Tax News Update
U.S. Edition

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Canada Federal budget 2023/24: A made-in-Canada plan

- *The Canadian federal budget for 2023/2024 has been tabled.*
- *The budget contains several measures affecting individuals and corporations, and proposes significant investments to support Canada's transition to a clean economy while also supporting job creation for Canadians.*
- *This Alert summarizes the key tax measures.*

Executive summary

On 28 March 2023, federal Finance Minister Chrystia Freeland tabled the 2023/24 budget.

This budget (Budget 2023 or 2023 federal budget) focuses on several priorities, including: providing targeted inflation relief for Canadians most in need and other affordability measures to support students, seniors, small businesses and the middle class; building more affordable housing; investing in public health care, including implementing the new Canadian Dental Care Plan; and making significant investments to support Canada's transition to a clean economy while also supporting the creation of good jobs for Canadians.

The Minister anticipates deficits of CA$43.0 billion[1] for fiscal 2022-23 and $40.1 billion for 2023-24, with reduced deficits for each of the next four years.

A summary of the key tax measures announced in Budget 2023 follows.

Detailed discussion

Business income tax measures

Corporate income tax rates

With the exception of the changes noted below for zero-emission technology manufacturers, there are no changes proposed to the general or small-business corporate income tax rates or to the $500,000 small-business limit of a Canadian-controlled private corporation (CCPC).

The enacted Canadian federal corporate income tax rates are summarized in Table A.

*Table A — Federal corporate income tax rates*1

	2023	2024
General corporate rate 2,3	15.0%	15.0%
Small-business rate 2	9.0%	9.0%

1 Rates represent calendar-year-end rates.

2 The corporate income tax rate for qualifying zero-emission technology manufacturers is reduced to 7.5% for eligible income otherwise subject to the 15% general corporate income tax rate or 4.5% for eligible income otherwise

subject to the 9% small-business corporate income tax rate (see changes to this rate reduction below).

3 An additional tax applies to banks and life insurers at a rate of 1.5% on taxable income (subject to a $100-million exemption shared by group members), effective for tax years ending after 7 April 2022 (prorated for tax years straddling this effective date). This additional tax is not reflected in the rates shown in the table above.

Zero-emission technology manufacturers

The 2021 federal budget previously announced a temporary reduction in corporate tax rates for manufacturers of qualifying zero-emission technology. Budget 2023 proposes an expansion of this measure to include the following manufacturing activities:

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

The expansion applies for tax years beginning on or after 1 January 2024.

The 2023 federal budget also proposes an extension of this measure by three years. The proposed reduced tax rates schedule and planned phase-out are outlined in Table B.

Table B — Reduced tax rates

Tax years that begin in:	2022-31	2032	2033	2034
Reduced rate on income eligible for the small-business deduction	4.5%	5.625%	6.75%	7.875%
Reduced rate on other eligible income	7.5%	9.375%	11.25%	13.125%

Tax on repurchases of equity

The 2022 Fall Economic Statement announced the Government's intention to introduce a 2% tax on the net value of all types of share repurchases by public corporations in Canada. Budget 2023 introduces the proposed measure.

The tax would apply to Canadian-resident corporations whose shares are listed on a designated stock exchange (excluding mutual fund corporations) and to real estate investment trusts, specified investment flow-through (SIFT) trusts and SIFT partnerships if they have units listed on a designated stock exchange. Certain other publicly traded entities that would be SIFT trusts or SIFT partnerships if their assets were located in Canada may also be caught.

The proposed tax is equal to 2% of the net value of an entity's repurchased equity for each tax year. Net value is defined as the fair market value of the equity that the issuer redeems, acquires or cancels in the year, less the fair market value of the equity that the issuer issues from treasury during the year.

Several important exemptions from the rule are proposed, including:

- Debt-like preferred shares and units (defined as "substantive debt")
- Shares or units that are issued or redeemed, acquired or cancelled in certain corporate reorganizations and acquisitions, including certain amalgamations, liquidations and share-for-share exchanges

Shares will only be considered substantive debt if they are not convertible or exchangeable (except into shares that are substantive debt of the same entity), they are non-voting, the dividend rate (if any) is fixed, and the redemption amount thereon does not exceed their issuance amount (plus any unpaid distributions or dividends thereon).

The tax will not apply if an entity repurchased less than $1 million of equity during the tax year (prorated for short tax years), as determined on a gross basis (i.e., without any regard to issuances from treasury).

The proposed rules are supported by certain anti-avoidance rules, including rules that deem purchases by certain related entities (other than certain registered securities dealers and employee benefit plan trusts) to be a repurchase.

The tax would apply in respect of repurchases and issuances of equity that occur on or after 1 January 2024.

Investment tax credit for clean technology manufacturing

Budget 2023 proposes a new 30% refundable investment tax credit (ITC) for investments in eligible property associated with eligible activities for clean technology manufacturing and processing, as well as critical mineral extraction and processing.

The credit would apply to investments in certain depreciable property, all of which or substantially all of which is used for eligible activities. This would generally include machinery and equipment, including certain industrial vehicles and related control systems used in manufacturing, processing or critical mineral extraction.

A portion of the tax credit would be recovered if eligible property is subject to a change in use or sold within a certain period of time.

Eligible activities related to clean technology manufacturing and processing include:

- Manufacturing certain renewable energy equipment (solar, wind, water or geothermal)
- Manufacturing nuclear energy equipment
- Processing or recycling nuclear fuels and heavy water
- Manufacturing nuclear fuel rods
- Manufacturing electrical energy storage equipment used to provide grid-scale storage or other ancillary services
- Manufacturing equipment for air- and ground-source heat pump systems
- Manufacturing zero-emission vehicles, including conversions of on-road vehicles
- Manufacturing batteries, fuel cells, recharging systems and hydrogen refueling stations for zero-emission vehicles
- Manufacturing equipment used to produce hydrogen from electrolysis
- Manufacturing or processing upstream components, sub-assemblies and materials provided they are purpose-built or designed exclusively to be integral to other eligible clean technology manufacturing and processing activities

Eligible activities would also include extraction and certain processing activities, both before and after the prime metal stage or its equivalent, related to the following six critical minerals essential for clean technology:

1. Lithium
2. Cobalt
3. Nickel
4. Graphite
5. Copper
6. Rare earth elements

Interaction with other federal support

Where property acquired is eligible for multiple tax credits, businesses may only claim one of the following ITCs:

- Clean technology manufacturing
- Clean technology
- Clean electricity
- Clean hydrogen

Further, the ITC for clean technology manufacturing would not be available for property used in the production of battery cells or modules if the production benefits from direct support through a Special Contribution Agreement with the Government of Canada.

Businesses may claim both the ITC for clean technology manufacturing and the Atlantic ITC.

Application and phase-out

The ITC for clean technology manufacturing applies to property acquired and available for use on or after 1 January 2024 and would be gradually phased out for property that becomes available for use in 2032. The credit would no longer be available for property that becomes available for use after 2034. Table C outlines that proposed schedule of rates for the ITC.

Table C — Proposed schedule of ITC rates

Available for use	**2024 to 2031**	**2032**	**2033**	**2034**
Applicable rate for the ITC	30%	20%	10%	5%

Clean technology investment tax credit — Geothermal energy

The 2022 Fall Economic Statement proposed a 30% refundable clean technology ITC for companies investing in eligible property that is acquired and available for use on or after 28 March 2023 (see EY Tax Alert 2022 Issue No. 42, Federal government delivers its Economic and Fiscal Update 2022).

Budget 2023 proposes to expand the eligibility of the clean technology ITC to include property described in subparagraph (d)(vii) of Class 43.1 that is used primarily for the purpose of generating electrical energy or heat energy, or both electrical and heat energy, solely from geothermal energy, including:

- Piping
- Pumps
- Heat exchangers
- Steam separators
- Electrical generating equipment

Equipment used for geothermal energy projects that will co-produce oil, gas or other fossil fuels is not eligible for the ITC.

The clean technology ITC is available for property that (1) has been acquired and becomes available for use on or after 28 March 2023 and (2) has not been used for any purpose prior to acquisition.

In addition to the expansion of the credit, Budget 2023 proposes to modify the phase-out of the credit. Under the Fall Economic Statement, the phase-out of the credit was set to begin in 2032. Budget 2023 proposes to modify the phase-out of the credit such that the rate would remain at 30% for property available for use in 2032 and 2033 and 15% in 2034. The credit will not be available after 2034.

To qualify for the 30% rate, certain labor requirements must be met (see Labor requirements related to certain investment tax credits). A 20% tax rate would apply where businesses do not meet these requirements.

Investment tax credit for clean hydrogen

Budget 2023 provides details of the clean hydrogen tax credit that was first announced in the 2022 Fall Economic Statement. This incentive, with a total estimated cost of $17.7 billion over 12 years, is aimed at helping Canadian companies remain competitive on a global scale and encouraging the use of clean energy.

The clean hydrogen ITC will:

- Provide support between 15% and 40% of eligible project costs, with the rate dependent on the carbon intensity of the production process. Processes with the lowest carbon intensity (measured as kg of carbon dioxide equivalent per kg of hydrogen produced) will earn the highest rate (see Table D below)
- Provide a 15% tax credit on equipment that converts clean hydrogen to ammonia to facilitate transportation
- Be reduced by 10 percentage points if specific labor requirements are not met (see Labor requirements related to certain investment tax credits)

The tax credit will only apply to eligible equipment costs for projects that produce all, or substantially all, hydrogen through their production process. All eligible equipment must be acquired and become available for use in Canada after 28 March 2023. The rates in Table D below apply for eligible property that becomes available for use before 2034. The credit will be phased out by 50% for property that becomes available for use in 2034 and will be fully phased out for property that becomes available for use after 2034.

Table D — Proposed tax credit incentive structure for clean hydrogen production

Carbon intensity tiers [1]	Tax credit rate (applied to eligible costs) [2]
<0.75 kg	40%
0.75 kg to <2.0 kg	25%
2.0 kg to <4 kg	15%
≥ 4.0 kg	Not applicable

[1] Reflects the expected lifecycle emissions of a project based on its carbon intensity (measured as kg of CO2e per kg of hydrogen produced).

[2] Assumes labor requirements are met.

Note that for equipment that may be eligible for multiple tax credits, only one of the following credits can be claimed for that particular property:

- Clean hydrogen tax credit
- Clean electricity tax credit
- Clean technology manufacturing tax credit
- Clean technology investment tax credit
- Carbon capture, utilization and storage tax credit

However, multiple tax credits could be available for the same project if the project includes different types of eligible property.

Clean electricity investment tax credit

This new 15% refundable tax credit has been announced to support clean electricity technologies and proponents to expand the capacity of Canada's clean electricity grid and accelerate our progress towards a net-zero grid.

The credit applies to eligible investments in both new and refurbishment projects relating to:

- Non-emitting electricity generation systems including wind, solar, hydro, wave, tidal and nuclear
- 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
- Equipment for the transmission of electricity between provinces and territories

This credit, estimated to cost a total of $25.7 billion over 12 years, would become available as of the day of Budget 2024 and would apply to projects that had not yet begun construction prior to 28 March 2023. The credit will not be available after 2034.

Similar to the clean hydrogen tax credit, certain labor requirements (see Labor requirements related to certain investment tax credits) must be met to receive the 15% rate. If these requirements are not met, the credit is reduced to by 10 percentage points. The clean electricity ITC could be claimed in addition to the Atlantic ITC, but generally not with any other ITC.

Other requirements for accessing the tax credit in each province and territory will include a commitment by a competent authority that the federal funding will be used to lower electricity bills and a commitment to achieve a net-zero electricity sector by 2035.

Labor requirements related to certain investment tax credits

Budget 2023 contains specific labor requirements that are attached to several ITCs, including the clean technology ITC and the clean hydrogen tax credit. To achieve the maximum tax credit rates, businesses must:

- Pay a total compensation package that equates to the prevailing wage. The definition of prevailing wage would be based on union compensation (including benefits and pension contributions) from the most recent, widely applicable multi-employer collective bargaining agreement or corresponding project labor agreements (in the relevant jurisdiction).
- Ensure at least 10% of the tradesperson hours worked must be performed by registered apprentices in the Red Seal trades.

These labor requirements would apply for workers engaged in project elements that are subsidized by the respective ITC, either as employees of the business or indirectly employed by a contractor or subcontractor. These requirements would apply to workers whose duties are primarily manual or physical in nature, but not to workers who are primarily involved in administrative, clerical, supervisory or executive duties.

Investment tax credit for carbon capture, utilization and storage (CCUS)

Budget 2022 proposed a refundable CCUS tax credit for businesses that incur eligible expenses starting on 1 January 2022 (see EY Tax Alert 2022 Issue No. 31, Proposed federal investment tax credit for CCUS and EY Tax Alert 2022 Issue No. 41, Proposed federal investment tax credit for carbon capture, utilization and storage — update). Budget 2023 proposes that:

- Dual-use equipment that produces heat and/or power or uses water used for CCUS would be eligible for the tax credit provided it meets all other conditions for the CCUS tax credit. For dual-use equipment:
  - The cost of the equipment would be eligible on a pro-rated basis proportional to the expected energy balance or material balance supporting the CCUS process over the first 20 years of the project.

  - Power or heat production equipment would only be eligible if the energy balance is expected to be primarily used (i.e., more than 50%) to support the CCUS process or hydrogen production eligible for the ITC. For equipment producing both heat and power, only one heat or power energy balance would need to meet this requirement.
- British Columbia will be added to the list of eligible jurisdictions for dedicated geological storage for eligible expenses incurred after 1 January 2022.
- Rather than obtaining approval from Environment and Climate Change Canada, taxpayers would need to have their technology validated by a qualified third party to confirm that the process meets the minimum 60% mineralization requirement. The process for CO2 storage in concrete would be evaluated against the ISO 14034:2016 standard "Environmental management — Environmental technology verification."
- A business with property eligible for more than one credit would only be able to claim one ITC for CCUS, ITC for clean technology, ITC for clean electricity, or ITC for clean hydrogen.
- For CCUS tax credits related to eligible refurbishment costs (refurbishment ITCs):
  - Total eligible refurbishment costs over the first 20 years of a project will be limited to 10% of the total pre-operational costs that were eligible for the CCUS tax credit. Refurbishment ITCs will not be available after the end of the 20-year period.
  - The refurbishment ITCs would be recovered if certain thresholds relating to eligible and ineligible uses are not met. (Details will follow in a future EY Tax Alert.)
- In addition to the annual Climate Risk Disclosure report, CCUS projects with $250 million or more in eligible expenses would be required to contribute to public knowledge sharing in Canada. Draft legislative proposals are included in the Notice of Ways and Means Motion.

As in some other ITCs, the Government intends to apply labor requirements to the CCUS ITC, with details to be announced at a later date.

The above measures related to the CCUS tax credit would apply to eligible expenses incurred after 2021 and before 2041.

Mineral exploration tax credit and flow-through shares

Budget 2023 proposes to expand the critical mineral exploration tax credit (CMETC) and flow-through share regime to include eligible expenses related to exploration and development activities for lithium from brines. Eligible expenses related to lithium from brines made after 28 March 2023 will qualify as Canadian exploration expenses and Canadian development expenses. The expanded CMETC applies to expenditures renounced under eligible flow-through share agreements entered into after 28 March 2023 and on or before 31 March 2027.

Dividend received deduction by financial institutions

Intercorporate dividends received from Canadian corporations are generally deductible for the recipient corporation. Budget 2023 proposes to deny the dividend received deduction for dividends received by financial institutions on shares that are mark-to-market property (MTM property).

Shares are MTM property when a financial institution holds less than 10% of vote or value of the corporation issuing the shares. Under the mark-to-market rules, any change in fair value of an MTM property during the year is included in the financial institution's taxable income for that year on account of income. Under the proposed measures, a financial institution, as defined under subsection 142.2(1) of the *Income Tax Act*, will be subject to tax on dividends received on shares from Canadian corporations that are MTM property.

This measure would apply to dividends received after 2023.

Income tax and GST/HST treatment of credit unions

Budget 2023 proposes to eliminate the revenue test from the definition of "credit union" included in the *Income Tax Act* and used in the *Excise Tax Act*, so that credit unions that earn more than 10% of their revenue from sources other than certain specified sources (such as interest income from lending activities) are no longer excluded from the definition. This proposed amendment to the definition of "credit union" for income tax and GST/HST purposes is introduced to accommodate how credit unions currently operate.

The amendment would apply for a credit union's tax years ending after 2016.

Alternative minimum tax (AMT)

Certain investment funds that do not qualify as mutual fund trusts under the *Income Tax Act* are subject to AMT. Budget 2023 proposes to increase the AMT rate (see Minimum tax for top earners below). AMT is generally unavoidable and can generally only be mitigated in situations where discretionary deductions are foregone. The investment funds industry has long sought measures to eliminate or reduce AMT for such funds.

International tax measures

International tax reform

Canada is one of 138 members of the Organisation for Economic Co-operation and Development (OECD)/Group of 20 (G20) Inclusive Framework on Base Erosion and Profit Shifting (the Inclusive Framework) that have joined a two-pillar plan for international tax reform agreed to on 8 October 2021.

Pillar One is intended to reallocate a portion of taxing rights over the profits of large/profitable multinational enterprises (MNEs) to market countries (i.e., where their users and customers are located). Pillar Two is intended to ensure that the profits of large MNEs with annual revenues of €750 million or more are subject to an effective tax rate of at least 15%, regardless of where revenues are earned.

In Budget 2023, the Government provided an update on the most recent developments and upcoming implementation steps regarding the OECD recommendations on Pillar One and Pillar Two.

Pillar One — reallocation of taxing rights: Following publication of the OECD draft rules, consolidated in two major progress reports released in July and October 2022, countries are working toward completing multilateral negotiations so that the convention to implement Pillar One can be signed by mid-2023, with a view to it entering into force in 2024.

Budget 2023 announced that the digital services tax (DST) could be imposed as of 1 January 2024, but only if the multilateral convention implementing the Pillar One framework has not come into force. In that event, the DST would be payable as of 2024 in respect of revenues earned as of 1 January 2022.

Pillar Two — global minimum tax: Consistent with the announcement in Budget 2022, Budget 2023 announces the Government's intention to introduce legislation implementing the income inclusion rule (IIR) and a domestic minimum top-up tax applicable to Canadian entities of MNEs that are within scope of Pillar Two, with effect for fiscal years of MNEs that begin on or after 31 December 2023.

The Government also intends to implement the undertaxed profits rule (UTPR) effective for fiscal years of MNEs that begin on or after 31 December 2024. The Government intends to release draft legislative proposals for the IIR and domestic minimum top-up tax for public consultation in the coming months, with draft legislative proposals for the UTPR to follow at a later time. Budget 2023 also announces the Government's intention to share with provinces and territories a portion of the revenues from the international tax reform.

Previously announced international measures

Budget 2023 confirms the Government's intention to proceed with the following previously announced measures:

- Legislative proposals released on 3 November 2022 with respect to Excessive Interest and Financing Expenses Limitations (EIFEL)[2]
- Legislative proposals released on 9 August 2022, including with respect to the following measures:[3]
  - Foreign affiliate share-for-share exchange exception
  - Foreign merger anti-avoidance
  - Foreign affiliate suppression election
  - Upstream loans from foreign affiliates
  - Base erosion rule for provision of services
  - Other technical amendments to the *Income Tax Act* proposed in the 9 August release
- Legislative proposals released on 29 April 2022 with respect to hybrid mismatch arrangements[4]
- The transfer pricing consultation announced in Budget 2021[5]

Anti-avoidance measures

Intergenerational share transfers

Section 84.1 of the *Income Tax Act* is an anti-surplus stripping rule designed to prevent the extraction of corporate surplus as a capital gain and would often apply to the intergenerational transfer of shares of a corporation. On 29 June 2021, private member's Bill C-208, *An Act to amend the Income Tax Act (transfer of small business or family farm or fishing corporation),* received Royal Assent. Bill C-208 contained amendments to section 84.1, including the introduction of an exception to the application of section 84.1 in respect of certain intergenerational transfers (the Intergenerational Transfer Exemption). Budget 2022 indicated that this exception may unintentionally permit surplus stripping without requiring a genuine intergenerational business transfer, and a consultation was launched on 7 April 2022 to solicit feedback from taxpayers as to how the existing rules could be modified to facilitate genuine intergenerational business transfers while maintaining the integrity of the tax system.

Consistent with the comments in Budget 2022, Budget 2023 proposes to introduce additional requirements to the Intergenerational Transfer Exemption to ensure it applies only where a **genuine** intergenerational business transfer takes place. The following existing conditions will be maintained:

- The transferor must be an individual (other than a trust).
- The transferred corporation shares must be qualified small business corporation shares or shares of the capital stock of a family farm or fishing corporation.
- The purchaser corporation must be controlled by one or more adult child of the transferor (which is defined to include grandchildren, stepchildren, children-in-law, nieces and nephews, and grandnieces and grandnephews).

In addition to the above, Budget 2023 proposes that, to obtain the Intergenerational Transfer Exemption, the transfer must be either an "Immediate Intergenerational Business Transfer" or a "Gradual Intergenerational Business Transfer." The key conditions of each are as follows:

Immediate Intergenerational Business Transfer

- At all times after the sale, the parents cannot legally or factually control the transferred corporation.
- Parents must immediately transfer a majority of the shares of the transferred corporation to the children and transfer the balance of the shares within 36 months (in each case, non-voting preferred shares are exempt from this condition).
- The child(ren) must retain legal control of the transferred corporation, and at least one child must remain actively involved in the transferred business, for a 36-month period following the share transfer.
- Parents must transfer management of the business to their child(ren) within a reasonable time, based on the particular circumstances (with a 36-month safe harbor).

Gradual Intergenerational Business Transfer

- At all times after the sale, the parents cannot legally control the transferred corporation.
- Parents must immediately transfer a majority of the shares of the transferred corporation to the children and transfer the balance of the shares within 36 months (in each case, non-voting preferred shares are exempt from this condition).
- Within 10 years of the initial sale, parents must reduce the economic value of their debt and equity interests in the transferred corporation to: (a) 50% if it is a family farm or fishing corporation, or (b) 30% if it is a qualified small business corporation, as compared to the time of the sale.
- The child(ren) must retain legal control of the transferred corporation, and at least one child must remain actively involved in the transferred business, for a 60-month period following the share transfer (or a longer period lasting until the reduction of economic value referred to above occurs).
- Parents transfer management of the business to their child(ren) within a reasonable time based on the particular circumstances (with a 60-month safe harbor).

Certain other conditions also exist relating to the control or ownership of shares of the purchaser corporation or of other entities that carry on a business related to the transferred corporation's business.

Budget 2023 also proposes changes to the current provisions of the Intergenerational Transfer Exemption dealing with subsequent transfers of the transferred shares and to the lifetime capital gains exemption formula used for purposes of this provision.

The transferor and child (or children) will be required to jointly elect for the Intergenerational Transfer Exemption to apply. The child (or children) will be jointly and severally liable for any additional taxes payable by the transferor if the transfer does not qualify for the Intergenerational Transfer Exemption.

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

Budget 2023 also proposes to provide a 10-year capital gains reserve for transfers that qualify for the Intergenerational Transfer Exemption.

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

General anti-avoidance rule (GAAR)

Following the consultation launched on 9 August 2022 on the modernization of the GAAR, Budget 2023 proposes to amend the GAAR by (1) introducing a preamble; (2) lowering the avoidance transaction standard; (3) introducing a "lack of economic substance" test; and (4) introducing a 25% penalty and extending the reassessment period by three years.

1. The proposed preamble explains that the GAAR (a) applies to deny a tax benefit if a transaction misuses or abuses the *Income Tax Act*, but allows tax benefits contemplated by the Act, (b) balances a taxpayer's need for certainty and the Government's need to protect the tax base and "the fairness of the tax system," and (c) can apply regardless of whether a tax strategy is foreseen.
2. The avoidance transaction threshold would be reduced. Currently, GAAR does not apply if a transaction was undertaken primarily for bona fide reasons other than to obtain a tax benefit. Now a transaction will be an avoidance transaction if "one of the main purposes" was to obtain a tax benefit.
3. A transaction will tend to misuse or abuse if it "is significantly lacking in economic substance." The legislation includes a list of non-exhaustive factors that "tend" to indicate a significant lack of economic substance, including no change in opportunity for gain, profit or risk of loss, the value of the tax benefit exceeding the non-tax economic return, and the transaction being substantially undertaken to obtain the tax benefit.
4. GAAR transactions will now be subject to a 25% penalty and a three-year extension to the normal reassessment period, unless the transaction has been voluntarily or mandatorily disclosed to the Canada Revenue Agency (CRA).

The Crown will still bear the burden of establishing the underlying object, spirit and purpose of the provisions or scheme of the Act. The 9 August 2022 consultation paper had proposed shifting this burden to the taxpayer.

A consultation period will remain open for comments until 31 May 2023, following which the Government intends to publish revised legislative proposals and announce the application date of the amendments.

Tax measures for individuals and trusts

Personal income tax rates

There are no personal income tax rate or tax bracket changes in this budget. The brackets will continue to be indexed for inflation.

See Table E for the 2023 federal personal income tax rates and brackets and the Appendix for the top combined marginal rates by province and territory.

Table E — Federal personal income tax rates

	2023
Up to $53,359	15.0%
$53,360 to $106,717	20.5%
$106,718 to $165,430	26.0%
$165,431 to $235,675	29.0%
Over $235,675	33.0%

Minimum tax for top earners

Following the Government's commitment announced in Budget 2022 to examine a new minimum tax regime to ensure all wealthy Canadians pay their fair share of tax, Budget 2023 proposes several changes to broaden the AMT regime, effective for tax years beginning after 2023, as follows:

- Increasing the AMT rate from 15% to 20.5% of adjusted taxable income (calculated for AMT purposes)
- Amending the calculation of adjusted taxable income by:

  - Increasing the AMT capital gains inclusion rate from 80% to 100% and including 100% of the benefit associated with employee stock options in the AMT base. Capital loss carryforwards and allowable business investment losses would apply at a 50% inclusion rate.
  - Including 30% of capital gains on donations of publicly listed securities in the AMT base, mirroring the AMT treatment of capital gains eligible for the lifetime capital gains exemption.
  - Disallowing 50% of several types of deductions, including deductions for CPP, QPP, and PPIP contributions, moving expenses, childcare expenses, interest and carrying charges incurred to earn income from property, non-capital loss carryovers, employment expenses (other than those to earn commission income), and the deduction for workers' compensation and social assistance payments. Certain other deductions are also subject to the 50% limitation.
- Disallowing 50% of non-refundable tax credits that are currently fully available to reduce the AMT. The special foreign tax credit calculated for AMT purposes will continue to be allowed in full (based on the new AMT rate). Non-refundable credits that are currently disallowed would continue to be disallowed in full, including the political contribution tax credit, the labor sponsored venture capital corporations credit, the non-refundable portion of ITCs and the dividend tax credit.
- Increasing the basic exemption from $40,000 to an amount corresponding to the lower threshold amount of the fourth federal income tax bracket (expected to be approximately $173,000 in 2024). The basic exemption will be indexed annually to inflation.

Grocery Rebate

Budget 2023 proposes a one-time payment to eligible individuals as targeted inflation relief known as the Grocery Rebate. It will be paid as soon as possible once the corresponding legislation is enacted, through the Goods and Services Tax Credit (GSTC) system, by increasing an eligible individual's entitlement for the January 2023 payment. Specifically, eligible individuals will receive an additional GSTC amount equal to twice the current credit amount received for January. The rebate remains non-taxable and income-tested in accordance with the GSTC system, and the existing income thresholds are unchanged.

Deduction for tradespeople's tool expenses

Budget 2023 proposes to increase the deduction available to a tradesperson for the purchase of eligible new tools from $500 to $1,000 effective for 2023 and subsequent years. This increased deduction allows a tradesperson to claim up to $1,000 of the amount by which the total cost of eligible new tools acquired in a tax year as a condition of employment exceeds the amount of the Canada employment credit ($1,368 in 2023). The total amount deducted may not exceed the total employment income earned as a tradesperson and any apprenticeship grants received to acquire the tools and included in income.

As a result of the increase in the deduction for tradespeople's tool expenses, the calculation of the separate deduction for the purchase of tools by eligible apprentice vehicle mechanics will be similarly amended to equal the cost in excess of the greater of $1,000 (increased from $500) plus the Canada employment credit, and 5% of the employee's total income for the year from being an eligible apprentice mechanic.

Registered education savings plans

Budget 2023 proposes to increase certain limits on educational assistance payments (EAPs) that may be withdrawn from a registered education savings plan (RESP) to assist with a beneficiary's post-secondary education-related expenses. Effective 28 March 2023, the proposed new withdrawal limit will increase from $5,000 to $8,000 in respect of the first 13 consecutive weeks of enrollment in a 12-month period for RESP beneficiaries who are full-time students, and from $2,500 to $4,000 per 13-week period for beneficiaries enrolled in part-time programs. Individuals who have already withdrawn EAPs may be permitted to withdraw an additional amount up to the new limit, subject to the terms of their plan, which may need to be amended by promoters to allow for this proposal.

Budget 2023 also proposes to allow divorced or separated parents to open joint RESPs for one or more of their children, or to move an existing joint RESP to another promoter, effective 28 March 2023.

Registered disability savings plans

Budget 2023 proposes to extend an existing temporary measure that is legislated to expire on 31 December 2023, allowing a qualifying family member who is a parent, spouse or common-law partner to open a registered disability savings plan (RDSP) and be the plan holder for an adult beneficiary whose capacity to enter into an RDSP contract is in doubt and who does not have a recognized legal representative. The proposal extends this temporary measure by three years, to 31 December 2026. A qualifying family member who becomes a plan holder before the end of 2026 could remain the plan holder after 2026.

Budget 2023 also proposes a broadening of the definition of "qualifying family member" to include a brother or sister of an adult beneficiary whose capacity to enter into an RDSP contract is in doubt and who does not have a recognized legal representative. This proposal will also be in effect until 31 December 2026.

Other personal tax measures

The following additional personal tax measure was announced:

Taxpayer information sharing for the Canadian Dental Care Plan

Budget 2023 proposes amendments to the *Income Tax Act* (as well as to the *Excise Tax Act* and *Excise Act, 2001*) to allow the CRA to share taxpayer information with Health Canada and Employment and Social Development Canada for the purpose of delivering the Canadian Dental Care Plan.

Employee ownership trusts

An employee ownership trust (EOT) is a form of employee ownership where a trust holds shares of a corporation for the benefit of the corporation's employees. A key appeal of an EOT is that it can be used to facilitate the purchase of a business by its employees without employees having to pay directly to acquire the shares. Typically, the underlying business will loan funds to the EOT, which then uses the funds to acquire a controlling interest in the business. The business is held in the EOT for the benefit of employees, and the loan is repaid out of earnings generated by the business.

An EOT is defined as a Canadian-resident trust that holds a **controlling interest** in a **qualifying business** where shares held for the benefit of employee beneficiaries and distributions are made to employee beneficiaries under a distribution formula that can only consider an employee's length of service, remuneration and hours worked. Otherwise, all beneficiaries must generally be treated in a similar manner.

All or substantially all the assets of the trust must be shares of a **qualifying business,** which is defined as a corporation that is a CCPC where all or substantially all of the fair market value of its assets is attributable to assets used in an active business carried on in Canada. Beneficiaries of the trust must consist exclusively of **qualifying employees,** which is defined as individuals employed by a qualifying business or a qualifying business that it controls.

Budget 2023 introduces several measures to provide efficacy to the EOT regime.

1. 10-year capital gains reserve
    - The EOT regime is premised on the idea that the shares acquired by the EOT are paid for over time from earnings generated by the business.
    - Recognizing that it can take time for the business to generate sufficient earnings to enable the EOT to pay the purchase price, Budget 2023 proposes to extend the capital gains reserve from 5 years to a maximum of 10 years in the case of a **qualifying business transfer** to an EOT.
2. New exception to shareholder loan rules
    - Recognizing that it will take EOTs longer to repay loans from earnings, Budget 2023 proposes to introduce a new exception to extend the repayment period from 1 to 15 years for amounts loaned to the EOT from the qualifying business to purchase shares.
3. Exception to 21-year deemed disposition
    - Since an EOT is intended to allow for shares to be held indefinitely, the 21-year deemed disposition could create a significant tax liability for the EOT.
    - Budget 2023 proposes to exempt EOTs from the 21-year deemed disposition rule.

The EOT amendments would apply as of 1 January 2024.

Retirement compensation arrangements (RCA)

A letter of credit (LOC) is a common way to secure employee retirement benefits. Where a LOC has been used, the arrangement was considered "funded," thereby triggering the obligation to remit refundable tax.

Since the LOC is only security to the employees and payment of retirement benefits is made from general company revenues, no mechanism to receive a return of refundable tax existed. Effective as of 28 March 2023, a LOC fee will

no longer attract refundable tax requiring the remittance of refundable tax.

Starting in 2024, it will be possible to obtain a refund of refundable tax held by the CRA in respect of arrangements secured by a LOC. Where payment secured by a LOC is made in 2024 and later years, employers will be eligible for a refund of 50% of the payments made up to the amount of the refundable tax remitted to the CRA in respect of the LOC fee.

Sales and excise tax legislative amendments

GST/HST measures

GST/HST treatment of payment card clearing services: In light of a recent Federal Court of Appeal decision, Budget 2023 proposes to amend the GST/HST definition of "financial service" to clarify that payment card clearing services rendered by a payment card network operator (e.g., payment processing and messaging services) are excluded from the definition to ensure that such services generally continue to be subject to the GST/HST (addition of new paragraph (r.6) in the definition of "financial service").

This measure would apply to a service rendered under an agreement for a supply if any consideration for the supply becomes due, or is paid without becoming due, after 28 March 2023.

Furthermore, this measure would also apply to a service rendered under an agreement for a supply if all of the consideration for the supply became due, or was paid, on or before 28 March 2023, except in certain situations, generally being where the following two conditions were both met:

- The supplier did not, on or before 28 March 2023, charge, collect or remit any amount as or on account of tax in respect of the supply.
- The supplier did not, on or before 28 March 2023, charge, collect or remit any amount as or on account of tax in respect of any other supply that is made under the agreement and that includes the provision of a payment card clearing service.

As such, a recipient who was charged by the supplier an amount as or on account of tax in respect of a payment card clearing service on or before 28 March 2023 should be viewed as having acquired a taxable supply and not an exempt supply of financial service.

Excise duty measures

Alcohol excise duty: Budget 2023 proposes to temporarily cap the inflation adjustment for excise duties on beer, spirits and wine at 2%, instead of adjusting the duties based on the total Consumer Price Index inflation, for one year only, as of 1 April 2023. The proposed alcohol excise duties are as follows:

Table F — Proposed alcohol excise duty rates as of 1 April 2023[1]

	Rate for 2022-23	Rate for 2023-24 (proposed adjustment)
Spirits[2]	$13.042	$13.303
Wine[3]	$0.688	$0.702
Beer[4]	$34.820	$35.516

[1] No excise duty is imposed on alcoholic products containing not more than 0.5% alcohol by volume.

[2] Rates per liter of absolute ethyl alcohol. Reduced rates apply to spirits containing not more than 7% alcohol by volume.

[3] Rates per liter of wine. Reduced rates apply to wine containing not more than 7% alcohol by volume.

[4] Rates per hectoliter of beer. Reduced rates apply for domestic brewers to the first 75,000 hectoliters of beer brewed in Canada each calendar year.

Cannabis taxation — Quarterly duty remittances: Budget 2023 proposes to amend the *Excise Act, 2001* to allow all licensed cannabis producers — not just certain smaller producers — to remit excise duties on a quarterly rather than monthly basis, starting from the quarter beginning on 1 April 2023.

Air travelers security charge: Budget 2023 proposes to increase the air travelers security charge (ATSC) rates by 32.85% to maintain and increase the Canadian Air Transport Security Authority's level of service, improve screening wait times and strengthen security measures at airports. The proposed ATSC rates are as follows:

Table G — Proposed ATSC rates[1]

	Current	May 2024 and ongoing
Domestic (one-way)	$7.48	$9.94
Domestic (round trip)	$14.96	$19.87
Transborder	$12.71	$16.89
Other international	$25.91	$34.42

[1] The above rates include the GST or the federal portion of the HST, where applicable.

The proposed new ATSC rates will apply to air transportation services that include a "chargeable emplanement" on or after 1 May 2024, for which any payment is made on or after that date.

Customs measures

Renewal of General Preferential Tariff (GPT) and Least Developed Country Tariff (LDCT)

Budget 2023 proposes to introduce amendments to the *Customs Tariff* to renew Canada's GPT and LDCT until the end of 2034, as well as to update these programs, notably to align them with Canada's progressive trade agenda. To that end, Budget 2023 proposes the creation of a GPT+ program that will encourage countries to adhere to international standards on human rights, labor conditions, gender equality and climate change. The updates would also include expanding benefits for certain import categories and simplifying administrative requirements for Canadian importers.

Indefinite withdrawal of most-favored-nation (MFN) status from Russia and Belarus

On 2 March and 12 October 2022, Canada withdrew entitlement to the MFN Tariff for goods that originate in Belarus and goods that originate in Russia. Budget 2023 proposes to amend the *Customs Tariff* to indefinitely extend the withdrawal of MFN preferential tariff treatment for Russian and Belarusian imports.

Eradicating forced labor from Canadian supply chains

Budget 2023 announces the federal Government's intention to introduce legislation by 2024 to eradicate forced labor from Canadian supply chains to strengthen the import ban on goods produced using forced labor. The Government will also work to ensure existing legislation fits within the Government's overall framework to safeguard Canadian supply chains.

Traveler modernization

Budget 2023 proposes to introduce amendments to the *Customs Act* that will allow the Canada Border Services Agency to transform how low-risk travelers are processed when entering Canada through enhanced use of technology.

Pending legislation

Budget 2023 confirms that the Government will proceed with the following pending legislative and regulatory proposals and other previously announced measures, modified to take into account consultations and deliberations since their release.

Income tax

- 3 November 2022 Economic and Fiscal Update (SR&ED program review, extension of residential property flipping rule to assignment sales, and advance quarterly Canada workers benefit payments) (refer to EY Tax Alert 2022 Issue No. 42)
- 3 November 2022 revised draft legislative proposals on the EIFEL rules (refer to EY Tax Alert 2022 Issue No. 43)
- 3 November 2022 draft legislative proposals on new reporting rules for digital platform operators
- 9 August 2022 remaining draft legislative proposals (refer to EY Tax Alert 2022 Issues No. 37 and 41)
    - Business income tax measures (ITC for carbon capture, utilization and storage and new capital cost allowance classes 59 and 60 for intangible exploration and development expenses related to storage of captured carbon, mandatory disclosure rules, hedging and short selling by financial institutions, substantive CCPCs, and elimination of tax deferral advantage for investment income earned through controlled foreign affiliates)
    - Personal income tax measures (defined contribution pension plans, veterans' and active service members' benefits, and borrowing by defined benefit pension plans)
    - Administrative measures (e-filing and certification of tax and information returns, and reporting requirements for RRSPs and RRIFs by financial institutions)
- 9 August 2022 draft legislative proposals for numerous income tax technical amendments (refer to EY Tax Alert 2022 Issue No. 40)
- 29 April 2022 legislative proposals relating to hybrid mismatch arrangements (refer to EY Tax Alert 2022 Issue No. 29)
- Remaining Budget 2022 tax measures (7 April 2022) not yet released as draft legislative proposals (career extension tax credit and collection of charity information) (refer to EY Tax Alert 2022 Issue No. 23)
- Notice of ways and means motion to introduce an *Act to implement a Digital Services Tax* (14 December 2021) (refer to EY Tax Alert 2021 Issue No. 36)
- Remaining Budget 2021 tax measures (19 April 2021) not yet released as draft legislative proposals (transfer pricing changes) (refer to EY Tax Alert 2021 Issue No. 19 and EY Tax Alert 2022 Issue No. 38)
- 20 December 2019 draft legislative proposal relating to amateur athlete trusts (extension of trust maturation period from eight years to nine years)

Indirect taxes

- 20 December 2022 draft regulations regarding *Greenhouse Gas Pollution Pricing Act* (GGPPA) and the *Fuel Charge Regulations* (adds Nova Scotia, Prince Edward Island, and Newfoundland and Labrador to listed provinces covered by the federal fuel charge and sets fuel charge rates for periods after 31 March 2023)
- Proposed regulations amending the *Output-Based Pricing System Regulations* and the *Environmental Violations Administrative Monetary Penalties Regulations* under the GGPPA and the *Environmental Violations Administrative Monetary Penalties Act* (29 October 2022)
- 9 August 2022 draft legislative proposals
    - GST/HST measures (election for exempt supplies of financial services, election for nil consideration, information reporting requirements for pension plans and pension entities, various changes to the *Selected Listed Financial Institution Regulations*, application rules for Lloyd's associations, and joint venture election extension)
    - Select luxury items tax measures regarding transition, relief for aircraft sales for export, and reporting simplification (14 July 2022) (refer to EY Tax Alert 2022 Issue No. 39)
    - Excise duty measures regarding exemption for cider/mead (14 July 2022)
    - Budget 2021 administrative measures (e-filing, e-correspondence and electronic payment)
- 9 August 2022 draft regulations amending the fuel charge regulations (relief for certain fuels and rebate for fuel removed from a listed province)
- Remaining Budget 2022 excise duty measures regarding virtual audits (7 April 2022) (refer to EY Tax Alert 2022 Issue No. 23)
- Remaining 4 February 2022 draft GST/HST legislative proposals regarding crypto asset mining activities (refer to EY Tax Alert 2022 Issue No. 3)
- Remaining Budget 2021 GST/HST/excise tax measures regarding input tax credit information requirements and excise tax rebate on goods purchased by provinces (19 April 2021) (refer to EY Tax Alert 2021 Issue No. 19)
- Remaining Budget 2016 GST/HST measures regarding joint venture election (stemming from the 2014 proposals) (22 March 2016) (refer to EY Tax Alert 2016 Issue No. 14)

Webcasts

28 March 2023 webcast: The evening of the Finance Minister's address, members of the EY Tax team recorded their analysis and insights on the tax measures in the 2023 budget. View our webcast at EY.com/ca/Budget.

Learn more

For more information on the above measures or any other topics that may be of concern, contact your EY or EY Law advisor. And for up-to-date information on the federal, provincial and territorial budgets, visit EY.com/ca/Budget.

Appendix

Maximum combined personal marginal income tax rates (as of 28 March 2023)[6]

	Ordinary income			2023		
	2022	2023	Increase (decrease)	Eligible dividends	Ordinary dividends	Capital gains
	%	%	%	%	%	%
Federal only	33.00	33.00	0.00	24.81	27.57	16.50
BC	53.50	53.50	0.00	36.54	48.89	26.75
Alberta	48.00	48.00	0.00	34.31	42.30	24.00
Saskatchewan	47.50	47.50	0.00	29.64	41.82	23.75
Manitoba	50.40	50.40	0.00	37.78	46.67	25.20
Ontario	53.53	53.53	0.00	39.34	47.74	26.76
Québec	53.31	53.31	0.00	40.11	48.70	26.65
NB	53.30	52.50	(0.80)	32.40	46.83	26.25
NS	54.00	54.00	0.00	41.58	48.27	27.00
PEI	51.37	51.37	0.00	34.22	47.04	25.69
NL	54.80	54.80	0.00	46.20	48.96	27.40
NWT	47.05	47.05	0.00	28.33	36.82	23.53
Nunavut	44.50	44.50	0.00	33.08	37.79	22.25
Yukon	48.00	48.00	0.00	28.92	44.05	24.00

Contact Information
For additional information concerning this Alert, please contact:

Ernst & Young LLP (Canada), Toronto
- **Linda Tang** (linda.y.tang@ca.ey.com)
- **Mark Kaplan** (mark.kaplan@ca.ey.com)
- **Phil Halvorson** (phil.d.halvorson@ca.ey.com)
- **Terri McDowell** (terri.mcdowell@ca.ey.com)
- **Trevor O’Brien** (trevor.obrien@ca.ey.com)

Ernst & Young LLP (Canada), Quebec and Atlantic Canada
- **Albert Anelli** (albert.anelli@ca.ey.com)
- **Angelo Nikolakakis** (angelo.nikolakakis@ca.ey.com)
- **Brian Mustard** (brian.mustard@ca.ey.com)
- **Nicolas Legault** (nicolas.legault@ca.ey.com)
- **Nik Diksic** (nik.diksic@ca.ey.com)

- **Philippe-Antoine Morin** (philippe-antoine.morin@ca.ey.com)

Ernst & Young LLP (Canada), Prairies

- **Mark Coleman** (mark.coleman@ca.ey.com)
- **Liza Mathew** (liza.mathew@ca.ey.com)

Ernst & Young LLP (Canada), Vancouver

- **Eric Bretsen** (eric.r.bretsen@ca.ey.com)

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ENDNOTES

[1] Currency references in this Alert are to the CA$.

[2] *See* EY Tax Alert 2022 Issue No. 43.

[3] *See* EY Tax Alert 2022 Issue No. 40.

[4] *See* EY Tax Alert 2022 Issue No. 29.

[5] *See* EY Tax Alert 2021 Issue No. 19.

[6] The income threshold at which the top personal marginal income tax rate applies varies by jurisdiction.

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