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FEDERAL BUDGET 2021

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2021 Canadian Federal Budget Commentary – Tax Measures

INTRODUCTION

On April 19, 2021 (Budget Day), Deputy Prime Minister and Finance Minister Chrystia Freeland tabled the Liberal Government's 2021 budget (Budget 2021). Budget 2021 is titled "A Recovery Plan for Jobs, Growth, and Resilience" and unveils $101.4 billion in new spending. Budget 2021 indicates that the federal deficit is projected to be $354.2 billion for the year that just ended and $154.7 billion for the 2021-22 fiscal year.

Contrary to pre-budget rumours, Budget 2021 does not include measures increasing the capital gains inclusion rate, eliminating the principal residence exemption or imposing a wealth tax. In addition, it does not propose any increase to personal or corporate tax rates.

Budget 2021 does include a number of very significant tax proposals, some of which were expected and many of which were not. Our commentary, which focuses on the tax measures in Budget 2021 that are most relevant to businesses, is provided below.

Unless otherwise stated, all statutory references below are to the *Income Tax Act* (Canada) (Tax Act).

INTERNATIONAL TAX MEASURES

BASE EROSION AND PROFIT SHIFTING (BEPS)

Interest Deductibility Limits

Budget 2021 introduces a new earnings-stripping rule to address the policy concern that existing Canadian rules, including the thin capitalization rules, are inadequate to protect the Canadian tax base from erosion. The Government's concern is that interest expense payable by a Canadian resident may erode the Canadian tax base inappropriately where

– the interest is receivable by a related party resident in a low-tax jurisdiction;

- the debt was incurred to acquire an asset yielding non-taxable income; or
- the Canadian resident bears a "disproportionate" portion of the third-party debt of the consolidated group.

In its report, "Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 Update," the Organisation for Economic Co-operation and Development (OECD) proposed earnings-stripping rules. They limit the deductibility of interest expense to an amount that is based on a fixed ratio of earnings before interest, taxes, depreciation and amortization (EBITDA). Several countries have adopted this approach in recent years. In Budget 2021, the Government proposes the new Canadian earnings-stripping rule, while preserving existing thin capitalization rules, to align Canadian tax policy with emerging international norms.

The new Canadian rule

- will limit the amount of interest expense that may be deducted in computing income of a corporation, a trust, a partnership and a Canadian branch of a non-resident for a taxation year;
- will deny a deduction for "net interest" that exceeds a fixed ratio of "tax EBITDA";
- is phased-in by varying the fixed ratio over a transitional period; and
- applies to existing and new borrowings.

Net interest generally comprises the difference between interest expense and interest income. However, interest expense would exclude interest that is not deductible under the thin capitalization rules. Further, interest expense and interest income would include financing charges and amounts that are economically equivalent to interest. In addition, interest income and interest expense on debts between Canadian group members would be excluded in order, among other things, to permit Canadian loss utilization arrangements. In turn, tax EBITDA means taxable income before taking into account interest expense, interest income, income tax, and deductions for depreciation and amortization, as computed under Canadian tax rules.

If the taxpayer is part of a consolidated group, it may be permitted to deduct interest expense based on a higher "group ratio" if it can show that the ratio of net interest owing on third-party debt against "book EBITDA" of the consolidated group indicates that a higher interest deduction limit is appropriate. For these purposes, the consolidated group comprises the parent company and all of its fully-consolidated subsidiaries for purposes of its audited financial statements. In this regard, Budget 2021 states that consistent with the rationale of the group ratio rule, "it is expected that standalone Canadian corporations and Canadian corporations that are members of a group none of whose members is a non-resident would, in most cases, not have their interest expense deductions limited under the proposed rule." The Government will explore measures to relieve the compliance burden on these taxpayers.

Canadian group members may transfer unused interest deductibility capacity to other Canadian group members. Denied interest expense could be carried back for up to three years, or forward for up to twenty years. The deductibility of the carryover interest expense in a prior year is based on whether the taxpayer would have had capacity to deduct the interest, if the new limitation rule had applied in that year.

The new limitation does not apply to a Canadian-controlled private corporation (CCPC) if the "taxable capital employed in Canada" (as determined for purposes of subsection 125(5.1)) of the corporation and its associated corporations is less than $15 million. The rule also does not apply to groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $250,000 or less. No exemptions are mentioned for partnerships or for capital-intensive businesses, such as farming or real estate.

The Government acknowledges that crafting an interest deduction limitation rule that is appropriate for financial institutions is challenging. The Government invites stakeholder comments on whether other targeted measures should be implemented to counter base erosion concerns for regulated banks and insurance companies.

The new earnings-stripping rule will be phased in gradually, applicable to taxation years that begin on or after January 1, 2023. Transitional rules will include the following:

- For taxation years beginning in calendar year 2023, the fixed ratio is 40%. Interest expense deductions that are denied in 2023 may be carried back to any of the three prior taxation years, subject to satisfying the greater of the 40% fixed ratio and the group ratio in that earlier taxation year.
- For taxation years thereafter, the fixed ratio shrinks to 30%. Interest deductions that are denied in 2024 or a later taxation year may be carried back to any of the three prior taxation years, subject to satisfying the greater of the 30% fixed ratio and the group ratio in that earlier taxation year.

The Government expects to release draft legislative proposals for public comment in the summer of 2021. The estimated fiscal impact of the proposals is $5.316 billion through 2026. Budget 2021 indicates that 75% of that tax revenue results from an expectation that the new rules will prevent debt from being shifted to Canada.

Hybrid Mismatch Arrangements

Budget 2021 also proposes to address hybrid mismatch arrangements. Hybrid mismatch arrangements involve entities or instruments that are treated differently under Canadian tax law and foreign tax law, producing aggregate tax benefits for the consolidated group.

The proposals align with the OECD's work on hybrid mismatches in connection with BEPS. In one of its final reports, "Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report" (Action 2 Recommendations), the OECD made a number of recommendations to tackle the perceived problem. The Action 2 Recommendations are very complex, and they invite policymakers to draft domestic tax rules that depend, in part, on the tax treatment of a transaction in one or more foreign jurisdictions. Following the report's release, a number of countries (including European Union member states, the United Kingdom and the United States) enacted measures to address hybrid mismatch arrangements.

Budget 2021 focuses on two types of hybrid mismatches: (i) a "deduction, non-inclusion" (DNI) mismatch, and (ii) a double-deduction mismatch. A DNI mismatch occurs where a cross-border payment produces a deduction in the payer's country without generating taxable income in the recipient's country. This result can arise for a payment under a hybrid financial instrument (such as an interest payment under a hybrid debt or a dividend payment under a repurchase obligation [REPO]), a disregarded payment made by a hybrid entity, or a payment made to a reverse hybrid entity. In turn, a double-deduction mismatch arises where a payment gives rise to a deduction in two countries simultaneously. This result can arise for a deductible payment made by a hybrid entity or reverse-hybrid entity (such as an interest payment under a "tower" financing structure) or a deductible payment made by a dual-resident entity.

Budget 2021 proposes to deny a deduction for a payment by a Canadian resident under a hybrid mismatch arrangement to the extent that it produces a further deduction in another country or is not included in the ordinary income of a non-resident recipient. Further, if a non-resident makes a payment under a hybrid mismatch arrangement that is deductible under foreign tax law, Budget 2021 states that "no deduction in respect of the payment would be permitted against the income of a Canadian resident." The new rules also deny a deduction in computing taxable income for a Canadian resident that receives a dividend payment from a foreign affiliate under a hybrid mismatch arrangement.

Budget 2021 acknowledges other forms of hybrid mismatches, such as imported mismatches and branch mismatches. An imported mismatch arises where a cross-border payment is deductible in the payer's country and included in computing income in the recipient's country, but is offset by another deduction in the recipient's country under a hybrid mismatch arrangement with a third country. In turn, a branch mismatch arises where a permanent establishment in a source country allocates income and expenses differently than the taxpayer's jurisdiction of residence. Budget 2021 provides that these forms will be addressed in the future, where relevant and appropriate in the context of the Canadian tax landscape.

Budget 2021 provides that the new measures will be mechanical in nature, and not based on a purpose test. They will apply to a payment between related entities and, if the payment is designed to create a hybrid mismatch, between unrelated entities. The Government will strive to coordinate with other countries by following the ordering rules set out in the Action 2 Recommendations in order to avoid double taxation or other negative consequences. For example, the

payer's jurisdiction may deny a deduction for a payment under a hybrid mismatch arrangement, failing which the recipient's jurisdiction may require the amount to be included in taxable income.

The Government will implement these measures in two legislative packages. The first set of rules, expected to be released later in 2021 for stakeholder comments, will be limited to DNI mismatches in respect of hybrid instruments. Once settled, the first set of rules will apply to payments as of July 1, 2022. The second legislative package will address all of the other topics raised in the Action 2 Recommendations; these rules will be released for stakeholder comment after 2021, and will apply no earlier than 2023. This delay provides time for taxpayers to restructure their affairs in contemplation of the advent of these rules.

TRANSFER PRICING

Budget 2021 announces the Government's intention to begin a consultation process on Canada's transfer pricing rules with a view to protecting the integrity of the tax system while preserving Canada's attractiveness for foreign investment. The Government expects to release a consultation paper "in the coming months" to allow stakeholders to comment on possible measures to improve Canada's transfer pricing rules. The consultation is a response to the Federal Court of Appeal decision in *Her Majesty The Queen v. Cameco Corporation* (2020 FCA 112), which the Government believes may encourage the inappropriate shifting of a corporation's income out of Canada, artificially reducing the corporation's taxes owed in Canada.

BUSINESS TAX MEASURES

EMERGENCY BUSINESS SUPPORTS

The Canada Emergency Wage Subsidy (CEWS), Canada Emergency Rent Subsidy (CERS) and Lockdown Support programs were scheduled to expire at the conclusion of the qualifying period ending June 5, 2021. Budget 2021 proposes to extend these support programs for an additional four qualifying periods, as follows:

- Period 17 – June 6 to July 3, 2021;
- Period 18 – July 4 to July 31, 2021;
- Period 19 – August 1 to August 28, 2021; and
- Period 20 – August 29 to September 25, 2021.

Budget 2021 also provides that the Government could further extend the support programs until November 20, 2021 by adding two additional qualifying periods:

- Period 21 – September 26 to October 23, 2021; and
- Period 22 – October 24 to November 20, 2021.

Budget 2021 also proposes a number of changes to the CEWS, CERS and Lockdown Support programs, and introduces a new Canada Recovery Hiring Program. Budget 2021 estimates that the extended CEWS and CERS (including Lockdown Support) programs will cost the Government $10.140 billion and 1.920 billion, respectively, and that the Canada Housing Recovery Hiring Program will cost the Government $595 million.

CEWS

Phase-out Rate Reduction

The current CEWS in respect of active employees (i.e., employees who are not on leave with pay during the particular week) consists of a base subsidy for eligible employers that have experienced any amount of revenue decline and a top-up subsidy for employers that have experienced a revenue decline of more than 50%. Budget 2021 proposes, beginning with Period 18, to gradually reduce the base CEWS amount and require that the eligible employer have a revenue decline

of more than 10%. Budget 2021 provides the following table containing the proposed CEWS rates in respect of active employees for Periods 17 to 20.

	Period 17 **June 6-July 3**	**Period 18** **July 4 – July 31**	**Period 19** **August 1 – August 28**	**Period 20** **August 29 – September 25**
Maximum weekly benefit per employee*	$847	$677	$452	$266
Revenue decline:				
70% and over:	75% (i.e., Base: 40% + Top-up: 35%)	60% (i.e., Base: 35% + Top-up: 25%)	40% (i.e., Base: 25% + Top-up: 15%)	20% (i.e., Base: 10% + Top-up: 10%)
50-69%	Base: 40% + Top-up: (revenue decline - 50%) x 1.75 (e.g., 40% + (60% revenue decline - 50%) x 1.75 = 57.5% subsidy rate)	Base: 35% + Top-up: (revenue decline - 50%) x 1.25 (e.g., 35% + (60% revenue decline - 50%) x 1.25 = 47.5% subsidy rate)	Base: 25% + Top-up: (revenue decline - 50%) x 0.75 (e.g., 25% + (60% revenue decline - 50%) x 0.75 = 32.5% subsidy rate)	Base: 10% + Top-up: (revenue decline - 50%) x 0.5 (e.g., 10% + (60% revenue decline - 50%) x 0.5 = 15% subsidy rate)
>10-50%	Base: revenue decline x 0.8 (e.g., 30% revenue decline x 0.8 = 24% subsidy rate)	Base: (revenue decline - 10%) x 0.875 (e.g., (30% revenue decline - 10%) x 0.875 = 17.5% subsidy rate)	Base: (revenue decline - 10%) x 0.625 (e.g., (30% revenue decline - 10%) x 0.625 = 12.5% subsidy rate)	Base: (revenue decline - 10%) x 0.25 (e.g., (30% revenue decline - 10%) x 0.25 = 5% subsidy rate)
0-10%	Base: revenue decline x 0.8 (e.g., 5% revenue decline x 0.8 = 4% subsidy rate)	0%	0%	0%
* The maximum weekly benefit per employee is equal to the maximum combined base and top-up wage subsidy for the qualifying period applied to the amount of eligible remuneration paid to the employee for the qualifying period, on remuneration of up to $1,129 per week.				

Requirement to Repay CEWS

Budget 2021 proposes to require publicly listed corporations (or employers controlled by publicly listed corporations) to repay CEWS for Period 17 and onwards if the aggregate compensation for specified executives during the 2021 calendar year exceeds the aggregate compensation for specified executives during the 2019 calendar year. Specified executives are the “Named Executive Officers” whose compensation is required to be disclosed under Canadian securities laws in

the corporation's annual information circular (or similar disclosure), including the chief executive officer, chief financial officer, and the three other most highly compensated executives.

The repayment obligation is determined on a group basis, and the amount of the CEWS to be repaid is equal to the lesser of

- the total CEWS received for active employees for Period 17 and onwards, and
- the amount of the aggregate excess compensation for specified executives.

CEWS for Furloughed Employees

Budget 2021 extends the CEWS in respect of furloughed employees (i.e., employees who are on leave with pay throughout a particular week during a qualifying period) until the end of Period 19. The rate structure for furloughed employees for Periods 17 to 19 will continue to be aligned with the benefits available through Employment Insurance (EI). The weekly CEWS in respect of a furloughed employee will be the lesser of

- the amount of eligible remuneration paid to the employee in respect of the week; and
- the greater of
  - $500, and
  - 55% of pre-crisis remuneration for the employee, up to a maximum subsidy amount of $595.

Employer-paid contributions to the Canada Pension Plan, EI, the Quebec Pension Plan and the Quebec Parental Insurance Plan for furloughed employees will continue to be subsidized by the CEWS.

Reference Periods

Eligible employers must demonstrate a revenue decline for each qualifying period using either (i) the general approach (which compares the qualifying revenue between a current reference period and a prior reference month), or (ii) the alternative approach (which compares the qualifying revenue of a current reference period and an average based on January and February 2020). An eligible employer's revenue decline for any particular qualifying period is deemed to be the greater of its revenue decline for such period and the immediately preceding qualifying period. Generally, once an eligible employer has chosen to use either the general approach or the alternative approach, it must continue to use the same approach. Budget 2021 provides the following reference periods for Periods 17 to 20:

Timing	**Period 17** **June 6-July 3**	**Period 18** **July 4 – July 31**	**Period 19** **August 1 – August 28**	**Period 20** **August 29 – September 25**
General approach	June 2021 over June 2019 **or** May 2021 over May 2019	July 2021 over July 2019 **or** June 2021 over June 2019	August 2021 over August 2019 **or** July 2021 over July 2019	September 2021 over September 2019 **or** August 2021 over August 2019
Alternative approach	June 2021 **or** May 2021 over average of January and February 2020	July 2021 **or** June 2021 over average of January and February 2020	August 2021 **or** July 2021 over average of January and February 2020	September 2021 **or** August 2021 over average of January and February 2020

Baseline Remuneration

An employee's pre-crisis (i.e., baseline) remuneration may be relevant to the computation of the CEWS. Baseline remuneration generally means the average weekly eligible remuneration paid to an eligible employee by an eligible employer during the period beginning January 1, 2020 and ending March 15, 2020, excluding any period of seven or more consecutive days for which the employee was not remunerated. However, the current CEWS rules provide that an eligible employer can elect to use an alternative baseline period. Budget 2021 proposes to allow an eligible employer to elect to use the following alternative baseline remuneration periods for Period 17 and onwards:

- for Period 17, March 1 to June 30, 2019 or July 1 to December 31, 2019; and
- for Periods 18 and onwards, July 1 to December 31, 2019.

CERS

Phase-out Rate Reduction

Beginning with Period 18, Budget 2021 proposes to gradually reduce the CERS for Periods 17 to 20 (see table below) and requires organizations to have a revenue decline of more than 10%. The expenses for each qualifying period remain subject to a cap of $75,000 per location and an overall cap of $300,000 shared amongst affiliated entities. The same reference periods applicable to the CEWS for Periods 17 to 20 also apply to the CERS for Periods 17 to 20 for purposes of calculating revenue declines. As set out in Budget 2021:

	Period 17 **June 6-July 3**	**Period 18** **July 4 – July 31**	**Period 19** **August 1 – August 28**	**Period 20** **August 29 – September 25**
Revenue decline:				
70% and over	65%	60%	40%	20%
50-69%	40% + (revenue decline - 50%) x 1.25 (e.g., 40% + (60% revenue decline - 50%) x 1.25 = 52.5% subsidy rate)	35% + (revenue decline - 50%) x 1.25 (e.g., 35% + (60% revenue decline - 50%) x 1.25 = 47.5% subsidy rate)	25% + (revenue decline - 50%) x 0.75 (e.g., 25% + (60% revenue decline - 50%) x 0.75 = 32.5% subsidy rate)	10% + (revenue decline - 50%) x 0.5 (e.g., 10% + (60% revenue decline - 50%) x 0.5 = 15% subsidy rate)
>10%-50%	Revenue decline x 0.8 (e.g., 30% revenue decline x 0.8 = 24% subsidy rate)	(Revenue decline - 10%) x 0.875 (e.g., (30% revenue decline - 10%) x 0.875 = 17.5% subsidy rate)	(Revenue decline - 10%) x 0.625 (e.g., (30% revenue decline - 10%) x 0.625 = 12.5% subsidy rate)	(Revenue decline - 10%) x 0.25 (e.g., (30% revenue decline - 10%) x 0.25 = 5% subsidy rate)
0-10%	Revenue decline x 0.8 (e.g., 5% revenue decline x 0.8 = 4% subsidy rate)	0%	0%	0%

Purchase of Business Assets

Current CEWS rules contain a continuity rule for computing revenue where an eligible employer purchases a business. Budget 2021 introduces a similar rule that allows certain purchasers of a business to qualify for the CERS. The proposed rule would apply retroactively to the commencement of the CERS (i.e., Fall 2020).

Lockdown Support

The Lockdown Support is a component of the CERS available to organizations that qualify for the CERS and that have been required to cease or significantly limit their activities by virtue of a public health order. Budget 2021 proposes to extend the Lockdown Support program for Periods 17 to 20, and to maintain the current 25% rate.

CANADA RECOVERY HIRING PROGRAM

Budget 2021 introduces the new “Canada Recovery Hiring Program” (CRHP), which is intended to facilitate hiring back laid-off employees and hiring new employees. The CRHP is an alternative to the CEWS, and will be available for qualifying periods from June 6 to November 20, 2021. Eligible employers will be permitted claim the higher of the CRHP and the CEWS.

In order to qualify for the CRHP in a particular qualifying period, the employer must be a “qualifying recovery entity.” A “qualifying recovery entity” for a qualifying period is defined to mean an “eligible entity” (as defined for purposes of the CEWS) that meets the following additional conditions:

- it files an application for the CRHP within 180 days of the end of the particular qualifying period in the prescribed form and manner;
- the individual who has principal responsibility for the financial activities of the eligible entity attests that the application is complete and accurate in all material respects;
- it had (or is deemed to have had) on March 15, 2020, a business number and payroll account (or, had one or more Canadian employees, the payroll for which was administered by a payroll service provider that had a business number and payroll account which the provider used to make payroll remittances in respect of the entity’s employees);
- if it is a taxable corporation, it must be a CCPC (or would be a CCPC absent the application of subsection 136(1));
- if it is a partnership, it is not more than 50% owned by any combination of persons who are not eligible entities (e.g., public institutions) and taxable corporations that are not CCPCs (or corporations that would be CCPCs absent the application of subsection 136(1)); and
- it has a revenue reduction percentage greater than 0% (if the qualifying period is the 17th qualifying period) or greater than 10% (if the qualifying period is any of the 18th to 22nd qualifying periods).

The decline in revenues is determined in the same manner for the CRHP as for the CEWS, and the employer is required to continue to follow the same approach for the CRHP as was previously used for the CEWS. For example, if the employer previously elected to use the alternative method under the CEWS (which is based on average revenues in January and February 2020), that method should continue to be followed for the CRHP. Budget 2021 contains a table summarizing the applicable reference periods for determining whether the revenue decline threshold is satisfied for a particular period.

Like the CEWS, the subsidy rate under the CRHP will decline over time. This decline is intended to incentivize businesses to begin hiring quickly. The subsidy for the initial three periods (from June 6 to July 3, 2021, July 4 to July 31, 2021, and August 1 to August 28, 2021) is equal to 50% multiplied by the employer’s incremental remuneration paid to eligible employees. The rate declines to 40% for the next period from August 29 to September 25, 2021; 30% for the subsequent period from September 26 to October 23, 2021; and 20% for the final period from October 24 to November 20, 2021. Employees that are “eligible employees” for purposes of the CEWS will be eligible employees under the CRHP, and remuneration that is “eligible remuneration” under CEWS will likewise qualify under the CRHP. Incremental

remuneration for a qualifying period is computed as the difference of the employer's aggregate eligible remuneration minus the aggregate eligible remuneration for the baseline period. Both are subject to a weekly maximum of $1,129 per eligible employee, and amounts in respect of a furloughed employee for a given week are deemed to be nil.

Like the CEWS and CERS, a subsidy under the CRHP operates as a deemed "overpayment" of an eligible entity's liability for tax under Part I of the Tax Act, and will be considered government assistance received immediately before the end of the qualifying period to which it relates for all purposes of the Tax Act other than section 125.7. Government assistance is generally included in a taxpayer's income for tax purposes under paragraph 12(1)(x).

IMMEDIATE EXPENSING OF DEPRECIABLE PROPERTY BY CCPC

Budget 2021 proposes to amend the capital cost allowance (CCA) system by providing for temporary immediate expensing in respect of certain depreciable property that is "eligible property" acquired by CCPCs, up to a maximum amount of $1.5 million per taxation year (subject to sharing among associated group members and proration for short taxation years). Eligible property will be capital property that is subject to the CCA rules, other than property included in CCA classes 1 to 6, 14.1, 17, 47, 49 and 51, which are generally long-lived assets.

Immediate expensing will be available only for the year in which the eligible property becomes available for use, and other accelerated deduction incentives will not reduce the $1.5 million dollar limit.

If a CCPC has capital costs of eligible property that exceed the $1.5 million limit, it may choose the CCA class that benefits from the immediate expensing rule and any excess capital cost would be subject to the normal CCA rules.

Current rules restricting CCA will continue to apply (e.g., specified leasing properties, specified energy properties). Additional restrictions will apply to used property acquired by a CCPC.

Budget 2021 proposes that these measures will apply to eligible property acquired on or after Budget Day and that becomes available for use before 2024.

RATE REDUCTION FOR ZERO-EMISSION TECHNOLOGY MANUFACTURERS

Budget 2021 proposes to reduce the applicable tax rates on certain eligible zero-emission technology manufacturing and processing income to:

- 7.5% (if that income would otherwise be taxed at the 15% general corporate rate); and
- 4.5% (if that income would otherwise be taxed at the 9% small business rate).

In order for a taxpayer to qualify for the reduced rates, at least 10% of a taxpayer's gross revenue from all active business carried on in Canada must be derived from eligible activities. Taxpayers that have income subject to both the general corporate rate and the small business rate would be able to choose to have their eligible income taxed at the reduced 4.5% or 7.5% rate. However, the amount of income taxed at the reduced 4.5% rate (together with the amount of income taxed at the 9% small business rate) may not exceed the taxpayer's small business limit.

The reduced tax rates will apply to taxation years that begin after 2021 and will be gradually phased out beginning in 2029, with the reduced rates fully phased out for taxation years beginning in 2032.

CAPITAL COST ALLOWANCE FOR CLEAN ENERGY EQUIPMENT

Budget 2021 proposes certain changes to the accelerated CCA rates with respect to Class 43.1 and 43.2 property, which generally includes certain specified clean energy generation and energy conservation equipment. The following table generally summarizes the proposed changes.

Expansion of Classes 43.1 and 43.2 to include:	Restriction of Classes 43.1 and 43.2:
• pumped hydroelectric storage equipment (e.g., reversing turbines, transmission equipment, dams, reservoirs and related structures, but excluding buildings or property used solely for backup electrical energy); • electricity generation equipment that uses physical barriers or dam-like structures to harness the kinetic energy of flowing water or wave or tidal energy; • active solar heating, geothermal, and ground source heat systems used for swimming pools; • equipment used to produce solid and liquid fuels (e.g., wood pellets and renewable diesel) from specified waste material or carbon dioxide; • a broader range of equipment used for the production of hydrogen by electrolysis of water; and • equipment used to dispense hydrogen for use in hydrogen-powered automotive equipment and vehicles.	• fossil-fuelled cogeneration systems will be removed; • fossil-fuelled enhanced combined cycle systems will be removed; • specified waste-fuelled electrical generation systems that exceed a heat rate threshold of 11,000 BTU per kilowatt-hour will be removed; • specified waste-fuelled heat production equipment for which more than one quarter of the total fuel energy input is from fossil fuels will be removed; and • producer gas generating equipment for which more than one quarter of the total fuel energy input is from fossil fuels will be removed.

The expansions of Classes 43.1 and 43.2 will apply in respect of eligible property that is acquired and becomes available for use on or after Budget Day. The removal of property from eligibility for Classes 43.1 and 43.2 will apply in respect of property that becomes available for use after 2024.

TAX INCENTIVE FOR CARBON CAPTURE, UTILIZATION, AND STORAGE

Budget 2021 proposes to introduce an investment tax credit to promote the adoption of carbon capture, utilization and storage technologies, which will be available for certain direct air capture projects (i.e., not for enhanced oil recovery projects). The Government has proposed a 90-day consultation period with various stakeholders, including provincial governments and industrial subsectors, in order to design the investment tax credit. Following the end of the consultation period, the Government proposes to introduce legislation to implement the investment tax credit at the "earliest opportunity."

FILM OR VIDEO PRODUCTION TAX CREDITS

Budget 2021 proposes to extend certain timelines applicable to the Canadian Film or Video Production Tax Credit and the Film or Video Production Services Tax Credit.

PERSONAL INCOME TAX MEASURES

TAXES APPLICABLE TO REGISTERED INVESTMENTS

Registered plans (e.g., RRSPs, RRIFs and DPSPs) are subject to adverse tax consequences if they hold investments that are not "qualified investments." Units of a unit trust that qualifies as a mutual fund trust and shares of a corporation that qualifies as a mutual fund corporation are qualified investments. To qualify as a mutual fund trust or mutual fund corporation, the trust or corporation must satisfy certain distribution requirements with respect to the number of unitholders or shareholders, as applicable. If a trust or corporation would otherwise qualify as a mutual fund trust or mutual fund corporation but for meeting such distribution requirements, it can become a registered investment (RI) if it

holds only qualified investments. As an RI, units of the trust or corporation will be qualified investments for registered plans. However, such an RI is liable to a monthly tax under subsection 204.6(1) of 1% of the fair market value (at the time of acquisition) of any property held at the end of the month that is not a qualified investment. The tax is payable even if no unitholders or shareholders are registered plans.

Budget 2021 proposes that the tax under subsection 204.6(1) be prorated such that it will be the tax otherwise determined multiplied by a fraction, the numerator of which is the number of units or shares owned by RRSPs, RRIFs, DPSPs and other RIs at the end of the month and the denominator of which is the total number of units or shares outstanding at the end of the month.

Trusts and corporations may issue units and shares in different series or classes. It is not clear how this is to be taken into account. In addition, it is not clear why TFSAs and RDSPs, which benefit from the RI regime, are not taken into account.

The amendment applies to months after 2020. It also applies to a month before 2021 if, before Budget Day, no notice of assessment in respect of an amount payable under subsection 204.6(1) for the month has been sent to the RI in respect of the month, or if such a notice of assessment has been sent to the RI in respect of the month, it is not the case that the RI has no further right of objection and appeal in respect of the assessment.

FIXING CONTRIBUTION ERRORS IN DEFINED CONTRIBUTION PENSION PLANS

Currently, a pension-plan administrator may not accept retroactive contributions to employee accounts under a defined contribution pension plan in order to correct under-contribution errors in respect of prior years.

Budget 2021 proposes to permit certain types of under-contribution errors to be corrected by additional contributions to an employee's account.

This measure would apply in respect of additional contributions made, and amounts of over-contributions refunded, in the 2021 and subsequent taxation years.

TAX TREATMENT OF COVID-19 BENEFIT AMOUNTS

Currently, if a COVID-19 benefit amount is repaid, the repayment can only be deducted for income tax purposes in the year the repayment is made.

Budget 2021 proposes to allow individuals the option to deduct the repayment of a COVID-19 benefit amount in the year the relevant benefit was received. Such option is proposed to be available for benefit amounts repaid at any time before 2023.

DISABILITY TAX CREDIT

Budget 2021 proposes to expand the definition of mental functions necessary for everyday life and types of therapy taken into account for the purpose of determining eligibility for the disability tax credit.

POSTDOCTORAL FELLOWSHIP INCOME

Budget 2021 proposes to include postdoctoral fellowship income in "earned income" for determining the amount of permitted RRSP contributions.

CANADA WORKERS BENEFIT

Budget 2021 proposes to enhance the Canada Workers Benefit (CWB), a non-taxable refundable tax credit, and to introduce a "secondary earner exemption."

NORTHERN RESIDENTS DEDUCTIONS

Budget 2021 proposes to expand access to the travel component of the Northern Residents Deductions.

MISCELLANEOUS – TAX ENFORCEMENT, ADMINISTRATION AND OTHER MEASURES

CONSULTATION REGARDING MANDATORY DISCLOSURE RULES—TAXPAYERS FACE LONGER ODDS IN THE AUDIT LOTTERY

Budget 2021 announces that the Government is consulting on proposals to amend the current rules relating to reportable transactions and to add new requirements to report "notifiable transactions," as well as new requirements for specified corporations to report uncertain tax positions. The Department of Finance seeks comments by September 3, 2021 on the proposals summarized below and on draft legislation and sample notifiable transactions, expected to be released in the coming weeks.

Budget 2021 states that to the extent that a proposed measure applies to taxation years (i.e., reporting of uncertain tax positions), amendments made as a result of this consultation would apply to taxation years that begin after 2021, and to the extent that a measure applies to transactions (i.e., reportable transactions and notifiable transactions), the amendments would apply to transactions entered into on or after January 1, 2022.

REPORTABLE TRANSACTIONS

Section 237.3 requires certain persons to file an information return in respect of a "reportable transaction." The return must be filed with the CRA on or before June 30 of the calendar year following the calendar year in which the transaction first became a reportable transaction. In general, the persons required to file a return are the taxpayer that participates in the transaction for whom a tax benefit would result, a "promoter," an "advisor" and a person who does not deal at arm's length with a promoter or advisor if the person is entitled to receive a fee with respect to the transaction. If more than one person is required to report the transaction, a report by any of them will satisfy the requirement. A lawyer who is an advisor in respect of a reportable transaction is not required to disclose in an information return in respect of the transaction any information in respect of which the lawyer, on reasonable grounds, believes that a client of the lawyer has solicitor-client privilege.

A reportable transaction is generally an "avoidance transaction" (as defined for the purposes of the general anti-avoidance rule in section 245 [GAAR]) where at least two of three hallmarks are present. In general, the hallmarks are the following:

- A promoter or advisor is entitled to a fee that: (i) is attributable to the amount of the tax benefit from the transaction, (ii) is contingent on obtaining a tax benefit from the transaction or (iii) is attributable to the number of participants in the transaction or the number of participants who have been provided access to advice or an opinion given by the promoter or advisor regarding the tax consequences of the transaction.
- A promoter or advisor obtains "confidential protection" in respect of the avoidance transaction (i.e., anything that prohibits disclosure to any person or the CRA of the details or structure of the transaction).
- The taxpayer obtains "contractual protection" (not including a contingent fee caught by the first hallmark) in respect of the transaction. "Contractual protection" means (i) insurance (other than standard professional liability insurance) or other protection that protects against failure to achieve any tax benefit from the transaction or pays for or reimburses any expense, fee, tax, interest, penalty or similar amount that may be incurred by a person in the course of a dispute in respect of a tax benefit from the transaction; and (ii) any form of undertaking provided by a promoter that provides assistance in the course of a dispute in respect of a tax benefit from the transaction.

A reportable transaction includes all the transactions in a series of transactions if at least one of the transactions in the series is an avoidance transaction. A reportable transaction does not include the acquisition of a "tax shelter" or the issuance of a "flow-though share" if the necessary tax shelter or flow-through share information return has been filed with the CRA.

The BEPS Action 12 Report identified a number of strengths and weaknesses in Canada's reportable transaction regime. Budget 2021 states that "[w]hile the current rules are intended to provide the CRA with the information it needs, they currently result in only limited reporting by taxpayers."

Budget 2021 proposes a number of changes to the reportable transaction rules:

- A transaction will be an avoidance transaction if it can reasonably be concluded that one of the main purposes of entering into the transaction is to obtain a tax benefit.
- Only one generic hallmark need be present in order for a transaction to be reportable.
- The due date for reporting will be substantially accelerated. A taxpayer who enters into a reportable transaction would be required to report the transaction to the CRA within 45 days of the earlier of the day on which the taxpayer becomes contractually obligated to enter into the transaction and the day on which the taxpayer enters into the transaction.

It is also proposed that reporting (as a reportable transaction) of a scheme that, if implemented, would be a reportable transaction must be made by a promoter or advisor (as well as by persons who do not deal at arm's length with the promoter or advisor and who are entitled to receive a fee with respect to the transaction) within the same time limits. An exception to the reporting requirement will be available for advisors if solicitor-client privilege applies.

NOTIFIABLE TRANSACTIONS

Budget 2021 identifies a number of countries that have adopted rules requiring that taxpayers notify the relevant tax authority if they enter into particular transactions. Budget 2021 refers to the disclosure regimes in the United States relating to "listed transactions" and "transactions of interest."

Budget 2021 proposes to introduce a regime under which the Minister of National Revenue would have the authority to designate transactions, with the concurrence of the Minister of Finance, as "notifiable transactions," which would include transactions that the CRA has found to be abusive and transactions identified as transactions of interest.

A taxpayer who enters into a notifiable transaction (or a transaction or series of transactions that is substantially similar to a notifiable transaction) would be required to report the transaction (or series) to the CRA within 45 days of the earlier of the day on which the taxpayer becomes contractually obligated to enter into the transaction and the day on which the taxpayer enters into the transaction.

It is also proposed that a promoter or advisor who offers a scheme that, if implemented, would be a notifiable transaction (or substantially similar to a notifiable transaction), as well as a person who does not deal at arm's length with the promoter or advisor and who is entitled to receive a fee with respect to the transaction, must report within the same time limits. An exception to the reporting requirement will be available for advisors if solicitor-client privilege applies.

UNCERTAIN TAX TREATMENTS

Budget 2021 proposes to introduce a regime under which "specified" corporate taxpayers would be required to report particular uncertain tax treatments to the CRA.

A corporation would generally be required to report a particular uncertain tax treatment in respect of a taxation year where the following conditions are met:

- It is required to file a Canadian tax return for the taxation year.
- It has at least $50 million in assets (generally determined using the carrying value of the assets on its balance sheet) at the end of the financial year that coincides with the taxation year (or the last financial year that ends before the end of the taxation year). This threshold would apply to each individual corporation.

- It, or a related corporation, has audited financial statements prepared in accordance with IFRS or other country-specific GAAP relevant for domestic public companies. If a private corporation has audited financial statements, it would meet this condition.
- Uncertainty in respect of its Canadian income tax for the taxation year is reflected in those audited financial statements (i.e., the entity concluded it is not probable that the taxation authority will accept an uncertain tax treatment).

Uncertain tax treatments must be reported when the corporation's tax return is due. The corporation will be required to provide prescribed information with respect to each uncertain position, including the amount of taxes at issue, a concise description of the relevant facts, the tax treatment taken (and statutory authority) and whether the uncertainty relates to a permanent or temporary difference in tax.

AVOIDANCE OF TAX DEBTS

Subsection 160(1) is an anti-avoidance rule (the "tax debt avoidance rule"), which applies where a person ("transferor") transfers property, directly or indirectly, by means of a trust or by any other means whatever, to a person ("transferee") with whom the transferor does not deal at arm's length for inadequate consideration. It provides that the transferee and the transferor shall be jointly and severally liable to pay the lesser of: (i) all amounts that the transferor is liable to pay under the Tax Act for the taxation year in which the property was transferred or any preceding taxation year (the transferor's tax debt), and (ii) the amount by which the fair market value of the property at the time of the transfer exceeds the fair market value of any consideration given for the property.

Budget 2021 asserts that taxpayers are engaging in transactions that attempt to circumvent the tax debt avoidance rule, including by

- arranging for a tax debt to crystallize after the end of the taxation year in which the property is transferred;
- arranging for the transferor to deal at arm's length with the transferee at the time of the property transfer; or
- stripping out net asset value of the transferor using a series of transactions that does not breach the point-in-time valuation test for the property transferred and consideration given therefor.

Budget 2021 asserts "this planning is often packaged with highly aggressive tax plans that attempt to eliminate the underlying tax liability of the transferor so that, if the latter planning fails, the [CRA] would be unable to collect the tax debt because the indebted taxpayer has been stripped of their assets." Recently, the CRA was unsuccessful in asserting that the general anti-avoidance rule applied to transactions where section 160 did not apply: *Damis Properties Inc. v The Queen* (2021 TCC 24).

Budget 2021 proposes the following measures to combat these transactions:

- Deferral of Tax Debts: A new anti-avoidance rule that deems a transferor's tax debt to arise before the end of the taxation year in which the transfer of property occurs where: (i) the transferor (or a non-arm's-length person) knows (or would know if the transferor had made reasonable inquiries) that the transferor would have a tax debt owing (or would have a tax debt owing but for additional tax planning undertaken as part of the series of transactions that includes the transfer of the property) that would arise after the end of the taxation year, and (ii) one of the purposes of the transfer of property was to avoid the payment of the future tax debt.
- Avoidance of Non-Arm's-Length Status: A new anti-avoidance rule that will deem a transferor and a transferee not to deal at arm's length at the time of the transfer of property if they would otherwise be considered to deal at arm's length. The rule will apply if: (i) at any time in the series of transactions or events that includes the transfer of property, the transferor and transferee do not deal at arm's length, and (ii) it is reasonable to conclude that one of the purposes of a transaction or event (or a series of transactions or events) within that series was to cause the transferor and transferee to deal at arm's length at the time of transfer.

- Valuations: A new rule that requires that, where the transfer of property occurs as part of a series of transactions or events, the overall result of the series be considered in determining the values of the property transferred and the consideration given for the property.
- Penalties: A new penalty for planners and promoters of tax debt avoidance schemes equal to the lesser of (i) 50% of the tax that is attempted to be avoided, and (ii) $100,000 plus the planner's or promoter's compensation for the scheme.

The proposed measures will apply in respect of transfers of property that occur on or after Budget Day, and similar amendments are proposed to be made to comparable provisions in other federal statutes (e.g., section 325 of the *Excise Tax Act* (Canada) [ETA]).

AUDIT AUTHORITIES

Under section 231.1, CRA officials have the authority to audit taxpayers and otherwise ensure compliance with the Tax Act. A recent decision of the Federal Court of Appeal in *Canada v. Cameco Corporation* (2019 FCA 67) put into question the scope of the CRA's authority to require a taxpayer to provide all reasonable assistance and to answer all proper questions relating to the administration and enforcement of the Tax Act and the extent to which CRA officials can require that questions be answered orally.

Budget 2021 proposes to amend section 231.1 and comparable provisions under the ETA and certain other statutes to override the decision of the Federal Court of Appeal. The amendments would provide that CRA officials have the authority to require persons to answer all proper questions, and to provide all reasonable assistance, for any purpose related to the administration or enforcement of the relevant statute. They would also provide CRA officials with the authority to require persons to respond to questions orally or in writing, including in any form specified by the relevant CRA official. The proposed amendments will come into force on Royal Assent.

GENERAL ANTI-AVOIDANCE RULE (GAAR)

In the 2020 Fall Economic Statement released on November 30, 2020, the Government announced its intention to launch consultations on the modernization of Canada's anti-avoidance rules, in particular, the GAAR in section 245. In Budget 2021, the Government announced that it intends to "take next steps" to strengthen and modernize Canada's GAAR.

CORPORATE BENEFICIAL OWNERSHIP REGISTRY

In early 2020, in order to combat money laundering, terrorist financing, tax evasion and abusive tax avoidance, the Government launched consultations on strengthening Canada's transparency rules regarding corporate beneficial ownership through the creation of a public corporate beneficial ownership registry. Building on that consultation process, Budget 2021 proposes to provide $2.1 million over two years to Innovation, Science and Economic Development Canada to support the implementation of a publicly accessible corporate beneficial ownership registry by 2025.

FUNDING THE CRA

Budget 2021 proposes an additional $304.1 million in spending over five years to fund new initiatives and extend existing programs operated by the CRA to combat tax evasion and aggressive tax avoidance, including increasing GST/HST audits of large businesses at greatest risk of non-compliance, modernizing the CRA's risk assessment process to prevent unwarranted and fraudulent GST/HST refund and rebate claims, and enhancing the CRA's capacity to identify tax evasion involving trusts. The Government estimates that these measures will result in an additional $810 million of tax revenues over five years.

Budget 2021 also proposes to spend an additional $230 million over five years to improve the CRA's ability to collect outstanding taxes, and expects that this proposal will lead to the collection of an additional $5 billion in outstanding taxes over five years.

To safeguard Canadians' personal information stored electronically by the CRA, Budget 2021 proposes to spend an additional $330.6 million over five years for the CRA to purchase new cyber security technologies and tools and to fund cybersecurity training for CRA officials.

ELECTRONIC FILING AND CERTIFICATION OF TAX AND INFORMATION RETURNS

Budget 2021 announced measures aimed at improving the CRA's ability to operate digitally.

The Government proposes that electronic correspondence be the default method of correspondence in the following circumstances:

- sending notices of assessment to individuals who file their income tax return electronically or who employ the services of a tax preparer that files their income tax return electronically. The CRA will not be required to obtain the individual's authorization; and
- communicating with businesses that use the CRA's My Business Account portal.

Issuers of T4A and T5 information returns will be permitted to provide such returns electronically without also having to issue a paper copy and without obtaining taxpayer authorization.

Budget 2021 proposes to reduce certain thresholds for electronic filing of tax returns in respect of calendar years after 2021. Currently, subsection 150.1(2.2) provides, *inter alia*, that a "tax preparer", for a calendar year, is a person or partnership who, in the year, accepts consideration to prepare more than 10 income tax returns of corporations or more than 10 income tax returns of individuals (other than trusts). Subsection 150.1(2.3) requires a tax preparer to file any income tax return prepared by the tax preparer for consideration by way of electronic filing, except that 10 corporate income tax returns and 10 individual income tax returns may be filed other than by way of electronic filing. Budget 2021 proposes:

- that professional preparers of income tax returns be required to file electronically if they prepare more than 5 income tax returns of corporations or 5 income tax returns of individuals. The prior exception for trusts would be removed; and
- to permit a tax preparer to only file a maximum of 5 paper returns of each type per calendar year.

Budget 2021 proposes that the threshold for mandatory electronic filing of income tax information returns will be lowered from 50 to 5 returns in respect of a particular type of information return. This measure would apply in respect of calendar years after 2021.

The mandatory thresholds for returns of corporations under the Tax Act and most GST/HST registrants will be eliminated, such that returns of most corporations and GST/HST registrants would be required to be filed electronically.

Budget 2021 proposes that electronic payments be required for remittances over $10,000 under the Tax Act and that the threshold for mandatory remittances to be made at a financial institution under the GST/HST portion of the ETA, the *Excise Act*, 2001, the Air Travellers Security Charge Act and Part 1 of the Greenhouse Gas Pollution Pricing Act be lowered from $50,000 to $10,000. This measure would apply to payments made on or after January 1, 2022.

Lastly, Budget 2021 proposes to eliminate the requirement that signatures be in writing on certain prescribed forms effective on Royal Assent.

REGISTERED CHARITIES

Budget 2021 includes the following proposed changes to the registration and revocation rules applicable to registered charities:

- The Minister of National Revenue will be permitted to revoke the registration of a charity or other qualified donee immediately upon its listing as a terrorist entity under the *Criminal Code*. The CRA will not be required to follow the usual steps to revoke the registration of a charity.

- The definition of “ineligible individual” will be expanded to include an individual who (i) is, or is a member of, a listed terrorist entity; or (ii) in respect of a listed terrorist entity, was, during a period in which the entity supported or engaged in terrorist activities, a director, trustee, officer or like official of the entity, or an individual that controlled or managed, directly or indirectly, in any manner whatever, the entity. If an ineligible individual is a director, trustee, officer or like official of a charity or Canadian amateur athletic association, or where such an individual controls or manages the charity or association, the Minister of National Revenue may refuse or revoke its registration, or suspend its authority to issue official donation receipts.
- The Minister of National Revenue will be permitted to suspend the registered charity’s ability to issue official donation receipts for one year or to revoke its registration if a false statement amounting to culpable conduct was made for the purpose of maintaining its registration.

The foregoing proposed measures would apply on Royal Assent.

Budget 2021 also indicates that the Government is concerned with the accumulation of assets by charitable foundations. The Government proposes launching public consultations with charities on potentially increasing the disbursement quota (the amount that charitable foundations are required to expend on charitable activities each year).

TAX ON UNPRODUCTIVE USE OF CANADIAN HOUSING BY FOREIGN NON-RESIDENT OWNERS

On November 30, 2020, the Government announced in the 2020 Fall Economic Statement that it would be taking steps to implement a national tax targeting the unproductive use of domestic housing owned by non-resident non-Canadians. Budget 2021 follows through with the Government’s announcement and includes a proposal for an annual tax, commencing in 2022, of 1% on the value of residential property in Canada that is considered to be underused or vacant and owned by a non-resident non-Canadian.

Commencing in 2023, an owner of Canadian residential property who is neither a Canadian citizen nor permanent resident of Canada will be required to file with the CRA an annual declaration in respect of such property owned during the prior calendar year. The declaration is to include information relating to the property (e.g., address, value and the owner’s interest), as well as whether any exemption from the tax is available in the circumstances (e.g., where the property is leased to certain qualifying tenants over a minimum period during the year). Any tax owing is to be reported on the declaration form and remitted to the CRA by the filing due date. Failure to timely file a declaration when required could result in the loss of an applicable exemption, the imposition of penalties and interest, and an unlimited assessment period.

Budget 2021 does not contain draft legislation in respect of the proposed tax. The Government intends to release a backgrounder on the proposed tax in the coming months and will provide an opportunity for stakeholders to comment on further parameters, including the following:

- the definition of residential property;
- the value on which the tax would apply;
- the application of the tax where a property is owned by multiple individuals or non-individuals;
- potential exemptions from the tax;
- compliance and enforcement mechanisms; and
- the applicability of the tax in smaller resort and tourist communities.

According to the projections set out in Budget 2021, the proposed tax is expected to generate approximately $700 million in tax revenue between 2022 and 2026.

SALES AND EXCISE TAX MEASURES

GST/HST FOR E-COMMERCE BUSINESSES

Application of the GST/HST to E-commerce

Budget 2021 confirms certain changes relating to GST/HST matters previously announced in the 2020 Fall Economic Statement in relation to e-commerce. Budget 2021 confirms the following:

- *GST/HST on Cross-Border Digital Products and Services*: It is proposed that non-resident vendors and distribution platform operators supplying digital products or services to Canadian consumers be required to register and collect GST/HST on the taxable supplies they facilitate to consumers in Canada.
- *GST/HST on Sale of Goods Shipped From a Fulfillment Warehouse*: It is proposed that distribution platform operators be required to register under the normal GST/HST registration system to collect and remit the applicable GST/HST on sales of goods shipped from a fulfillment warehouse (or any other similar place) in Canada when such sales are made by non-registered vendors through distribution platforms. Non-resident vendors making such sales on their own (i.e., not through a distribution platform) would also be subject to new GST/HST registration and collection requirements in respect of goods shipped from a fulfillment warehouse.
- *GST/HST on Short-Term Accommodations*: Supplies of short-term accommodations in Canada facilitated though a digital accommodation platform are proposed to be subject to GST/HST. Under the proposed measures, the GST/HST would be required to be collected and remitted on such supplies by either the property owner or the accommodation platform operator.
- Budget 2021 also proposes certain amendments and clarifications to the draft legislation relating to the foregoing, which take into account consultations and comments received from stakeholders.

DIGITAL SERVICES TAX

As announced in the 2020 Fall Economic Statement, and given the delays in reaching agreement with Canada's international partners, Budget 2021 proposes to implement a digital services tax (DST) as of January 1, 2022. The DST is intended to be an interim measure until a multilateral approach comes into effect with respect to the affected businesses. The DST aims to ensure that revenue earned by large businesses, whether foreign or domestic, from engagement with online users in Canada, including through the collection, processing and monetizing of data and content contributions from those users, is subject to Canadian tax.

In particular, it is proposed that the DST will have the following parameters:

- *Rate and Base*: it will apply at a rate of 3% on revenue (excluding VAT and sales taxes) earned from certain digital services that rely on the engagement, data and content contributions of Canadian users.
- *In-Scope Revenue*: it will apply to revenue from online business models in which the participation of users is a key value driver, including revenue from: (i) online marketplaces, (ii) social media platforms, (iii) online advertising, and (iv) the sale or licensing of user data collected from users of an online interface.
- *Taxpayers*: it will apply to an entity (including a corporation, trust or partnership) that meets (or is a member of a business group that meets) both of the following thresholds:
  - global revenue from all sources of €750 million in the previous calendar year; and
  - in-scope revenue associated with Canadian users of more than $20 million in the particular calendar year.
- *Revenue Sourcing*: Budget 2021 proposes certain transactional and formulaic rules to determine the relevant revenues that represent in-scope revenue for purposes of the DST as compared to out-of-scope revenue.

- *User Location*: Whether an online user is located in Canada or not would generally be determined based upon the ordinary location or place of business of the user.
- *Treatment under the Tax Act*: The DST payable by an entity will generally only be deductible for income tax purposes where general principles would permit deductibility (i.e., if it is incurred for the purpose of earning the entity's income subject to Canadian income tax). Furthermore, no credit for the DST would be available against Canadian income tax payable.
- *Administration*: Entities subject to DST would be required to file an annual DST return. DST returns may be filed by a designated entity on behalf of a group. Each entity within a group would be jointly and severally liable for the DST of each other group entity.

The Government invites stakeholders to submit written representations by June 18, 2021 to the Department of Finance Canada, Tax Policy Branch, at: ST-TSN@canada.ca. Furthermore, draft legislation for a new statute implementing the DST is expected to be released during summer 2021.

INFORMATION REQUIREMENTS TO SUPPORT ITC CLAIMS

The GST/HST system allows businesses engaged in commercial activities to recover the GST/HST they pay on their inputs by means of the input tax credit (ITC) mechanism. In order to claim ITCs, businesses are required to obtain certain documents/information. Under the current ITC information rules, either the supplier or an intermediary (i.e., a person that causes or facilitates the making of a supply on behalf of the supplier) must provide such supporting documents/information. Budget 2021 proposes to allow billing agents to be treated as intermediaries for purposes of the ITC information rules, thereby allowing billing agents (rather than the underlying vendor) to provide the supporting documents/information. Budget 2021 proposes that these ITC information measures come into force on the day after Budget Day.

EXCISE DUTY ON VAPING PRODUCTS

Budget 2021 proposes to implement a tax on vaping products in 2022 through the introduction of a new excise duty framework. The Government invites input from industry and stakeholders on these proposals. Written comments are to be sent by June 30, 2021 to: fin.vaping-taxation-vapotage.fin@canada.ca

OTHER MEASURES

Budget 2021 also proposes certain commodity tax amendments to

- the GST New Housing Rebate conditions;
- clarify entitlement to GST rebates in respect of certain assets purchased by provinces for their own use;
- increase the tobacco excise duty; and
- introduce a tax on the retail sale and importation of new luxury cars and personal aircraft priced over $100,000, and boats priced over $250,000.

DUTY AND TAX COLLECTION ON IMPORTED GOODS

Budget 2021 proposes amendments to the *Customs Act* for the stated purpose of improving the collection of duties and taxes on imported goods. Budget 2021 proposes to amend the *Customs Act* to ensure that all importers value their goods using the value of the last sale for export to a purchaser in Canada with the stated goal of "ensuring fairness for all importers and enhancing consistency with international rules." Budget 2021 also proposes to modernize payment processes for commercial importers.

PREVIOUSLY ANNOUNCED MEASURES

The Government confirmed its intention to proceed with the following previously announced measures, as modified to take into account consultations and deliberations since their release:

- Budget 2016 measures relating to the GST/HST joint venture election;
- Budget 2018 measures to implement enhanced reporting requirements for certain trusts;
- May 17, 2018 and July 27, 2018 proposals relating to GST/HST;
- July 30, 2019 legislative proposals and measures implementing and modifying the 2018 Fall Economic Statement and Budget 2019, in respect of
  - the accelerated investment incentive;
  - the expensing of the cost of machinery and equipment used in the manufacturing or processing of goods, the cost of specified clean energy equipment, and certain zero-emission vehicles;
  - owners of multi-unit residential properties;
  - permitting additional types of annuities under registered plans;
  - contributions to specified multi-employer pension plans for older members;
  - pensionable service under an individual pension plan;
  - the "allocation to redeemers" methodology for unitholders of mutual funds;
  - character conversion transactions;
  - electronic delivery of requirements for information;
  - transfer pricing;
  - foreign affiliate dumping; and
  - cross-border share lending arrangements;
- August 29, 2019 measure to clarify the definition of "shared-custody parent" in section 122.6;
- December 9, 2019 measure to increase the maximum basic personal amount to $15,000 by 2023;
- December 20, 2019 measure to extend the maturation period of amateur athletes trusts maturing in 2019 by one year;
- April 17, 2020 legislative proposals to clarify subsidies for Canadian journalism;
- July 2, 2020 regulatory proposals providing relief during the COVID-19 pandemic for deferred salary leave plans and registered pension plans;
- November 27, 2020 legislative proposals to facilitate the conversion of health and welfare trusts to employee life and health trusts;
- November 30, 2020 anti-avoidance rules consultation and measures in the 2020 Fall Economic Statement in respect of:
  - registered disability savings plans;
  - GST/HST relief for face masks and face shields;
  - employee stock options; and
  - patronage dividends paid in shares;

- December 15, 2020 legislative proposals in respect of capital cost allowance claims for purchases of zero-emission automotive equipment and vehicles;
- December 16, 2020 legislative proposals extending timelines in respect of flow-through shares by 12 months;
- December 21, 2020 legislative proposals in respect of temporary changes to the automobile standby charge;
- January 19, 2021 legislative proposals in respect of temporary adjustments to the child care expense and disability supports deductions;
- February 24, 2021 legislative proposals in respect of the CEWS, the CERS and the Lockdown Support; and
- March 3, 2021 legislative proposals in respect of "baseline remuneration" for the CEWS.

Budget 2021 also reaffirms the Government’s commitment to implement technical amendments to “improve the certainty and integrity of the tax system.”