TD Wealth

Federal Budget 2023:

A Plan to Grow Our Economy and Make Life More Affordable

March 2023

Introduction

The Federal government has delivered the 2023 Budget: *A Made-in-Canada Plan: Strong Middle Class, Affordable Economy, Healthy Future* – which includes a wide range of measures aimed to make life more affordable for the middle class, support the creation of a clean economy, and build a strong, sustainable, and more secure economy. These measures are geared to help Canadians in this time of high inflation.

Individual Tax Measures

Registered Education Savings Plans

The Budget proposes an increase to the amounts that subscribers of Registered Education Savings Plans (RESPs) may withdraw as Educational Assistance Payments (EAPs). Currently, RESP beneficiaries who are enrolled in full-time post-secondary education programs can withdraw up to $5,000 of EAPs during the first 13 consecutive weeks of enrolment in a 12-month period. For beneficiaries who are enrolled in part-time studies, the EAP withdrawal limit for this same time period is $2,500. The Budget proposes increasing the EAP withdrawal limit to $8,000 for beneficiaries enrolled in full-time studies, and $4,000 for those enrolled part-time. These changes are proposed to go into effect immediately and individuals who have already withdrawn the previous maximum would be eligible to withdraw additional funds to bring them up to the new maximum.

Additionally, the Budget proposes to enable divorced or separated parents to open joint RESPs for their children or to move an existing joint RESP to another RESP promoter. These changes are also proposed to go into effect immediately.

Registered Disability Savings Plans

The Budget proposes to extend to December 31, 2026, a temporary legislative measure pertaining to Registered Disability Savings Plans (RDSPs) that is set to expire on December 31, 2023. This temporary measure allows a 'qualifying family member', who is a parent, spouse or common-law partner, to open an RDSP and be the plan holder for an adult whose capacity to enter into an RDSP contract is in doubt and who does not have a legal representative.

In addition, the Budget proposes to broaden the definition of 'qualifying family member' to include a sibling of the beneficiary who is 18 years of age or older. This broadened definition would apply as of royal assent of the enabling legislation and be in effect until December 31, 2026. A 'qualifying family member' that becomes a plan holder before the end of 2026 could remain a plan holder after 2026.

The Grocery Rebate

As a means to combat the impact of rising food prices on low- and modest-income households, the Budget proposes to increase the maximum Goods and Services Tax Credit (GSTC) amount for January 2023. Eligible Canadians would receive an additional GSTC amount equal to twice the amount they received for January. This additional amount would be known as the Grocery Rebate and would be limited to:

- $153 per adult;
- $81 per child; and
- $81 for the single parent supplement.

Intergenerational Business Transfer Framework (Amendments to Bill C-208)

The Budget proposes to amend the rules introduced by Bill C-208 with additional conditions to ensure that they apply only to a genuine intergenerational business transfer.

Taxpayers who wish to undertake a genuine intergenerational share transfer may choose to rely on one of two transfer options:

- An immediate transfer (three-year test) based on arm's length sale terms; or
- A gradual transfer (five-to-ten-year test) based on traditional estate freeze characteristics.

The immediate transfer option provides finality earlier in the process but has more stringent conditions. Alternatively, the gradual transfer option provides additional flexibility for those who choose that approach.

The proposed conditions that would need to be satisfied under the gradual transfer option are as follows (transfers to grandchildren, nieces and nephews would also qualify):

- *Transfer of Control of the Business* – Parents immediately and permanently transfer only legal control, including an immediate transfer of a majority of voting shares (no transfer of factual control), and a transfer of the balance within 36 months.
- *Transfers of Economic Interests in the Business* – Parents immediately transfer a majority of the common growth shares and transfer the balance within 36 months. In addition, within 10 years of the initial sale, parents reduce the economic value of their debt and equity interests in the business to:
  - 50% of the value of their interest in a farm or fishing corporation at the initial sale time; or
  - 30% of the value of their interest in a small business corporation at the initial sale time.

- *Transfer of Management of the Business* – Parents transfer management of the business to their children within a reasonable time based on the particular circumstances (with a 36-month safe harbour).
- *Child Retains Control of the Business* – Child(ren) retain(s) legal (not factual) control for the greater of 60 months or until the business transfer is completed.
- *Child Works in Business* – At least one child remains actively involved in the business for the greater of 60 months or until the business transfer is completed.

The rules introduced by Bill C-208 that apply to subsequent share transfers by the purchaser corporation and the lifetime capital gains exemption are proposed to be replaced by relieving rules that would apply upon a subsequent arm's length share transfer or upon the death or disability of a child.

The transferor and child (or children) would be required to jointly elect for the transfer to qualify as either an immediate or gradual transfer. The child or children would be jointly and severally liable for any additional taxes payable by the transferor, if the transfer does not meet the above conditions.

The limitation period for reassessing a transferor's liability for tax that may arise on the transfer is proposed to be extended by three years for an immediate transfer and by 10 years for a gradual transfer.

In addition, the Budget also proposes to provide a 10-year capital gains reserve for genuine intergenerational share transfers that qualify under the immediate or gradual transfer tests.

These measures would apply to transactions that occur on or after January 1, 2024.

Alternative Minimum Tax

The Alternative Minimum Tax (AMT) is a parallel tax calculation that allows fewer tax credits, exemptions and deductions under the ordinary income tax rules. Instead of the usual progressive tax rate structure, the AMT applies a 15% tax rate after a $40,000 exemption. The taxpayer pays the AMT or regular tax, whichever is highest.

Focusing on high-income individuals, the Budget proposes to increase the AMT rate from 15% to 20.5% and to raise the AMT exemption amount from $40,000 to the start of the fourth federal tax bracket (which is expected to be approximately $173,000 for the 2024 taxation year). The exemption amount would be indexed annually to inflation.

In addition, the Budget proposes to broaden the AMT base by implementing the following:

- Increasing the AMT capital gains inclusion rate from 80% to 100%. Capital loss carry forwards and allowable business investment losses would apply at a 50% rate.
- Including 100% of the benefit associated with employee stock options.
- Including 30% of capital gains on donations of publicly listed securities. The 30% inclusion would also apply to the full benefit associated with employee stock options to the extent that a deduction is available because the underlying securities are publicly listed securities that have been donated.
- Disallowing 50% of a number of currently allowed deductions (such as: employment expenses not related to commission income, deductions for CPP/QPP, child care expenses, interest and carrying charges incurred to earn property income, and non-capital loss carryovers).
- Most non-refundable tax credits that are currently allowed to reduce the AMT will be limited to 50%.

The proposed changes would apply for taxation years beginning after 2023.

Retirement Compensation Arrangements

A retirement compensation arrangement (RCA) is a type of employer-sponsored arrangement that generally allows an employer to provide supplemental pension benefits to employees. Currently, a 50% refundable tax is imposed on contributions to an RCA trust, as well as on income and gains earned or realized by the trust.

The Budget proposes to exempt from the 50% refundable tax, any premiums or fees paid for the purposes of securing or renewing a letter of credit for an RCA that is supplemental to a registered pension plan. This would apply to fees or premiums paid on or after Budget Day.

The Budget also proposes to allow refunds to employers for previously remitted refundable tax on such fees and premiums, effective for retirement benefits paid after 2023.

Deduction for Tradespeople's Tool Expenses

Under the current deduction for tradespeople's tool expenses, a tradesperson can claim a deduction of up to $500 of the amount by which the total cost of eligible new tools acquired in a taxation year exceeds the amount of the Canada Employment Credit ($1,368 in 2023).

The Budget proposes to double the maximum employment deduction for tradespeople's tools from $500 to $1,000, effective for 2023 and subsequent taxation years.

Employee Ownership Trusts

An Employee Ownership Trust (EOT) is a Canadian resident trust that holds shares of a corporation for the benefit of the corporation's employees. The Budget proposes new rules to facilitate the use of EOTs to acquire and hold shares of a business. The new rules would define qualifying conditions to be an EOT and propose changes to tax rules to facilitate the establishment of EOTs. Below are some of the qualifying conditions and general rules that would apply to EOTs.

A trust would generally be considered an EOT if it holds the shares of a qualifying business for the benefit of the business's employees and makes distributions to employee beneficiaries under a formula that considers the employee's length of service, remuneration, and hours worked. The EOT would be required to own a controlling interest in the business, and all or substantially all of the EOT's assets must be shares of the business. Additionally, the EOT's trustees would need to be Canadian residents and elected by the adult beneficiaries at least once every five years. The beneficiaries of the EOT must consist exclusively of employees of the business, subject to some exceptions.

An EOT would be a taxable trust and generally subject to the same rules as other personal trusts. However, an EOT would have three important deviations from the tax treatment applied to most other trusts:

- Normally, capital gains on the sales of capital property such as a business can be deferred up to 5 years. EOTs are expected to have a 10-year deferral period, making them more attractive.
- Taxpayers who receive a shareholder's loan are normally required to include the loan amount in income unless it is repaid within one year. However, an EOT, acting as a shareholder of a business, would be able to borrow money from the business to purchase shares in a qualifying business transfer and not include the loan amount in income if the loan is repaid within 15 years.
- Canada has a 21-year deemed disposition rule that applies to capital property held by trusts. However, an EOT would be exempt from the application of this deemed disposition rule.

The amendments related to EOTs are expected to apply as of January 1, 2024.

Business Tax Measures

Tax on Repurchases of Equity

In the 2022 Fall Economic Statement, the government proposed a 2% tax on the net value of all types of share repurchases by public corporations in Canada. The Budget provides the design and implementation details of the proposed measure.

The tax is intended to apply to Canadian-resident corporations whose shares are listed on a designated stock exchange. These include real estate investment trusts (REITs), specified investment flow-through (SIFT) trusts, and SIFT partnerships, but would exclude mutual fund corporations. The Budget proposes that certain transactions will be exempt from this tax, including certain debt-like preferred share transactions as well as certain corporate reorganizations and/or acquisition transactions. Furthermore, exceptions are proposed for registered securities dealers as well as activity intended to fulfill certain equity-based compensation arrangements.

This tax would not apply to entities that repurchase less than $1 million (gross) of equity during a taxation year and would take effect on January 1, 2024.

General Anti-Avoidance Rule Reform

The General Anti-Avoidance Rule (GAAR) in the *Income Tax Act* is designed to prevent abusive tax avoidance transactions without obstructing legitimate personal or business transactions.

The Budget proposes to lower the threshold for the avoidance transaction test in the GAAR from a 'primary purpose' test to a 'one of the main purposes' test. It also proposes that the economic substance of a transaction be considered at the 'misuse or abuse' stage of the GAAR analysis.

Indicators for determining whether a transaction is lacking in economic substance are to be provided in legislative amendments.

To further disincentivize abusive tax avoidance, the Budget proposes a new penalty which would be applied to offending taxpayers. Subject to certain exceptions, this penalty would be equivalent to 25% of the amount of the tax benefit created by the abusive transaction.

Finally, a three-year extension has been proposed for GAAR reassessments.

A consultation will be held on the proposed legislative changes, until May 31, 2023. Following this period of consultation, the government will release revised legislative proposals and announce the effective date.

Dividend Received Deduction by Financial Institutions

The *Income Tax Act* permits corporations to claim a deduction in respect of dividends received on shares of other corporations resident in Canada which effectively excludes these dividends from income. The dividend received deduction is intended to limit the imposition of multiple levels of corporate tax.

The mark-to-market rules in the Income Tax Act recognize the unique nature of certain property ("mark-to-market property") held by financial institutions in the ordinary course of business. Under these rules, gains on the disposition of mark-to-market property are included as ordinary income, not capital gains, and unrealized gains are included in computing income annually (in addition to when the property is disposed). Shares are generally mark-to-market property when a financial institution holds less than 10% of the votes or value of the corporation that issues the shares ("portfolio shares").

Although the mark-to-market rules essentially classify gains on portfolio shares as business income, dividends received on the shares remain eligible for the dividend received deduction and are excluded from income. To align the treatment of dividends and gains on portfolio shares under the mark-to-market rules, Budget 2023 proposes to deny the dividend received deduction in respect of dividends received by financial institutions on shares that are mark-to-market property. This measure applies to dividends received after 2023.

Green Tax Incentives

Investment Tax Credit for Clean Electricity

The Budget proposes to introduce a 15% refundable Clean Electricity Investment Tax Credit (subject to certain labour requirements) for eligible clean electricity investments in:

- Non-emitting electricity generation systems: wind, concentrated solar, solar photovoltaic, hydro (including large-scale), wave, tidal, and nuclear (including large-scale and small modular reactors);
- Abated natural gas-fired electricity generation (which would be subject to an emissions intensity threshold compatible with a net-zero grid by 2035);
- Stationary electricity storage systems that do not use fossil fuels in operation, such as batteries, pumped hydroelectric storage, and compressed air storage; and
- Equipment for the transmission of electricity between provinces and territories.

Both new projects and the refurbishment of existing facilities would qualify.

The Clean Electricity Investment Tax Credit would be available as of Budget Day 2024 for projects that did not begin construction before Budget Day 2023. It would also not be available after 2034.

Investment Tax Credit for Clean Hydrogen

The Budget proposes to introduce a Clean Hydrogen Investment Tax Credit (subject to certain labour requirements), which will provide the following:

- A refundable tax credit between 15% and 40% of eligible project costs; and
- A refundable tax credit equal to 15% of the cost of equipment needed to convert clean hydrogen into clean ammonia.

This measure would apply to property that is acquired and that becomes available for use on or after Budget Day.

Clean Technology Investment Tax Credit – Geothermal Energy

The Budget proposes to expand the eligibility of the Clean Technology Investment Tax Credit (subject to certain labour requirements), introduced in the 2022 Fall Economic Statement, to include geothermal energy systems that are eligible for Class 43.1 of Schedule II of the Income Tax Regulations.

The phase-out schedule of the Clean Technology Investment Tax Credit will also be extended to 2034, with the rate remaining at 30% for property that becomes available for use in 2032 and 2033 and would be reduced to 15% in 2034. After 2034, the credit would be unavailable.

Investment Tax Credit for Clean Technology Manufacturing

The Budget proposes to introduce a refundable investment tax credit for clean technology manufacturing and processing, and critical mineral extraction and processing, equal to 30% of the capital cost of eligible property associated with eligible activities. Eligible property would generally include machinery and equipment used in manufacturing, processing, or critical mineral extraction, as well as related control systems.

The credit for Clean Technology Manufacturing would be applicable to property that is acquired and becomes available for use after 2023. It would be gradually phased out, starting with property that becomes available for use in 2032, and will no longer be in effect for property that becomes available for use after 2034.

Interaction of Credits

Businesses would be able to claim only one of the Investment Tax Credit for Clean Electricity, Investment Tax Credit for Clean Hydrogen, Clean Technology Investment Tax Credit, or Investment Tax Credit for Clean Technology Manufacturing, if a particular property is eligible for more than one of these credits.

Zero-Emission Technology Manufacturers

The Budget proposes that income from the following nuclear manufacturing and processing activities would qualify for reduced tax rates, for zero-emission technology manufacturers:

- Manufacturing of nuclear energy equipment;
- Processing or recycling of nuclear fuels and heavy water; and
- Manufacturing of nuclear fuel rods.

The expansion of eligible activities would apply for taxation years beginning after 2023.

Other

GST/HST Treatment of Payment Card Clearing Services

The Budget proposes to amend the GST/HST definition of "financial service" to clarify that payment card clearing services rendered by a payment card network operator are excluded from the definition to ensure that such services generally continue to be subject to GST/HST.

Alcohol Excise Duty

The Budget proposes to temporarily cap the inflation adjustment for excise duties on beer, spirits and wine at 2%, for one year only, as of April 1, 2023.

Cannabis Taxation – Quarterly Duty Remittances

The Budget proposes to allow all licensed cannabis producers to remit excise duties on a quarterly rather than monthly basis, starting from the quarter beginning on April 1, 2023.

Air Travellers Security Charge

The Air Travellers Security Charge is generally paid by passengers when they purchase airline tickets. The Budget proposes to increase the rates by 32.85%, which would apply to air transportation services that include a chargeable emplanement on or after May 1, 2024, for which any payment is made on or after that date.

Automatic Tax Filing

The Budget proposes that, starting next year, the Canada Revenue Agency pilots a new automatic filing service to help vulnerable Canadians who do not currently file their taxes or receive the benefits to which they are entitled.