CRS apply to the 2026 and subsequent calendar years. The first reporting and exchange of information under the CARF and amended CRS are scheduled to take place in 2027 for the 2026 calendar year.

KPMG observations
Financial institutions and crypto-asset service providers will need to assess the implications of these proposals, including any process or system changes required to comply with the additional due diligence and reporting obligations.

Budget measures affecting asset management companies

Qualified investments

The budget proposes a new consultation to modernize the qualified investment rules that apply to registered plans. The qualified investment rules apply to seven different types of registered plans:

- Registered retirement savings plans (RRSPs)
- Registered retirement income funds (RRIFs)
- Tax-free savings accounts (TFSAs)
- Registered education savings plans (RESPs)
- Registered disability savings plans (RDSPs)
- First home savings accounts (FHSAs) and
- Deferred profit sharing plans (DPSPs).

The budget notes that the qualified investment rules have evolved incrementally as new registered plans have been introduced since 1966, resulting in the rules being inconsistent or difficult to understand in some cases. For example, different registered plans have different rules for investing in small businesses or annuities. The budget also specifically highlights that certain pooled investment products are qualified investments only if they apply to the CRA to be “registered investments”.

To modernize the qualified investment rules, the budget invites stakeholders to provide comments on how to improve the clarity and coherence of these rules, and is seeking input on questions including:

- Whether the conditions that must be met by pooled investment products that are registered investments are appropriate, including the value of the formal registration process, and
- Whether crypto-backed assets should be qualified investments.

Comments are due to Finance by July 15, 2024.

KPMG observations
Industry associations and other commentators have previously raised concerns with Finance that some aspects of the qualified investment rules have not kept pace with global securities developments. This consultation provides a welcome opportunity to revisit these issues as part of a comprehensive effort to modernize the rules.

Mutual fund corporations

The budget proposes amendments to disallow mutual fund corporation status for mutual fund corporations that are controlled by a corporate group. A mutual fund is an investment vehicle where investors pool their money to invest in a diversified portfolio without directly purchasing the investments. A mutual fund corporation, as defined under the *Income Tax Act*, enjoys special tax treatment relative to typical corporations, allowing capital gains to be distributed to investors. To qualify, the corporation must meet specific conditions,

including qualifying as a public corporation, which can be met by having a class of shares listed on a designated stock exchange. The budget proposes amendments to disallow mutual fund corporation status for corporations controlled by or for the benefit of corporate groups, with exceptions for widely held mutual fund corporations. This change is intended to prevent unintended tax benefits for corporate groups and would apply to taxation years starting after 2024.

KPMG observations
While Finance has not quantified revenue inflows for this proposed measure, it appears that this change is intended to close what Finance perceives as a "loophole" in the *Income Tax Act* that could allow corporate groups to inappropriately obtain mutual fund corporation status.

Synthetic equity arrangements

The budget proposes to remove the tax-indifferent investor exception. The synthetic equity arrangement rules, which generally deny the intercorporate dividend deduction in the case of certain synthetic equity arrangements in respect of a share, currently include an exception where no tax-indifferent investor has all or substantially all of the economic exposure in respect of the share and a related exception for synthetic equity arrangements traded on a recognized derivatives exchange, unless it can reasonably be considered that the counterparty is a tax-indifferent investor. The budget proposes to remove the tax-indifferent investor exception (including the associated exception for synthetic equity arrangements traded on a recognized derivatives exchange) from the synthetic equity arrangement rules. effective for dividends received on or after January 1, 2025.

KPMG observations
The budget indicates that the elimination of this exception is intended to simplify the rules and that Finance does not expect material tax revenue inflow from the measure. Although it is unclear whether reliance on the exception is prevalent, any taxpayer who relies on the tax-indifferent investor exception to the synthetic equity arrangement rules may be adversely impacted by this change.

Interest deductibility — Purpose-built rental housing

The budget proposes to provide an elective exemption from the excess interest and financing expenses limitation (EIFEL) rules on purpose-built rental housing in Canada. Specifically, the budget proposes to provide an elective exemption from the EIFEL rules for certain interest and financing expenses in respect of arm's-length financing used to build or acquire certain purpose-built rental housing in Canada. The conditions for eligible housing are consistent with newly proposed GST and accelerated Capital Cost Allowance (CCA) provisions for purpose-built rental housing (i.e., residential complexes with at least four private apartments or ten private rooms or suites and in which at least 90% of units are held for long-term rental). This exemption would be available for taxation years beginning

on or after October 1, 2023, and apply to interest and financing expenses incurred before January 1, 2036.

KPMG observations
This new elective exemption may provide relief from any denied interest and financing expense under the EIFEL rules for taxpayers involved in the construction or acquisition of purpose-built rental housing, including potentially REITs.

Mineral Exploration Tax Credit Flow-through shares

The budget proposes to extend the Mineral Exploration Tax Credit (METC) to March 31, 2025. The METC provides an additional income tax benefit for individuals who invest in mining flow-through shares, which augments the tax benefits associated with the amounts that are flowed through. The tax credit is equal to 15% of the specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors. The METC legislation was expected to expire on March 31, 2024. However this credit has since been extended to March 31, 2025 in respect of flow-through share agreements entered into on or before this date.

KPMG observations
This change is good news for asset managers who offer these products in support of junior mining companies, as it extends the ability to offer these products for an additional year that may have otherwise have been discontinued.

Capital gains inclusion rate

The budget proposes to increase the inclusion rate for capital gains realized on or after June 25, 2024. In particular, the budget proposes to increase the inclusion rate for corporations and trusts to 2/3 (from 1/2) and for individuals to 2/3 (from 1/2) subject to certain thresholds. The increased inclusion rate will apply to all capital gains realized by corporations and trusts.

For individuals (excluding trusts), the increased inclusion rate would only apply on capital gains realized in the year in excess of $250,000. As such any gains under $250,000 would remain subject to the 50% inclusion rate. In addition, the amount of net capital losses carried forward from prior years would be adjusted to reflect the new capital gains inclusion rate when deducted against taxable capital gains arising in the current year. This annual $250,000 threshold for individuals would be fully available in 2024 (i.e., not prorated) and would apply only in respect of net capital gains realized after June 25, 2024.

The budget advises that transitional rules are expected to be drafted to address capital gains realized in tax years that straddle June 25, 2024.

KPMG observations

Asset managers will be significantly impacted by the increase to the inclusion rate on taxable capital gains, which is proposed to apply to individuals, corporations and trusts and partnerships. This change is expected to have a broad effect on the industry, including on respective taxation considerations described to investors in offering documents and marketing material, the applicable computations in respect of the capital gains refund mechanism, the allocation to redeemers and, in certain instances, Part XIII withholding tax. The extensive effort for reprogramming systems as well as tracking and reporting the respective timing of capital gains both pre- and post-June 25, 2024 should not be understated, particularly in light of the numerous technical questions that remain outstanding related to this change.

We can help

Your KPMG adviser can help you assess the effect of the tax changes in this year's federal budget on the financial services industry, and point out ways to take advantage of their 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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