



TaxNewsFlash

Canada

2025 Federal Budget Highlights

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Canada's Finance Minister delivered the 2025 federal budget on November 4, 2025. The budget expects a deficit of \$78.3 billion for 2025-26. This year's budget includes several notable tax enhancements, including measures allowing for immediate expensing for manufacturing and processing buildings, increasing the expenditure limit for the Scientific Research and Experimental Development (SR&ED) program, and expanding several clean economy input tax credits. In addition, the budget includes significant amendments to modernize Canada's transfer pricing rules. Note that the budget does not change the federal personal or corporate tax rates.

This year's budget also announces specific measures intended to simplify and tighten the tax system, including introducing changes to streamline qualified registered savings plans and expanding the anti-avoidance measures relating to the 21-year trust rule. The budget also eliminates certain taxes, including measures removing the Underused Housing Tax (UHT) as of the 2025 calendar year and removing the luxury tax on subject aircraft and subject vessels.

Business tax changes

Immediate Expensing for Manufacturing and Processing Buildings

The budget provides temporary immediate expensing (100% capital cost allowance (CCA) deduction rate) for the cost of eligible manufacturing or processing buildings, including the cost of eligible additions or alterations made to such buildings. This measure is available in the first taxation year that eligible property is used for manufacturing or processing provided the minimum 90% floor space requirement is met. This change is effective for eligible property acquired on or after November 4, 2025 and is used for manufacturing and

processing before 2030. The CCA deduction rate is gradually reduced for the years after 2030 and is eliminated after 2033.

Tax deferral through tiered corporate structures

The budget limits the deferral of tax on investment income using tiered corporate structures with mismatched year ends. Generally, this limitation suspends the dividend refund that could otherwise be claimed by a payer corporation on the payment of a taxable dividend to an affiliated recipient corporation, if the recipient corporation's balance-due day for the taxation year in which the dividend was received ends after the payer corporation's balance-due day for the taxation year in which the dividend was paid.

This measure will not apply if each corporate dividend recipient in the chain of affiliated corporations pays a subsequent dividend on or before the payer's balance-due day, such that no deferral is achieved by the affiliated corporate group. To accommodate *bona fide* commercial transactions, the rule would also not apply to a dividend payer that is subject to an acquisition of control where it pays a dividend within 30 days before the acquisition of control.

The payer corporation would generally be entitled to claim the suspended dividend refund in a subsequent taxation year when the recipient corporation pays a taxable dividend to a non-affiliated corporation or an individual shareholder.

This measure applies to taxation years that begin on or after November 4, 2025.

Agricultural cooperatives — Patronage dividends paid in shares

The budget extends the deferral of income taxes and withholding obligations on patronage dividends that are received as eligible shares until the disposition (including a deemed disposition) of the shares. The budget extends this measure to apply to eligible shares issued before the end of 2030 (as opposed to 2025, when this measure was set to expire).

Tax incentives

Scientific Research and Experimental Development Tax Incentive Program

The budget increases the expenditure limit on which the SR&ED program's enhanced 35% tax credit can be earned to \$6 million (from the previously announced \$4.5 million). This measure applies to taxation years that begin on or after December 16, 2024.

KPMG observations

The government promised to increase the expenditure limit to \$6 million in its 2025 election platform.

Critical Mineral Exploration Tax Credit

The budget expands eligibility for the Critical Mineral Exploration Tax Credit (CMETC) to the following critical minerals: bismuth, cesium, chromium, fluor spar, germanium, indium, manganese, molybdenum, niobium, tantalum, tin, and tungsten. The CMETC is equal to 30% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors. This measure applies to expenditures renounced under eligible flow-through share agreements entered into after November 4, 2025, and on or before March 31, 2027.

Canadian Exploration Expense — Eligible activities

The budget clarifies that expenses incurred for the purpose of determining the quality of a mineral resource do not include expenses related to determining the economic viability or engineering feasibility of the mineral resource. This amendment applies as of November 4, 2025.

Clean Electricity Investment Tax Credit — Canada Growth Fund eligible entity

The budget includes the Canada Growth Fund as an eligible entity for purposes of the 15% refundable Clean Electricity Investment Tax Credit (CEITC). The budget also introduces an exception so that financing provided by the Canada Growth Fund would not reduce the cost of eligible property for the purpose of computing this investment tax credit. These measures apply to eligible property that is acquired and that becomes available for use on or after November 4, 2025.

Clean Technology Manufacturing Investment Tax Credit — Eligible minerals

The budget expands the list of critical minerals eligible for the 30% refundable Clean Technology Manufacturing Investment Tax Credit (CTMITC) to include antimony, indium, gallium, germanium, and scandium. This measure is effective for property that is acquired and becomes available for use on or after November 4, 2025.

ITC for Carbon Capture, Utilization, and Storage — Extension of full tax credit rates

The Carbon Capture, Utilization, and Storage (CCUS) investment tax credit is a refundable tax credit that provides support for eligible expenditures relating to CCUS. Depending on the purpose of the equipment, different credit rates apply (ranging from 37.5% to 60%) to eligible CCUS expenditures incurred from the start of 2022 to the end of 2030. Eligible expenditures that are incurred from the start of 2031 to the end of 2040 are subject to lower credit rates (ranging from 18.75% to 30%).

The budget extends the availability of the full credit rates by five years, so that the full rates apply to eligible expenditures incurred from the start of 2022 to the end of 2035. Eligible expenditures that are incurred from the start of 2036 to the end of 2040 would continue to

be subject to the lower credit rates. The government will postpone the review of the CCUS investment tax credit rates, to be undertaken before 2035 (rather than before 2030).

International tax changes

Modernizing transfer pricing rules

The budget modernizes Canada's transfer pricing rules, effective for taxation years that begin after November 4, 2025. Specifically, the budget aligns these rules with the international arm's length principle in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and Capital, Canada's bilateral tax treaties and the OECD Transfer Pricing Guidelines. The measures provide more detail on how to analyze cross-border transactions between non-arm's length persons based not only on the contractual terms of the transaction or series, but also on economically relevant characteristics.

The measures also add a new transfer pricing adjustment application rule to provide more detail on how cross-border transactions between non-arm's length persons must be analyzed. This new rule proposes to adjust the quantum or nature of amounts to align with arm's length principles and new definitions of "arm's length conditions" and "economically relevant characteristics". The economically relevant characteristics of a transaction or series will be defined to include specific comparability factors.

The budget also modifies the following measures:

- *Penalty relief* — The budget increases the threshold for application of the transfer pricing penalty to a \$10 million adjustment from a \$5 million adjustment
- *Documentation* — The budget clarifies documentation requirements to more closely align with the new definitions and requirements, and introduces new simplified documentation requirements
- *Time period to provide documentation* — The budget reduces this period to 30 days (from 3 months).

Investment income derived from assets supporting Canadian insurance risks

The budget clarifies that, for taxation years that begin after November 4, 2025, investment income derived from assets supporting Canadian reinsurance risks qualifies as foreign accrual property income (FAPI). The new budget measure is intended to address certain positions that were being taken by taxpayers that a specific FAPI rule did not apply to investment income where assets were held by an insurer directly, or indirectly through a foreign affiliate of the insurer as part of their integrated insurance business.

Under the Canadian tax system, certain income earned by a controlled foreign affiliate of a Canadian-resident taxpayer may be treated as FAPI and taxed on an accrual basis. Currently, the FAPI regime is intended to capture circumstances where income from a business involving the insurance of Canadian risks (i.e., risks in respect of persons resident

in Canada, property situated in Canada, or businesses carried on in Canada) is shifted into a foreign affiliate.

Personal tax changes

Bare trust reporting rules

The budget defers the trust reporting rules applicable to bare trusts to apply to taxation years ending on or after December 31, 2026. These rules were proposed on August 15, 2025.

Trusts and the 21-year rule

The budget broadens the anti-avoidance provisions relating to the 21-year trusts rule to include indirect transfers of trust property to other trusts on or after November 4, 2025. The budget states that this measure is intended to address certain tax planning that avoids the 21-year rule, such as where trust property is transferred on a tax-deferred basis to a beneficiary that is a corporation owned by a new trust.

In general, personal trusts are deemed to have disposed of their capital property and certain other property for proceeds equal to fair market value on the 21st anniversary of their creation, and every 21st anniversary thereafter. This is colloquially referred to as the “21-year” rule. Currently, the anti-avoidance rules ensure that the 21-year rule cannot be circumvented by direct trust-to-trust property transfers, such as transferring property from a trust to a new trust on a tax-deferred basis.

Qualified investments for registered plans

The budget simplifies and harmonizes the qualified investment rules that apply to certain registered plans (i.e., Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), Tax-Free Savings Accounts (TFSA), Registered Education Savings Plans (RESPs), Registered Disability Savings Plans (RDSPs), First Home Savings Accounts (FHSAs), and Deferred Profit Sharing Plans (DPSPs)).

The budget states that the following amendments for small business investments would apply as of January 1, 2027:

- RDSPs will be permitted to invest in specified small business corporations, venture capital corporations, and specified cooperative corporations similar to RRSPs, RRIFs, TFSA, RESP, and FHSA
- Shares of eligible corporations and interests in small business investment limited partnerships and small business investment trusts will no longer qualify as qualified investments. However, any such interests that were acquired before 2027 under the current rules will continue to be qualified investments.

In addition, the budget provides that the current registered investment regime will be repealed for all registered plans as of January 1, 2027, and replaced with two new

categories of qualified investments that do not have to be registered with the CRA. The new qualified investment trust rules apply as of November 4, 2025. The budget notes that it is generally expected that units or shares of funds that were registered investments would continue to qualify, either under existing rules or under one or both of the new categories of qualified investment trusts.

In addition, the budget consolidates investment rules for all registered plans (except DPSPs) into one definition and updates and reorganizes the list of qualified investments prescribed in the regulations by asset class (e.g., debt or equity) for clarity and simplicity.

Canadian Entrepreneurs' Incentive

The budget acknowledges the abandoned capital gains tax increase and provides the costing details of removing this measure.

KPMG observations

Interestingly, the budget documents note that, as part of the costing for the capital gains tax increase cancellation, the Canadian Entrepreneurs' Incentive and the proposal to fully allow resource expense deductions under the Alternative Minimum Tax have also been cancelled.

Home Accessibility Tax Credit

The budget introduces changes to ensure that an expense claimed under the Medical Expense Tax Credit cannot also be claimed under the Home Accessibility Tax Credit. This measure applies to the 2026 and subsequent taxation years.

Top-Up Tax Credit

The budget introduces a new non-refundable Top-Up Tax Credit that would effectively maintain the current 15% for non-refundable tax credits claimed on amounts in excess of the first income tax bracket threshold rate (rather than the 14.5% rate for 2025 and 14% rate for 2026 and subsequent years). The Top-Up Tax Credit applies for the 2025 to 2030 taxation years.

The budget notes that this measure is intended to address situations in which an individual could have their tax liability increased by the middle-class tax cut (e.g., where an individual claims a large one-time expense, such as amounts for high tuition or medical expenses, or claims a combination of large tax credits).

Personal Support Workers Tax Credit

The budget introduces a temporary Personal Support Workers Tax Credit applicable for the 2026 to 2030 taxation years. This tax credit provides certain eligible personal support

workers working for certain health care establishments with a refundable tax credit of 5 per cent of eligible earnings up to \$1,100.

Indirect tax changes

Underused Housing Tax

The budget eliminates the UHT as of the 2025 calendar year. As a result, no UHT would be payable and no UHT returns would be required to be filed in respect of the 2025 and subsequent calendar years. The budget states that all UHT requirements continue to apply for the 2022 to 2024 calendar years, including penalties and interest.

Luxury tax on aircraft and vessels

The budget ends the luxury tax on subject aircraft and subject vessels. This tax will cease to be payable after November 4, 2025, including the tax on sales, the tax on importations, and the tax on improvements.

Registered vendors are required to file a final return covering the reporting period that includes November 4, 2025. Registrations in respect of subject aircraft and subject vessels must be maintained after November 4, 2025, allowing registered vendors to claim any rebates. However, the budget advises that returns of these items would otherwise no longer need to be filed for subsequent reporting periods. The budget states that all registrations in respect of subject aircraft and subject vessels would be automatically cancelled on February 1, 2028, after which time vendors would no longer be able to claim rebates.

GST/HST treatment of manual osteopathic services

The budget clarifies that osteopathic services rendered by individuals who are not osteopathic physicians are taxable under the GST/HST. This measure would apply to supplies made after June 5, 2025, except to a supply of osteopathic services made after June 5, 2025 but on or before November 4, 2025 if the supplier did not charge, collect or remit any amount as or on account of tax in respect of the supply.

Carousel fraud

The budget announces changes to help prevent “carousel fraud” in which GST/HST is collected in respect of a supply of property or services but is not remitted to the government. Specifically, the government is proposing to introduce a new reverse charge mechanism (RCM) beginning with certain supplies in the telecommunications sector.

The federal government invites stakeholders to share their feedback on the carousel proposals outlined in the budget documents by January 12, 2026.

Administrative changes

Information sharing — Worker misclassification

The budget allows the CRA to share taxpayer information (under the *Income Tax Act*) and confidential information (under the *Excise Tax Act*) with Employment and Social Development Canada (ESDC) for the purposes of the administration and enforcement of the *Canada Labour Code* as it relates to the classification of workers. This measure, which the budget states is intended to address the misclassification of employees as independent contractors in the trucking industry, would come into force on royal assent of the enacting legislation.

Automatic federal benefits for lower-income individuals

The budget proposes to grant the CRA the discretionary authority to file a tax return for a taxation year on behalf of certain lower-income individuals (other than a trust) for 2025 and subsequent taxation years. This proposal is open for consultation until January 30, 2026.

As currently proposed, eligible individuals must meet the following requirements to qualify for automatic tax filing:

- The individual's taxable income for the taxation year is below the lower of either the federal basic personal amount or provincial equivalent (plus the age amount and/or disability amount, as applicable)
- All income of the individual for the taxation year is from sources for which specified information returns have been filed with the CRA
- At least once in the preceding three taxation years, the individual has not filed a return
- The individual has otherwise not filed a return for the taxation year prior to, or within 90 days following, the tax filing deadline for the year, and
- Any other criteria, as determined by the CRA.

Once processed, the individual generally has 90 days to review the information and submit changes to the CRA. Individuals may also opt-out of automatic tax filing.

Canada Carbon Rebate

The budget provides that no Canada Carbon Rebate payments will be made for tax returns or adjustment requests filed after October 30, 2026. The government provided a final

quarterly Canada Carbon Rebate payment starting in April 2025 to eligible households following the removal of the federal fuel charge as of April 1, 2025.

Previously announced tax changes

The budget confirms that Finance intends to proceed with numerous previously announced tax measures including, among others:

- Capital Gains Rollover on Small Business Investments
- Substantive CCPCs
- Reporting by Non-profit Organizations
- Tax exemption for sales to Employee Ownership Trusts
- Excessive Interest and Financing Expenses Limitation Rules
- Technical amendments to the *Global Minimum Tax Act*
- Bare trust reporting rules
- Lifetime capital gains exemption changes
- Hybrid mismatch rules
- Legislative and regulatory proposals released on August 12, 2024, including rules related to withholding for non-resident service providers, Alternative Minimum Tax, and avoidance of tax debts.

We can help

Your KPMG adviser can help you assess the effect of the tax changes in this year's 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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