Tax Perspectives

Review of 2023 and 2024 Outlook

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Tax Perspectives: Review of 2023 & 2024 Outlook

Over the past few years the Government of Canada (Government) has been active in its commitment to further tax reform by introducing legislative proposals, draft legislation and technical amendments to Canadian tax law addressing a wide range of tax measures. 2023 continued that trend as the Government announced new legislative proposals and the Department of Finance (Finance) consulted Canadians on draft and, in some cases, revised draft legislation implementing prior proposals.

2023 also saw the tabling in Parliament of two significant packages of legislation to enact many of the tax measures announced by the Government over the past few years. The Canadian tax community spent the year digesting legislative proposals and draft legislation to determine their impact on current transactions and structures and addressing the impact of tax measures, which have been in draft form for the past few years, being tabled in Parliament and coming, or soon to come, into force.

This article provides an overview of the important Canadian legislative and judicial tax developments of 2023, and looks ahead to potential significant Canadian tax changes in 2024. Given the substantial volume of tax developments this year, this article does not attempt to be comprehensive but highlights those developments we consider to be most impactful to a broad audience of our clients.

Our commentary is divided into sections as follows:

- **Part 1 – Overview of Canadian Tax Developments in 2023**
  - Income Tax – Legislation
  - Income Tax – Cases
  - Commodity Tax
- **Part 2 – Outlook for 2024**

Part 1 - Overview of Canadian Tax Developments in 2023

INCOME TAX – LEGISLATION

The significant volume of new proposals and draft legislation and tabled legislation implementing previously announced proposals included the following.[1]

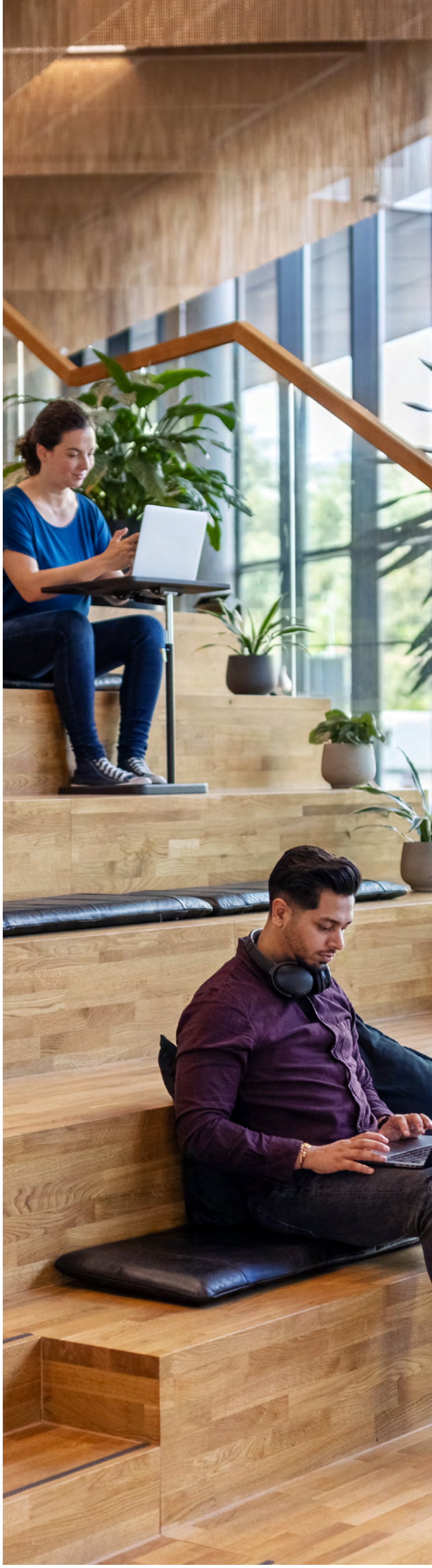
— On March 28, 2023, the Government released the **2023 federal budget** (Budget 2023) which included specific proposals to strengthen the general anti-avoidance rule (GAAR), particulars regarding previously announced, as well as a number of new, clean economy investment tax credits (Clean Economy Tax Credits), particulars of the tax on repurchases of equity by publicly traded Canadian entities originally announced in the 2022 Fall Economic Statement (2022 FES), new rules to facilitate the purchase of businesses by employee ownership trusts (EOT), measures to deny the dividend received deduction for financial institutions on shares that are mark-to-market property, changes to the intergenerational business transfer framework, an expansion of the reduced corporate income tax rate for zero-emission technology manufacturers, and an update on the Government's commitment to follow through on the Organisation for Economic Co-operation and Development (OECD) international tax reform recommendations and other previously announced tax measures. The **McCarthy Tétrault LLP overview of Budget 2023** provides a more detailed review.

— On April 20, 2023, the Government introduced Bill C-47, the *Budget Implementation Act, 2023, No. 1*, in the House of Commons. Bill C-47 introduced a number of tax measures announced in Budget 2023 and in prior years including significant changes to the mandatory disclosure rules (Mandatory Disclosure Rules) that were originally announced in the 2021 federal budget.

— On June 6, 2023, Finance released a consultation paper and draft legislative amendments initiating consultation with Canadians regarding Canada's transfer pricing rules.

— Also on June 6, 2023, Finance announced that it was seeking feedback on design details for the Clean Economy Tax Credits, being the clean electricity investment tax credit (CEI Tax Credit), clean technology manufacturing investment tax credit (CTM Tax Credit), clean hydrogen investment tax credit (CH Tax Credit), clean technology investment tax credit (CTI Tax Credit), and investment tax credit for carbon capture, utilization and storage (CCUS Tax Credit), as well as the prevailing wage and apprenticeship requirements (Labour Requirements) applicable to the Clean Economy Tax Credits.

— On June 22, 2023, Bill C-47 received Royal Assent and the amended Mandatory Disclosure Rules came into force.



1 All statutory references herein are to the *Income Tax Act* (Canada) ("Act") unless specifically otherwise noted.

— On July 5, 2023, the CRA published administrative **guidance** to the new Mandatory Disclosure Rules (CRA Guidance). The CRA Guidance was updated on November 2, 2023 and is expected to continue to evolve.

— On August 4, 2023, Finance released **proposed draft legislation** for a number of previously announced proposals (August 4 Proposals). The August 4 Proposals included revised draft legislation for the excess interest and financing expenses limitation rules (EIFEL Rules), the GAAR amendments announced in Budget 2023, the tax on repurchases of equity by Canadian publicly traded entities, the CTI Tax Credit, the CCUS Tax Credit, the Labour Requirements and the alternative minimum tax (AMT) for high income individuals amendments announced in Budget 2023. The August 4 Proposals also included a draft Global Minimum Tax Act (GMTA) to implement the global anti-base erosion model rules (Model GloBE Rules) that were released as part of Pillar Two of the OECD/G20 inclusive framework on base erosion and profit shifting (Inclusive Framework) and revised draft Digital Services Tax Act (DSTA) to implement the digital services tax (DST) as part of the OECD's Pillar One.

— In September, 2023, the Canada Revenue Agency (CRA) released **updated guidance** regarding determining an employee's province of employment for employer payroll deduction purposes where a full-time remote work arrangement is in place in respect of an employee.

— On November 21, 2023, the Government presented the **Fall Economic Statement 2023** (Fall Economic Statement) in the House of Commons. The tax measures included in the Fall Economic Statement were not as extensive as prior years but did include additional design details for some of the Clean Economy Tax Credits, additional particulars regarding the amendments to the dividend received deduction for financial institutions, and draft legislation amending the Underused Housing Tax Act (Canada) (UHTA).

— On November 30, 2023, the Government introduced Bill C-59, the *Fall Economic Statement Implementation Act, 2023* (Bill C-59) in the House of Commons. Bill C-59 includes legislation implementing many significant tax measures including, inter alia, the expanded GAAR, the EIFEL Rules, the EOT rules, the CTI Tax Credit, the CCUS Tax Credit, the Labour Requirements, the tax on repurchases of equity Canadian publicly traded entities, the intergenerational business transfer framework, the dividend received deduction for financial institutions, the Substantive CCPC rules, the hybrid mismatch rules (Hybrid Mismatch Rules) and the DSTA.

— On December 12, 2023, CRA published **guidance** in the form of responses to questions and answers about the new trust reporting rules that received Royal Assent on December 15, 2022, and which come into effect for certain express trusts in respect of taxation years ending after December 30, 2023. The guidance included a statement that the CRA will provide relief to bare trusts by waiving the penalty payable under subsection 162(7) for the 2023 tax year in situations where the required reporting is filed after the filing deadline.

— On December 20, 2023, Finance released **proposed draft legislation** for a number of previously announced proposals (December 20 Proposals) including draft legislation to implement the CTM Tax Credit and CH Tax Credit. Finance invited feedback on the draft legislation to be provided by February 5, 2024.

The volume of legislative developments in the year precludes a comprehensive review. In the immediately following sections, we provide an overview of some of the more noteworthy 2023 developments.

EIFEL RULES

A proposal to introduce an excessive interest and financing expense limitation (EIFEL) regime was first announced in Budget 2021, and the draft EIFEL Rules were included in draft legislative proposals released by Finance on February 4, 2022. The EIFEL Rules have since been revised three times: first on November 3, 2022, second as part of the August 4 Proposals, and finally as part of the legislation tabled in Bill C-59. A description of the draft EIFEL Rules as at the end of 2022 can be found in our Firm's **2022 Tax Year in Review** publication.

This summary provides an overview of certain of the changes made to the EIFEL Rules in 2023. Many of these changes are highly technical in nature, and a detailed review of the various amendments is beyond the scope of this summary.

Overview of the EIFEL Rules and Coming into Force

The EIFEL Rules limit the amount that a taxpayer (a corporation or a trust) may deduct in respect of interest and financing expenses in any given taxation year to a fixed ratio of the taxpayer's "adjusted taxable income" (ATI). The fixed ratio is 30% of the taxpayer's ATI for the year (except for taxation years beginning after September 30, 2023 and before January 1, 2024, for which the fixed ratio is 40%). ATI is effectively "tax EBITDA" earned in Canada; essentially a taxpayer's taxable income for the year (or, if the taxpayer is a non-resident, its taxable income earned in Canada) adjusted to add back any deductions claimed in computing taxable income in respect of interest and financing expenses (IFE), certain tax expenses, capital cost allowance and resource pool deductions, and to subtract any income inclusions for interest and financing revenues (IFR), untaxed income (including foreign source income in respect of which a foreign tax credit is claimed in Canada) and certain other amounts. The general effect of the rules is IFR offsets IFE and the fixed ration limitation applies to net IFE.

Assuming Bill C-59 is enacted the EIFEL Rules will apply to taxation years beginning on or after October 1, 2023.

Excluded Entity – Domestic Exception

The EIFEL Rules are intended to apply broadly to both Canadian-resident and non-resident corporations and trusts. There are, however, exceptions for certain specified categories of entities (an "excluded entity") whose IFEs should pose a low base erosion and profit shifting risk. One such exception, referred to as the domestic exception, generally applies to a Canadian-resident corporation or trust provided that in addition to other criteria, the group's foreign affiliate holdings, if any, do not exceed a *de minimis* threshold (i.e., the greater of the book cost of all foreign affiliate shares held by the group and the fair market value (FMV) of the assets of all foreign affiliates held by the group does not exceed $5,000,000).

Prior to Bill C-59, the $5,000,000 threshold in respect of the foreign affiliate's assets applied regardless of the group's ownership percentage in the foreign affiliate. Bill C-59 provides some relief in this respect by requiring that only the amount that can reasonably be considered to be the taxpayer's or the taxpayer group's proportionate share of the value of an affiliate's assets is to be considered.

Group Ratio

The EIFEL regime includes a number of ancillary rules that are generally relieving in nature – one such set of rules is the group ratio concept. A taxpayer that is a member of an accounting consolidated group may elect to compute its IFE limit using a "group ratio" in lieu of the fixed ratio where the group ratio exceeds the applicable fixed ratio. This group ratio should effectively exempt a taxpayer that is a member of a group with only Canadian operations from the application of the 30% deduction limitation where the Domestic Exception above was not otherwise available. A consolidated group's group ratio is equal to the group's "group net interest expense" divided by the group's "group adjusted net book income"; these amounts are generally determined based on the worldwide accounting income of the group, with certain adjustments.

The August 4 Proposals added a factor of 1.1 to the group ratio computation, resulting in a 10% up-lift to the group ratio. The Explanatory Notes released with the August 4 Proposals explained that the 10% up-lift follows a recommendation in the OECD's BEPS Action 4 Report "to mitigate against book-tax timing difference that may arise from the group ratio calculation". This change recognizes that the group ratio is computed using accounting measures of income and expense, whereas the fixed ratio in the EIFEL Rules is based on tax measures.

Excess Capacity

The EIFEL Rules contain transitional rules for determining the "cumulative unused excess capacity" of a corporation or a fixed interest commercial trust for a taxation year. A taxpayer's cumulative unused excess capacity for a particular year is the total of the taxpayer's unused "excess capacity" (generally the amount by which the taxpayer's capacity for deducting IFE exceeds the amount of actual IFE plus carry forwards of restricted IFE) for the year and the three immediately preceding years. In particular, the transitional rules permit a taxpayer to carry forward excess capacity from the three immediate pre-EIFEL regime years by including this amount in the taxpayer's cumulative unused excess capacity. These rules effectively approximate what would have been the unused portion of a taxpayer's excess capacity had the EIFEL rules applied in those earlier years. An excess capacity carry forward is only permitted if the taxpayer and all eligible group entities jointly elect to have the rules apply.

In addition to setting out certain additional information that must be provided when making such an election, Bill C-59 provided that amended elections may be made in certain circumstances. In particular, an amended election is deemed to be made in certain circumstance where an assessment or reassessment results in an excess capacity that is different than the one reported on a prior election; otherwise, an election may be late-filed or amended in certain circumstances with the Minister's permission.

Controlled Foreign Affiliates

Under the EIFEL Rules, Canadian taxpayers with a controlled foreign affiliate (CFA) are required to include their share of a CFA's "relevant affiliate interest and financing expenses" (RAIFE) and "relevant affiliate interest and financing revenue" (RAIFR) in the taxpayer's IFE and IFR, respectively. If a portion of a taxpayer's IFEs are denied pursuant to the EIFEL Rules, a proportionate amount of the CFA's RAIFE will also be denied for purposes of computing the CFA's foreign accrual property income (FAPI).

The August 4 Proposals provided some clarity on how to treat interest amounts paid between CFA's with the introduction of the concept of "relevant inter-affiliate interest" which is relevant in determining the portion of interest that is included in a CFA's RAIFE or RAIFR. These concepts are relevant to where interest is paid by one CFA to another CFA and generally only apply where the taxpayer's ownership interest in the two CFAs is not the same. The relevant inter-affiliate interest of a CFA of a taxpayer is, essentially, an amount of interest that is paid or payable by the affiliate to, or received or receivable by, the affiliate from, a CFA of the taxpayer or a CFA of an eligible group entity in respect of the taxpayer. Generally, relevant inter-affiliate interest represents interest that, in the absence of the EIFEL Rules, would be deductible in computing the payer affiliate's FAPI, and included in computing the recipient affiliate's FAPI.

The August 4 Proposals also clarified the definition of "relevant affiliate financing expenses" by specifying that such expenses include only amounts that are taken into account in computing FAPI. Very generally, the definition of relevant affiliate financing expenses expressly carves out amounts that are deductible in computing deemed active business income and certain amounts that are paid or payable under certain financing structure and treated as nil in computing certain elements of FAPI.

The August 4 Proposals also introduced an election that allows a taxpayer to essentially forgo a CFA's foreign accrual property losses (FAPL) and avoid including the expenses that gave rise to the FAPL in the taxpayer's IFE. In general, a foreign affiliate's FAPL can only be applied against its FAPI, and

not against the Canadian taxpayer's income; as such, to the extent a CFA never has sufficient FAPI, there are situations where a FAPL may never actually be used to reduce Canadian taxable income. That being said, absent the proposed election discussed below, RAIFE include expenses that give rise to a FAPL, and in turn reduce the amount of IFE that the Canadian shareholder can deduct. Under the August 4 Proposals, a Canadian taxpayer may now make an election with respect to all or a portion of the affiliate's otherwise deductible IFE. The elected amount is not deductible in computing the affiliate's non-active business income (more specifically, the elected amount is not deductible in computing its income or loss from property, a business other than an active business or a non-qualifying business). The impact of this election is two-fold: (1) the elected amount is not included in the affiliate's relevant affiliate interest and finance expenses, and thus is not included in the Canadian taxpayer's IFE and will not impact that taxpayer's interest deduction capacity; (2) the affiliate's FAPL is reduced by the elected amount such that the CFA can not use the amount to offset FAPI.

Certain Other Changes of Note

Other key changes to the EIFEL Rules that were made in 2023 include the following:

— The August 4 Proposals clarified that taxpayers that elect under section 216 are subject to the EIFEL rules, but cannot benefit from certain relieving provisions under the EIFEL Rules. For additional information please refer to our Firm's **blog post** on this measure.

— The concept of "exempt interest and financing expenses" provides an exemption from the EIFEL Rules for IFE incurred in respect of certain Canadian P3 infrastructure projects. The August 4 Proposals proposed amendments to the definition of exempt interest and financing expenses which moderately widened the scope of its application. In addition, Bill C-59 included further reporting requirements for taxpayers with exempt interest and financing expenses.

— The ATI definition contains an add-back to ATI in respect of a pre-EIFEL regime loss carry forwards arising from interest deductions deducted in a post-EIFEL regime year. In order to ease the compliance burden associated with this add-back, the August 4 Proposals modified the ATI definition to provide for an optional election to treat non-capital losses arising in a taxation year ending before February 4, 2022 (i.e., the date of the initial draft EIFEL Rules) as a "specified pre-regime loss". This election has the effect of adding back to ATI a flat 25% of the non-capital loss carryforward deducted.

— The August 4 Proposals revised the IFR definition to reduce an amount otherwise included in IFR to the extent it is sheltered from Canadian tax by virtue of a credit or deduction in respect of foreign taxes, other than foreign withholding taxes. A similar change was made to the IFE definition to ensure that certain amounts related to financing arrangements will not reduce IFE to the extent that such amounts are effectively sheltered by Canadian tax by virtue of a credit or deduction in respect of foreign taxes, other than withholding taxes. Bill C-59 introduced further changes to the IFR definition in order to ensure that amounts that are exempt from tax under Part I of the Act are not included in IFR.

— Under the EIFEL rules, a "financial institution group entity" is only permitted to transfer cumulative unused excess capacity to other group members that are also financial institution group entities. Bill C-59 expanded the definition of financial institution group entity to include an entity that is in the same corporate group as a financial institution and whose primary business is the provision of portfolio/fund management or investment advice with respect to real estate.

CHANGES TO THE GAAR

Budget 2023 included proposals to amend the GAAR following the consultation process that occurred in 2022. Draft legislation was included in the Notice of Ways and Means Motion and draft legislation implementing the GAAR amendments was included in the August 4

Proposals. The Fall Economic Statement confirmed the Government's intention to proceed with the GAAR amendments and provisions implementing the amendments were included
in Bill C-59.

Bill C-59 provides that the amended GAAR will apply to transactions occurring on or after January 1, 2024 with the exceptions that: (a) the added preamble (described below) will be effective upon Bill C-59 receiving Royal Assent; and (b) the GAAR penalty (described below) will be effective in respect of transactions occurring after the later of January 1, 2024 and Bill C-59 receiving Royal Assent.

The proposals include significant revisions to the GAAR, including:

— inserting a preamble that attempts to deal with "interpretive issues and ensure the GAAR applies as intended";

— lowering the avoidance transaction threshold from "the main purpose" to "one of the main purposes";

— layering an economic substance rule on to the misuse and abuse analysis; and

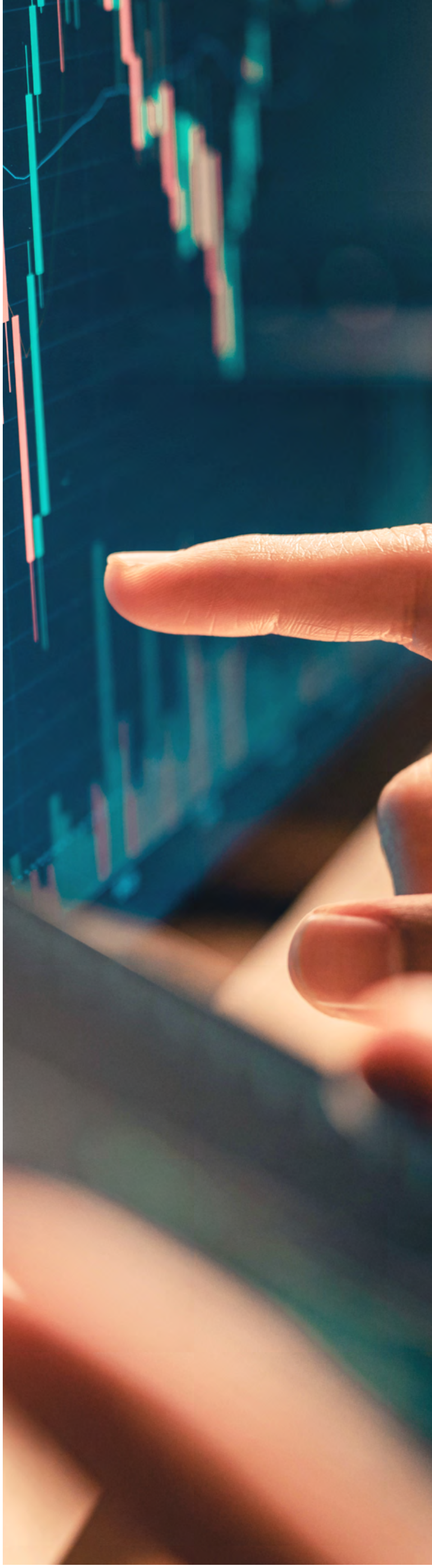
— imposing a penalty equal to 25% of the tax benefit and extending the reassessment period by three years unless, in each case, the taxpayer notified the CRA of the transaction as described below.

The preamble is described as clarifying the role the GAAR plays in delineating the line between tax planning to achieve the benefits intended by Parliament, on the one hand, and abusive tax planning that obtains unintended tax benefits, on the other hand. It also recognizes that taxpayers are entitled to certainty in planning their affairs, but this must be weighed against the Government's obligation to ensure that the tax system is "fair". The proposed preamble is notable in that it seeks to define what counts as "fairness" for purposes of the GAAR as ensuring those who undertake abusive tax avoidance are not allowed to shift the tax burden to other taxpayers.

The lowering of the threshold for the existence of an avoidance transaction to a "one of the main purposes" test was largely expected. As noted in Budget 2023, this lower threshold has been used in other recent anti-avoidance rules. It is not expected this change will have much practical impact, given that the existence of an avoidance transaction has not been the focus of many GAAR cases
to date.

More noteworthy is the introduction of an economic substance test to the misuse and abuse analysis. Bill C-59 provides that, if an avoidance transaction lacks economic substance, that will be an important consideration that tends to indicate the transaction results in a misuse or abuse for purposes of the GAAR analysis. Bill C-59 identifies the following non-exhaustive list of factors that may indicate that a transaction lacks economic substance:

— "all or substantially all of the opportunity for gain or profit and risk of loss of the taxpayer – taken together with those of all non-arm's length taxpayers – remains unchanged, including because of (i) a circular flow of funds, (ii) offsetting financial positions, or (iii) the timing between steps in the series";



- at the time the transaction is entered into, it is reasonable to conclude that "the expected value of the tax benefit exceeded the expected non-tax economic return (which excludes both the tax benefit and any tax advantages connected to another jurisdiction)"; and
- it is reasonable to conclude that "the entire, or almost entire, purpose for undertaking or arranging the transaction or series was to obtain the tax benefit."

Importantly, Budget 2023 expressly acknowledged that under Canadian tax law, legal form governs, and the introduction of an economic substance requirement to the GAAR does not allow transactions to be re-characterized based on their economic substance, nor does the lack of economic substance automatically lead to the conclusion that a transaction is abusive. Instead, Bill C-59 provides that a significant lack of economic substance "tends to indicate" that a transaction misused a provision or abused a provision. The existing jurisprudence should continue to provide the framework for a GAAR analysis, requiring an examination of whether the intended tax benefit of a transaction is consistent with the object, spirit and purpose of the relevant provisions or scheme of the Tax Act. Where the tax benefit of the transaction is consistent with the intended purpose of the relevant provisions, a lack of economic substance should not cause the GAAR to apply to deny that tax benefit. In the cases where it is unclear whether the tax benefit is consistent with the relevant purpose or scheme, the proposed rule makes the lack of economic substance a factor the court can consider in determining whether abusive tax avoidance occurred. As such, economic substance is an indicia to be considered in close calls, but should not result in a significant change to the third branch of the GAAR test.

Bill C-59 implemented a penalty of 25% of the tax benefit to be imposed on transactions that are subject to the GAAR unless the transaction was disclosed to the CRA pursuant to subsection 237.3(2) (i.e., as part of the reportable transaction rules) or pursuant to proposed subsection 237.3(12.1) (i.e., a new optional disclosure rule introduced for this purpose). Since a tax benefit now includes a tax attribute that has not been used to reduce tax, the proposal deems these tax benefits to be nil for purposes of the penalty. In a further effort to encourage disclosure, the normal reassessment period is extended by three years for GAAR reassessments unless the transaction was previously disclosed to the CRA in accordance with section 237.3. Quebec included similar penalty and extended reassessment provisions when it reformed its GAAR a decade ago, but there has not yet been a published court decision in which such penalties have been imposed, making it difficult to predict the impact of these changes from Quebec's experience.

TRUST REPORTING RULES

A proposal to introduce new trust reporting rules was first announced in Budget 2018, and the draft rules were included in draft legislation released on February 4, 2022, with a revised version released on August 9, 2022. The new rules were enacted by Bill C-32, which came into force on December 15, 2022. The new regime requires most trusts to file a T3 Trust Income Tax and Information Return (T3 Return) annually for taxation years ending on or after December 31, 2023. The filing deadline is March 30, 2024 for a trust with a December 31, 2023 taxation year-end.

Leading up to the enactment of the new reporting rules, Finance expressed the view that the information collected under the previous trust reporting rules was insufficient. Under the previous rules, a T3 Return had to be filed for only those trusts that had tax payable in the year, disposed of capital property, or made distributions to beneficiaries. The new rules aim to resolve this perceived inadequacy by implementing more extensive reporting requirements for certain types of trusts.

Under the new reporting rules, all trusts subject to the rules are required to file a T3 Return and Schedule 15 and provide information regarding reportable entities, including the trust's trustees, beneficiaries and settlors. In addition, any person who has control or the ability to exert control or override trustee decisions (for example, a protector) is considered a reportable entity. The new rules also require that the following information be provided for each reportable entity: name, type and classification of entity, address, date of birth (if a natural person), country of residence and tax identification number (e.g., social insurance number, trust account number, or business number).

Trusts required to file a T3 Return under the new rules include all trusts that are resident in Canada and are express trusts, or that are for civil law purposes trusts other than trusts that are established by law or by judgement, unless one of the limited exceptions applies. Bare trusts are also subject to the new trust reporting rules unless an exception applies. Among other exceptions, there are exceptions for:

— trusts that have been existence for less than three months at the end of the year;

— trusts that hold less than $50,000 in assets throughout the taxation year (provided that their holdings are confined to property generally consisting of money, government debt obligations and listed securities); and

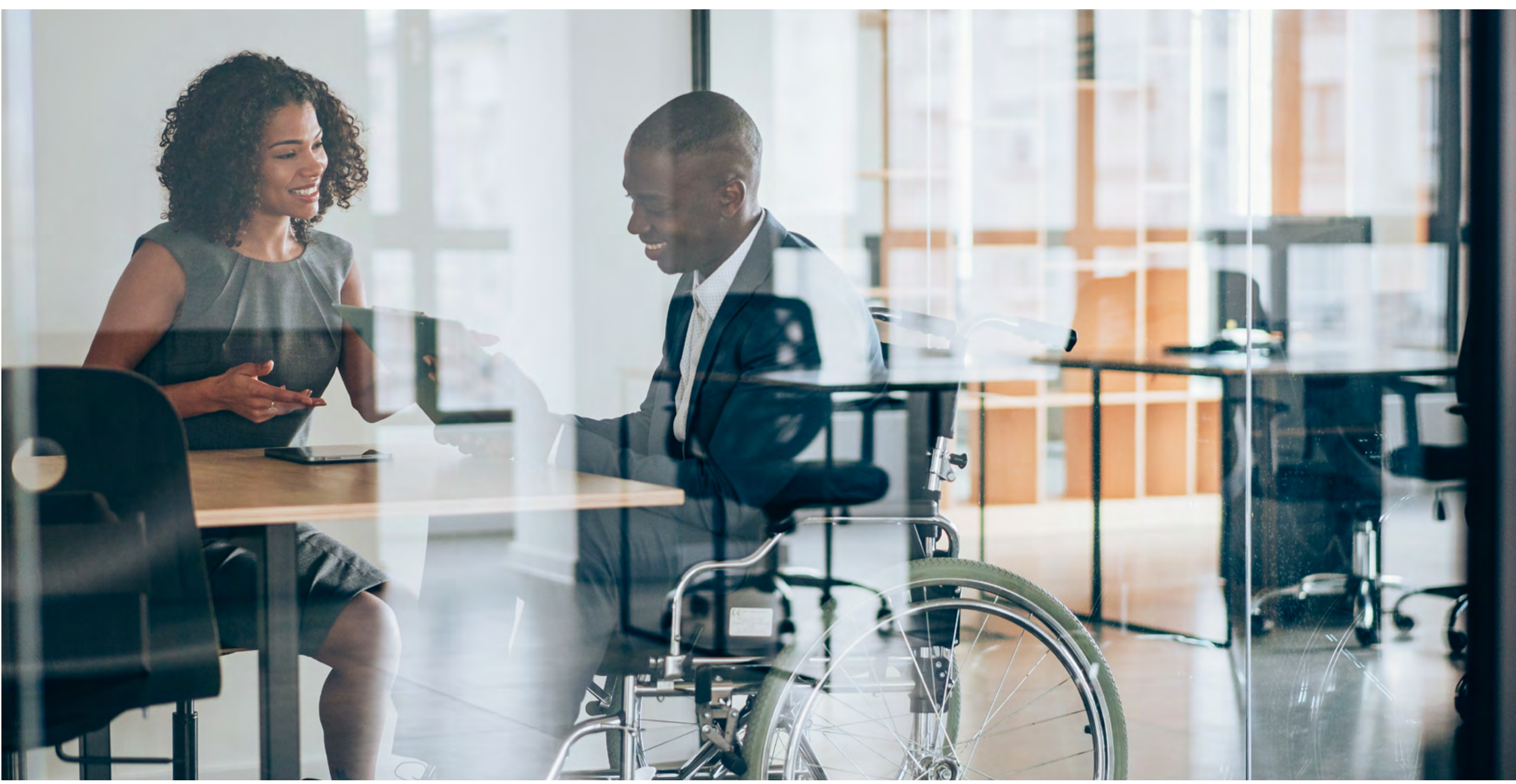
— trusts that have all units listed on a designated stock exchange.

The new reporting rules provide that, for greater certainty, they do not require the disclosure of information that is subject to solicitor-client privilege.

Failure to comply with the new trust reporting requirements may result in penalties under subsection 162(7) equal to the greater of: (i) $100; or (ii) $25 per day of non-compliance for up to a maximum of $2,500. Additionally, under subsections 163(5) and 163(6), where a failure to file or provide accurate information was done knowingly or under circumstances amounting to gross negligence, there is a penalty equal to the greater of: (a) $2,500; and (b) 5% of the highest total FMV of the trust's property at any time in the year.

The CRA has indicated that it will provide administrative relief for bare trusts by waiving the penalty under subsection 162(7) for the 2023 tax year where the T3 Return and Schedule 15 are filed after the filing deadline. The CRA's relief does not appear to extend to the penalties under subsection 163(6). In relation to a bare trust, the amount of a subsection 163(6) penalty may arguably be limited to $2,500 in any event, as that may be greater than 5% of the total FMV of the property of the bare trust (i.e., nil).

The CRA published administrative **guidance** in the form of responses to questions and answers about the new trust reporting rules on December 12, 2023.



MANDATORY DISCLOSURE RULES

The new Mandatory Disclosure Rules received Royal Assent on June 22, 2023. The Mandatory Disclosure Rules were initially proposed in Budget 2021. Draft legislation was first released on February 4, 2022. Revised draft legislation was released on August 9, 2022. Further revised legislation was included in Bill C-47 which received Royal Assent on June 22, 2023. The CRA Guidance was published on July 5, 2023 and updated on November 2, 2023. The CRA Guidance is expected to continue to evolve.

The new Mandatory Disclosure Rules: (a) expand the application of the "reportable transaction" rules; (b) require the reporting of "uncertain tax treatments" by certain corporations; and (c) create a new regime for reporting "notifiable transactions".

A failure to report under the new Mandatory Disclosure Rules can result in significant penalties and extended reassessment periods.

Reportable Transactions

Generally, a transaction will be a reportable transaction under the new legislation if:

- It would be reasonable to consider that one of the main purposes of the transaction, or a series of transactions of which it is a part, is to obtain a tax benefit (referred to as an "avoidance transaction"); and
- One of the following hallmarks is present in respect of the avoidance transaction or a series of transactions of which it is a part:
  - Contingent Fees - an advisor, promoter, or person that does not deal at arm's length with an advisor or promoter, is entitled to fees: (i) based on the quantum of the tax benefit; (ii) contingent upon achieving the tax benefit; or (iii) attributable to the number of persons who participate in the same or similar transaction or series of transactions or have been provided access to advice or an opinion given by an advisor or promoter regarding the tax consequences from the same or similar transaction or series;
  - Confidential Protection - an advisor, promoter, or person that does not deal at arm's length with an advisor or promoter, obtains confidential protection from certain persons in respect of a tax treatment in relation to the transaction or series of transactions; or
  - Contractual Protection - any of the taxpayer, a person who has entered into the transaction or series of transactions for the benefit of the taxpayer, an advisor or promoter, or a person that does not deal at arm's length with any of the foregoing, has contractual protection that protects against a failure to achieve the tax benefit or pays for the costs of a related dispute. Contractual protection generally does not include standard professional liability insurance or protection that is integral to an agreement between arm's length persons for the sale or transfer of all or part of a business (in an asset or securities deal) where it is reasonable to consider that the insurance or protection is (i) intended to ensure that the purchase price paid under the agreement

takes into account any liabilities of the business immediately prior to the sale or transfer; and (ii) obtained primarily for purposes other than to achieve any tax benefit from the transaction or series of transactions. The CRA Guidance includes a number of additional examples where it generally does not consider the contractual protection hallmark to be present.

The new reportable transaction rules apply to reportable transactions entered into on or after June 22, 2023, generally including where any part of the series of transactions occurs on or after June 22, 2023.

Reporting Reportable Transactions and Associated Penalties

Reportable transactions must generally be reported by the following persons:

— persons for whom a tax benefit results or is expected to result from the transaction or series of transactions;

— persons who enter into an avoidance transaction for the benefit of a person for whom a tax benefit results or is expected to result; and

— advisors and promoters in respect of the transaction or series of transactions, and persons not dealing at arm's length with an advisor or promoter, if the advisor or promoter, or non-arm's length person, is entitled to a contingent fee or a fee for providing contractual protection.

A person is not required to report solely because the person provides clerical or secretarial services in relation to a reportable transaction.

Penalties for failure to report may include:

— financial penalties, including a penalty of up to 25% of the tax benefit for a person for whom the benefit results or a person who entered into an avoidance transaction for such a person's benefit;

— an extended reassessment period; and

— a lower threshold for the application of the GAAR.

There is a due diligence defence from the application of the financial penalties similar to the due diligence defence under the uncertain tax treatment rules (discussed below).

Information reasonably believed to be subject to solicitor-client privilege is not required to be disclosed under the reportable (or notifiable) transaction rules. The Federation of Law Societies of Canada has brought a constitutional challenge to the application of the new Mandatory Disclosure Rules to lawyers. An injunction is currently in effect such that lawyers are not required to report under the reportable or notifiable transaction rules pending the outcome of this application.

Notifiable Transactions

A notifiable transaction is a transaction, or a transaction in a series of transactions, that is the same as, or substantially similar to, a transaction or a series of transactions that is designated at that time by the Minister of National Revenue, with the concurrence of the Minister of Finance. The following **list of transactions** was designated effective November 1, 2023:

— straddle loss creation transactions using a partnership;

— avoidance of deemed disposal of trust property;

— manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation;

— reliance on purpose tests in section 256.1 to avoid a deemed acquisition of control; and

— back-to-back arrangements.

Notifiable Transactions and Associated Penalties

Notifiable transactions must generally be reported by the following persons:

— persons for whom a tax benefit results or is expected to result from the transaction or series of transactions;

— persons who enter into the notifiable transaction for the benefit of a person for whom a tax benefit results or is expected to result;

— advisors and promoters in respect of the notifiable transaction, and persons not dealing at arm's length with an advisor or promoter if the non-arm's length person is entitled to a fee in respect of the notifiable transaction.

As in the case of reportable transactions, a person is not required to report solely because the person provides clerical or secretarial services in relation to a notifiable transaction. The notifiable transaction rules further provide that where an employer or partnership reports the transaction, the reporting is deemed to have been made by each employee or partner.

Penalties for failure to report may include:

- financial penalties, including a penalty of up to 25% of the tax benefit for a person for whom the benefit results or a person who entered into a notifiable transaction for such a person's benefit; and
- an extended reassessment period.

The above penalties are subject to due diligence defences. Different standards apply to a person for whom the benefit results or a person who entered into a notifiable transaction for such a person's benefit, on the one hand, and advisors or promoters, on the other. With respect to the former, no reporting obligation arises if the person has exercised the degree of care, diligence and skill in determining whether the transaction is a notifiable transaction that a reasonably prudent person would have exercised in comparable circumstances. The CRA Guidance indicates that this standard will generally be met if the person sought advice and was informed by their advisors that there was no requirement to report. A higher standard applies to advisors and promoters.

As indicated above, information reasonably believed to be subject to solicitor-client privilege is not required to be disclosed under the notifiable transaction rules.

Uncertain Tax Treatments

For certain corporations that file a Canadian income tax return and have assets with a carrying value of at least $50 million at the end of the taxation year, the uncertain tax treatment (UTT) rules generally require the reporting of a tax treatment in respect of which uncertainty is reflected in the audited financial statements of the corporation, or a group of which it is a member, for the taxation year. These rules generally apply to taxation years that begin after 2022, except that financial penalties do not apply to taxation years that began before June 22, 2023 (being the date of Royal Assent).

For each failure to report a UTT, the corporation is liable to a penalty of $2,000 per week, up to a maximum of $100,000. A taxpayer's normal reassessment period in respect of a UTT does not begin to run until the UTT is reported.

If a corporation has exercised due diligence to prevent a failure to file, it will not be liable for a financial penalty under the UTT rules. The wording used for the due diligence defence is parallel to that of the due diligence defence in respect of director liability under the Act. The CRA Guidance indicates that the interpretation of the due diligence defence under the UTT rules will likely be informed by established case law and guidance on director liability under the Act.

For additional details on the new Mandatory Disclosure Rules, please refer to **A Practical Guide to the New Mandatory Disclosure Rules of the *Income Tax Act***, published by McCarthy Tétrault's National Tax Group and current as of September 12, 2023.

TAX ON REPURCHASES OF EQUITY

The 2022 FES announced the Government's intent to introduce a tax on share buybacks by public corporations in Canada. Budget 2023 included draft legislation on a proposed tax on certain equity repurchases by publicly-listed corporations, partnerships and trusts. Updated draft legislation was included in the August 4 Proposals. The Fall Economic Statement confirmed the Government's intent to proceed with the proposed tax on repurchases of equity and Bill C-59 tabled further updated legislation.

Under new Part II.2, a 2% tax will generally be levied on repurchases of a covered entity's equity in a taxation year.

For the purposes of Part II.2:

- the term "equity" is defined to mean a share of a corporation, an income or capital interest in a trust, or an interest as a member of a partnership; and
- the term "covered entity" is, generally, defined to include an entity whose equity is listed on a designated stock exchange and is a corporation resident in Canada (other than a mutual fund corporation), a real estate investment trust, a specified investment flow-through trust, or a specified investment flow-through partnership.

The tax is levied based on the formula A + B - C, where, very generally:

- Variable A is the total FMV of certain equity of the covered entity that is redeemed, acquired or cancelled by it in the taxation year;
- Variable B is either nil or, where applicable, the excess of the total FMV of equity redeemed, acquired or cancelled pursuant to certain reorganizations over the total FMV of certain equity consideration received, if any, pursuant to such reorganizations; and
- Variable C is the total FMV of certain equity of the covered entity that is issued in the taxation year.

Variable A is subject to three exclusions and a *de minimis* rule. The first exclusion is for equity that constitutes "substantive debt" (i.e., equity with debt-like characteristics). The second exclusion is for certain reorganizations, including where the holder exchanges its equity for consideration that includes the equity (other than substantive debt) of: (i) the covered entity, (ii) certain other covered entities that are related to the covered entity, or (iii) certain other covered entities that control the covered entity (each a Relevant Entity). This exclusion may also apply in respect of specified amalgamations, liquidations, equity exchanges, statutory dissent rights, reorganizations and butterfly transactions. The third exclusion is for repurchases of equity previously acquired by a "specified affiliate" (described below) of the covered entity, if an anti-avoidance rule (discussed below) applied to deem such equity to have been acquired by the covered entity and was previously included in variable A. The *de minimis* rule provides that no Part II.2 tax is payable where the total of the amounts determined under variables A and B is less than $1 million (which is prorated for taxation years that are shorter than 365 days).

Variable B is relevant where equity is redeemed, acquired or cancelled: (i) in a reorganization where the holder exchanges equity for consideration that includes the equity of a Relevant Entity, or (ii) in a specified amalgamation, where the holder receives consideration other than those described in respect of such reorganizations. In those circumstances, variable B is the total FMV of the equity (other than substantive debt) redeemed, acquired or cancelled in such reorganizations, minus the total FMV of such equity consideration received in such reorganizations. Otherwise, variable B is nil.

Variable C is the total FMV of equity that is: (i) issued in a "qualifying issuance" in the taxation year, or (ii) disposed of by a "specified affiliate" of the covered entity (other than to the covered entity or another specified affiliate of the covered entity) if an anti-avoidance rule applied to deem such equity to have

been acquired by the covered entity and was previously included in variable A. Variable C is subject an exclusion for the issuance of equity that constitutes "substantive debt". A "qualifying issuance" is very generally defined to mean any portion of an issuance made: (i) in exchange for cash, to settle a convertible debt originally issued for cash, or any combination thereof, (ii) for employment remuneration, or (iii) to a person or partnership that deals at arm's length, and is not affiliated, with the covered entity, in exchange for property that is used in the covered entity's business.

New Part II.2 contains specific anti-avoidance rules:

— equity that is redeemed, acquired, or cancelled or that is issued by a covered entity as part of a transaction or series is included in variable A or B or excluded from variable C if it is reasonable to consider the primary purpose of the transaction or series is to reduce the Part II.2 tax base;

— if it is reasonable to consider that one of the main purposes of a transaction or series is to cause a person or partnership to acquire equity of a covered entity to avoid Part II.2 tax otherwise payable, such person or partnership is deemed to be a specified affiliate (described below) of the covered entity for the entire duration of the transaction or series; and

— subject to certain exclusions, equity acquired by a "specified affiliate" of a covered entity is deemed to be acquired by the covered entity for purposes of the Part II.2 tax calculation.

The term "specified affiliate" is defined based on whether it is a corporation, trust or partnership. For example, where it is a corporation, the term is defined to mean a corporation that is controlled by the covered entity, or a corporation in which the covered entity has a direct or indirect interest in the equity of the corporation having 50% or more of the FMV of the total equity of the corporation.

A covered entity that redeems, acquires or cancels its equity in a taxation year is required to file a Part II.2 return in prescribed form. The filing deadline will depend on the type of covered entity being considered (e.g., where the covered entity is a corporation, such return is to be filed on or before the day it is required to file its Part I tax return).

The rules under new Part II.2, if enacted, will apply as of January 1, 2024.

HYBRID MISMATCH

Both Budget 2023 and the Fall Economic Statement confirmed the Government's intent to proceed with implementing the first of two packages to amend the Act with respect to hybrid mismatch arrangements. Proposed draft legislation to implement the Hybrid Mismatch Rules was released on April 29, 2022. A description of the April 29, 2022 draft legislation can be found in our Firm's **2022 Tax Year in Review** publication. Bill C-59 tabled legislation implementing the Hybrid Mismatch Rules. Part 2 of the Hybrid Mismatch rules are still to be released by Finance.

The Hybrid Mismatch Rules implement the recommendations in Chapters 1 and 2 of the OECD's BEPS Action 2 Report with respect to hybrid financial instruments. The Hybrid Mismatch Rules specifically contemplate that the relevant provisions of the Act are to be interpreted consistently with the OECD's recommendations in the BEPS Action 2 Report unless the context specifically requires otherwise. This is the first time

the Act will include an interpretive rule specifically requiring provisions of the Act to be interpreted in a manner consistent with an OECD publication. Other examples of this type of interpretive rule are found in the Pillar 2 rules included in the GMTA (as discussed below) and the common reporting standard.

The Hybrid Mismatch Rules include two main operative provisions:

— a primary operative rule which neutralizes a deduction/non-inclusion mismatch arising from a payment under a hybrid mismatch arrangement by restricting the deduction by the payer; and

— a secondary operative rule which is intended as a defensive rule that neutralizes a deduction/non-inclusion mismatch by including an amount in the income of the payment recipient.

In order for the Hybrid Mismatch Rules to apply to a particular payment it must be determined that the relevant payment arises under a hybrid mismatch arrangement and that there is a deduction/non-inclusion mismatch in respect of the hybrid mismatch arrangement. A hybrid mismatch arrangement is defined to mean any of the following three specified types of arrangements (with more categories to be added in the future).

— Hybrid financial instrument arrangement – simplified, where the mismatch arises from differences in the income tax treatment of payments under or in connection with a financial instrument due to the terms or conditions of the instrument.

— Hybrid transfer arrangement – simplified, where the mismatch results from different entities being treated as the owner of returns on a transferred instrument.

— Substitute payment arrangement – generally, where a payment under, or in connection with, a transfer of a financial instrument functions as a substitute for certain returns on the instrument.

In response to consultations, Bill C-59 introduced a few relieving changes to the determination of whether certain forms of hybrid mismatch arrangement exist:

— it introduced a carve-out for “exempt dealer compensation payments” from the conditions for a hybrid transfer arrangement;

— amended the conditions for a substitute payment arrangement to require that one of the entities involved in the arrangement must be a non-resident of Canada such that a substitute payment arrangement should no longer be possible in purely domestic arrangements; and

— a new exception to the specified entity rule in subsection 18.4(17) to deem an entity (a particular entity) not to be a “specified entity” (as defined in subsection 18.4(1) with reference to the deeming rules in subsection 18.4(17)) in respect of another entity if:

    — the particular entity would otherwise be a specified entity;

— there was in effect at that time an agreement or arrangement under which, on the satisfaction of a condition or the occurrence of an event that it is reasonable to expect will be satisfied or will occur, the particular entity will cease to be a specified entity in respect of the other entity; and

— the purpose for which the particular entity became a specified entity was the safeguarding of rights or interests of the particular entity or an entity with which the particular entity is not dealing at arm's length in respect of any indebtedness owing at any time to the particular entity or an entity with which the particular entity is not dealing at arm's length.

The changes introduced in Bill C-59 also provide relief where Canadian withholding tax was required to be remitted on interest as a result of the application of the Hybrid Mismatch Rules deeming the interest to be a dividend but the amount of the interest was subsequently subject to tax in the foreign jurisdiction. In these circumstances a refund of the Part XIII withholding tax will be available.

The Hybrid Mismatch Rules, assuming Bill C-59 is enacted, are effective with respect to payments made on or after July 1, 2022.

DIVIDEND RECEIVED DEDUCTION

Budget 2023 proposed to deny the inter-corporate dividend deduction in respect of dividends received by a financial institution (FI) on shares that are mark-to-market property (MTM property) of the FI. The Fall Economic Statement added an exception to the denial of the intercorporate dividend deduction for dividends paid on "taxable preferred shares" (TPS Exception). Bill C-59 included provisions implementing the denial of the dividend received deduction for FIs and the TPS Exception.

In general, subject to certain rules, a corporation is entitled to deduct, in computing its taxable income for a taxation year, dividends received by the corporation on shares of taxable Canadian corporations. In effect, the provision allows dividends on such shares to flow tax-free through a corporate chain so as to mitigate double taxation at the corporate level.

As defined, an FI includes, among others, a bank, registered securities dealer, credit union and insurance corporation. In general, shares held by an FI at any time in a taxation year would be MTM property of the FI for the taxation year unless, at that time, the FI holds shares giving the FI 10% or more of the votes and having a FMV of 10% or more of all of the shares of the issuer corporation. MTM property also includes property (referred to as tracking property) the FMV of which is determined primarily by reference to one or more criteria (i.e., FMV, or revenue, income or cash flow) in respect of property that, if owned by the FI, would be MTM property of the FI.

Under the mark-to-market rules, where an FI disposes of MTM property in a taxation year, any gain (or loss) from the disposition is included (or deducted) in computing the income of the FI for the year. Where an FI holds MTM property at the end of a taxation year, the FI is deemed to have disposed of the property immediately before the end of the year for proceeds equal to FMV and to have reacquired the property at the end of the year at a cost equal to those proceeds.

The Government stated in Budget 2023 that "[t]he policy behind the dividend received deduction conflicts with the policy behind the mark-to-market rules." In essence, the Government suggests that there is an inconsistency between, on the one hand, shares that are MTM property being treated as being held on income account and, on the other hand, dividends received on such shares being eligible for the dividend received deduction.

The proposed measure is implemented by way of a new provision which denies the inter-corporate dividend deduction by a corporation in computing its taxable income for a taxation year in respect of a dividend received on a share if the corporation is an FI at any time in the year, and the share is MTM property of the corporation for the year (or would be MTM property of the corporation for the year if the share was held at any time in the year by the corporation). For this purpose, a share (other than a share of an FI) that is tracking property of a corporation at any time in a taxation year is deemed to be MTM property of the corporation for the year.

Assuming Bill C-59 is enacted the measure applies in respect of dividends received after 2023.

CLEAN ECONOMY TAX CREDITS

Over the past few years, the Government has introduced the Clean Economy Tax Credits to promote investment in clean technology in Canada.

In 2023, there were significant updates regarding the Clean Economy Tax Credits. Budget 2023 introduced new investment tax credits, including the CEI Tax Credit, and provided further detail on, and proposed enhancements to, previously announced tax credits. The August 4 Proposals included proposed draft legislation for the CTI Tax

Credit, the CCUS Tax Credit and the Labour Requirements. The Fall Economic Statement provided additional design and implementation details regarding the CH Tax Credit, CTI Tax Credit and CEI Tax Credit. Bill C-59 included tabled legislation, significantly departing from the August 4 Proposals, to implement the CTI Tax Credit, CCUS Tax Credit and the Labour Requirements. Finally, the December 20 Proposals included proposed draft legislation for the CH Tax Credit and the CTM Tax Credit.

Herein we provide a chronology and high-level overview of each of the clean economy tax credits and the Labour Requirements to date. More detailed information regarding the Clean Economy Tax Credits is available on the McCarthy Tétrault website (links embedded below).

Investment Tax Credit for Carbon Capture, Utilization, and Storage

Announced in Budget 2021, the CCUS Tax Credit is intended to encourage and support the investment of capital in the development and operation of carbon capture, transportation, utilization and storage capacity in Canada. Draft legislation was released in August, 2022. In 2023, additional details regarding the tax credit were announced in Budget 2023, and the Government released revised draft legislation on August 4. The Fall Economic Statement indicated that legislation would be introduced in the House of Commons in fall 2023 and Bill C-59 did indeed include tabled legislation implementing the CCUS Tax Credit.

The rate of the CCUS Tax Credit depends on the type of expense and when the expense is incurred. Between January 1, 2022 and December 31, 2030, the rates will be 37.5%, 50% or 60%. Between January 1, 2031 and December 31, 2040, the rates will be one-half of the said rates. As discussed below, if the taxpayer does not elect to satisfy the Labour Requirements, the amount of the CCUS Tax Credit could be reduced by 10%. The credit may be clawed back through a recovery tax based on a comparison between the actual percentage of captured carbon stored or used in an eligible use and the projected percentages, subject to a discretionary relieving rule for extraordinary circumstances.

The CCUS Tax Credit is a refundable tax credit composed of the taxpayer's "cumulative CCUS development tax credit" and the taxpayer's "CCUS refurbishment tax credit". For either component, the CCUS Tax Credit is only available in respect of "qualified CCUS expenditures". "Qualified CCUS expenditures" are comprised of qualified carbon capture expenditures, qualified carbon transportation expenditures, qualified carbon storage expenditures and qualified carbon use expenditures, which are, broadly, the cost of acquiring certain equipment and property used in a "qualified CCUS project". A "qualified CCUS project" must meet the following conditions, among others: the Minister of Natural Resources must issue a project evaluation for the project, the project must plan to operate for at least 20 years, and at least 10% of captured carbon must be expected to be stored or used in an "eligible use". An "eligible use" of captured carbon is storing it in "dedicated geological storage" or using it in producing concrete in Canada or the United States using a "qualified concrete storage process". Among other things, "dedicated geological storage" must be in a "designated jurisdiction" as defined in subsection 127.44(1).

The credit is only available for "qualifying taxpayers", which are taxable Canadian corporations. As previously noted, the draft legislation includes rules that apply to partnerships, enabling partners that are taxable Canadian corporations to claim their reasonable share, limited to a limited partner's at-risk amount, of the CCUS Tax Credit derived from qualified CCUS expenditures made by the partnership to acquire property in respect of qualified CCUS projects.

The CCUS Tax Credit will apply to eligible expenses incurred on or after January 1, 2022 and before January 1, 2041.

Our detailed review of the CCUS Tax Credit as of November 17, 2023 can be found **here**. An updated, detailed review will follow including consideration of the implications of Bill C-59.

Clean Technology Investment Tax Credit

Announced in the 2022 FES, the CTI Tax Credit is a 30% refundable tax credit applicable to investments in "clean technology property" (as defined in subsection 127.45(1)). The stated purpose of the CTI Tax Credit is "to encourage the investment of capital in the adoption and operation of clean technology property in Canada". The August 4 Proposals included draft legislation and revised draft legislation to implement the CTI Tax Credit. On November 28, 2023, legislation implementing the CTI Tax Credit was tabled in Parliament. The Fall Economic Statement indicated that legislation would be introduced in the House of Commons in fall 2023 and Bill C-59 did indeed include tabled legislation implementing the CTI Tax Credit.

The Fall Economic Statement also proposed to expand the property eligible for the CTI Tax Credit to support the generation of electricity, heat, or both electricity and heat (i.e., cogeneration), from waste biomass. The Government indicated it intends to commence draft legislation consultations regarding this expanded eligibility in summer 2024 and to introduce legislation in the House of Commons in fall 2024.

As discussed below, if a taxpayer does not elect to satisfy the Labour Requirements, the amount of the CTI Tax Credit could be reduced by 10%. The credit received by a taxable Canadian corporation or partnership may be subject to recapture where, within 10 calendars years of the acquisition of the clean technology property that entitled the taxpayer to the credit, the property is (i) converted to a "non-clean technology use", (ii) exported from Canada, or (iii) disposed of. There is an exception to this recapture for taxable Canadian corporations where the property is disposed of pursuant to certain non-arm's length transfers.

There are various conditions within the definition of "clean technology property", including that the property be situated in Canada (which includes wind energy and kinetic energy conversion systems that are installed in the exclusive economic zone of Canada) and that the property be intended for use exclusively in Canada. The types of eligible property are described in part by reference to the classes of property described in Schedule II to the Regulations for capital cost allowance purposes. As noted, the Fall Economic Statement proposed to expand eligible property further to include systems that use "specified waste materials" solely to generate electricity, heat, or electricity and heat. As revised by the November tabled legislation, eligible property now includes equipment that is used exclusively to generate electrical or heat energy from geothermal energy for sale or use. Equipment that co-produces fossil fuel for sale is not eligible.

The CTI Tax Credit is limited to "qualifying taxpayers", defined as taxable Canadian corporations or a mutual fund trust that is a "real estate investment trust" (as defined in subsection 122.1(1)). Additionally, the tabled legislation includes a series of rules regarding the application of the CTI Tax Credit and CCUS Tax Credit to partnerships, enabling partners that are taxable Canadian corporations to claim their share of the CTI Tax Credit derived from expenditures made by the partnership to acquire clean technology property. Pursuant to new section 127.47, the total tax credit amount that may be allocated to a limited partner is restricted to a reasonable proportion and may not exceed a partner's at-risk amount in respect of the partnership. Additionally, the total clean economy tax credit allocated to a partner must be apportioned among each individual tax credit in a manner that reasonably corresponds to each credit.

The August 4 Proposals included a rule in subsection 127.45(9) which incorporated by reference existing subsections 127(8.1) to (8.5) with whatever modifications are necessary. Very generally, these provisions restrict a limited partner's reasonable share of a partnership's investment tax credit to the lesser of the partner's at-risk amount and the amount of credit arising from the partner's expenditure base. The aggregate amount by which the limited partners' reasonable shares is reduced is deemed to be the reasonable share of the general partner or partners. The November 28 tabled legislation does not include a provision incorporating existing subsections 127(8.1) to (8.5) by reference. The tabled legislation includes subsection 127.47(3), which limits a limited

partner's share to be its at-risk amount but does not include any provision deeming the amount by which the limited partners' shares are reduced to be the reasonable share of the general partner or partners. The exclusion of such a provision makes it questionable what happens to the excess of the credit and draws into question whether this amount can be the reasonable share of the general partner absent the deeming provision. We expect this change to cause significant disruption in the renewable energy infrastructure industry where limited partnerships are the preferred business structure and often there is debt at the partnership level.

Notably, the Explanatory Notes to the November tabled legislation state that new section 127.47 will also apply to the CH Tax Credit, CTM Tax Credit and CEI Tax Credit when they are enacted.

The CTI Tax Credit will be applicable to investments in eligible property that are acquired and become available for use on or after Budget Day 2023 until December 31, 2033. The expanded CTI Tax Credit will only be available in respect of eligible waste biomass equipment that is acquired and becomes available for use on or after November 21, 2023. Budget 2023 indicated that the Government proposes to phase the CTI Tax Credit out gradually, with property that becomes available for use in 2034 eligible for only a 15% credit and no credit available for property that becomes available for use after December 31, 2034.

For additional details, our review of the CTI Tax Credit as of September 18, 2023 can be found **here**. An updated, detailed review will follow including consideration of the implications of Bill C-59.

Clean Electricity Investment Tax Credit

Budget 2023 announced the Government's intention to introduce the CEI Tax Credit to support investments in clean electricity in Canada. The Fall Economic Statement indicated that, for taxpayers except for publicly-owned utilities, details will be published in early 2024 and draft legislation consultations will be launched in summer 2024. For publicly-owned utilities, consultations with provinces and territories will be launched in 2024. For all taxpayers, the Government targets to introduce legislation in the House of Commons in fall 2024.

The CEI Tax Credit is a 15% refundable investment tax credit that may be claimed by both taxable and tax-exempt entities. However, as discussed below, if the taxpayer does not elect to satisfy the Labour Requirements, the amount of the CEI Tax Credit could be reduced by 10%. The CEI Tax Credit will be available in respect of costs incurred in refurbishing existing facilities as well as new projects, and will broadly apply to investments in non-emitting electricity generation systems, abated natural gas-fired electricity generation (subject to an emission intensity threshold), stationary electricity storage systems that do not use fossil fuels in operation, and equipment for the transmission of electricity between provinces and territories. The Fall Economic Statement expanded the property eligible for the tax credit to support the generation of electricity or both electricity and heat (i.e., cogeneration) from waste biomass.

There is significant (although not perfect) overlap between the types of property that qualify for the CEI Tax Credit and the CTI Tax Credit. It is not entirely apparent how the two credits will interact in the context of a partnership involving a taxable entity and a tax-exempt entity.

Budget 2023 included a statement that the CEI Tax Credit will only be available in respect of projects in jurisdictions in which a competent authority has committed that the federal funding will be used to lower electricity bills and committed to achieving a net-zero electricity sector by 2035 (Competent Authority Commitments Criteria). The Fall Economic Statement indicated that the credit will treat publicly-owned utilities and taxpayers other than publicly-owned utilities differently. It is not clear at this point what the differences will be. Some are speculating that the Competent Authority Commitments Criteria will only apply in respect of publicly-owned utilities.

The CEI Tax Credit will be available as of Budget Day 2024 in respect of projects that commenced construction on or after Budget Day 2023 and before January 1, 2034.

Clean Hydrogen Investment Tax Credit

The 2022 FES announced the Government's intention to introduce the CH Tax Credit, which is a 15%, 25% or 40% refundable tax credit to encourage investment in clean hydrogen production that would reduce emissions of greenhouse gases. The Fall Economic Statement indicated the Government intends to introduce legislation in Parliament in early 2024. The December 20 Proposals included proposed draft legislation and Finance initiated a public consultation process.

The CH Tax Credit will apply in respect of the cost of purchasing and installing eligible equipment for eligible projects that produce hydrogen from electrolysis or natural gas (so long as emissions are abated using carbon capture, utilization, and storage). The Fall Economic Statement introduced eligibility for clean ammonia production equipment at the lowest credit rate of 15% and confirmed that the Government will continue to review eligibility for other low-carbon hydrogen production pathways in the lead up to Budget 2024.

To determine the applicable credit rate, projects will be required to assess the expected carbon intensity (CI) of the hydrogen that is produced (measured in kg of carbon dioxide equivalent per kg of hydrogen). As discussed below, if the taxpayer does not elect to satisfy the Labour Requirements, the amount of the CH Tax Credit could be reduced by 10%. Additionally, the credit may be subject to a clawback or recovery based on a comparison between the actual CI of the hydrogen produced by a project and the assessed CI. The Fall Economic Statement proposed that this potential clawback or recovery occur pursuant to a one-time verification, based on a five-year compliance period. It also proposed allowing an acceptable margin of error between the actual CI of the produced hydrogen and the assessed CI.

The CH Tax Credit will apply in respect of eligible equipment that is acquired and becomes available for use (in accordance with the available for use rules applicable to depreciable property) in an eligible project on or after Budget Day 2023. Budget 2023 proposed to phase out the CH Tax Credit gradually, with property that becomes available for use in 2034 eligible for one-half of the applicable credit and no credit available for property that becomes available for use after December 31, 2034.

Our Firm's detailed overview of the proposed draft legislation included in the December 20 Proposals for the CH Tax Credit is forthcoming.

Clean Technology Manufacturing Investment Tax Credit

Budget 2023 announced the Government's intention to introduce the CTM Tax Credit for investments in clean technology manufacturing and processing or investments in critical mineral extraction and processing. The Fall Economic Statement indicated the Government's intent to introduce legislation in Parliament in early 2024. The December 20 Proposals included proposed draft legislation and Finance initiated a public consultation process.

The CTM Tax Credit is proposed to be a 30% refundable tax credit available in respect of certain depreciable property that is used all or substantially all for eligible activities. Eligible property would generally include machinery and equipment (including certain industrial vehicles) used in manufacturing, processing, or critical mineral extraction, as well as related control systems. Eligible activities will be, broadly, processing or recycling nuclear fuels and heavy water, extracting and certain processing activities related to critical minerals, and manufacturing certain equipment and machinery. If the property becomes subject to a change in use, or is sold, within a certain (unspecified) period of time, a portion of the CTM Tax Credit will be clawed back.

The CTM Tax Credit will apply to property that is acquired and becomes available for use on or after January 1, 2024. Budget 2023 proposes a gradual phase-out of the CTM Tax Credit based on when the eligible property is acquired and becomes available for use: a 20% tax credit is available between January 1, 2024 and December 31, 2032, a 10% tax credit is available in 2033, and a 5% tax credit in 2034. The CTM Tax Credit will not be available for property that becomes available for use after December 31, 2034.

Our Firm's detailed overview of the proposed draft legislation included in the December 20 Proposals for the CTM Tax Credit is forthcoming.

Labour Requirements

The 2022 FES announced the Government's intention to attach the Labour Requirements to certain of the Clean Economy Tax Credits and Budget 2023 provided additional details. The August 4 Proposals specified the Labour Requirements applicable to the CH Tax Credit, CTI Tax Credit, CEI Tax Credit and the CCUS Tax Credit. Bill C-59 included tabled legislation to implement the Labour Requirements.

In brief, in order for a taxpayer to claim the maximum available specified tax credit, the taxpayer must elect to satisfy the Labour Requirements. If the taxpayer does not elect to satisfy the Labour Requirements, the applicable percentage of the relevant specified tax credit is reduced by 10%. If the taxpayer elects to satisfy the Labour Requirements but fails to do so, absent the Minister determining that the taxpayer knowingly or in circumstances amounting to gross negligence failed to meet the Labour Requirements, the credit is not reduced but the taxpayer will be liable to certain additional taxes and penalties which may be mitigated in certain circumstances by taking corrective measures.

The Labour Requirements apply in respect of each "covered worker" at a "designated work site" of an "incentive claimant" for an "installation taxation year" (all as defined in subsection 127.46(1)). Broadly, a "covered worker" is an individual who is engaged in the preparation or installation of specified property at a designated worksite as an employee of an incentive claimant or of another engaged person or partnership (e.g., a contractor). A covered worker must be engaged in primarily manual or physical work or duties. A "designated work site" is where specified property is located, and includes the site of a CCUS project. An "incentive claimant" means a person, or a partnership at least one member of which, plans to claim or has claimed a specified tax credit for a taxation year. Finally, an "installation taxation year" is a taxation year during which preparation or installation of specified property occurs.

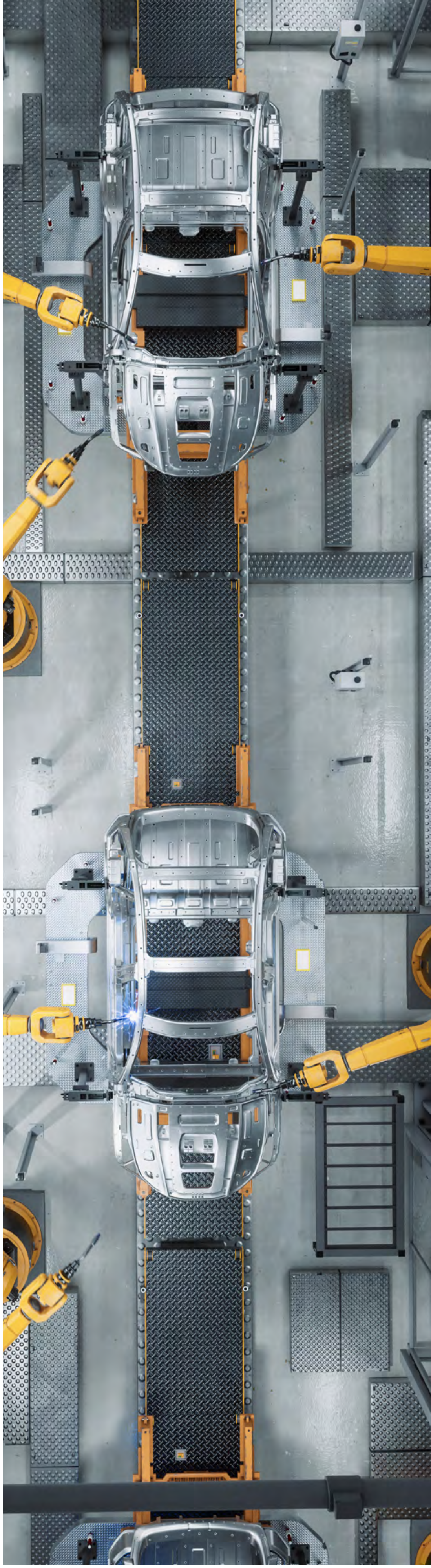
The Labour Requirements have two prongs: a prevailing wage requirement and an apprenticeship requirement.

The prevailing wage requirement requires that each covered worker at a designated work site of an incentive claimant for an installation taxation year must be compensated for their work under the terms of an “eligible collective agreement” or, if there is no eligible collective agreement, in an amount that is at least equal in value to the wages and benefits specified in the eligible collective agreement that most closely aligns with the covered worker’s experience level, tasks and location, calculated on a per-hour or similar basis. If the relevant eligible collective agreement expires, the relevant wages and benefits stipulated under the agreement are to be indexed for inflation.

The “standard” requirement for the apprenticeship requirement is that the incentive claimant must make “reasonable efforts” to ensure that apprentices registered in a “Red Seal trade” work at least 10% of the total hours that are worked during each installation year by Red Seal workers at the incentive claimant’s designated work site on the preparation or installation of specified property. However, if the number of apprentices employed at a designated work site is restricted or a maximum ratio of apprentices to journeypersons is specified by an applicable collective agreement or by applicable law which prevents the standard requirement from being met, the incentive claimant must make “reasonable efforts” to ensure that the highest possible percentage of the total labour hours performed during the installation year by Red Seal workers on the preparation or installation of specified property is performed by apprentices registered in a Red Seal trade within such restrictions or limitations.

Pursuant to the November tabled legislation, an incentive claimant is deemed to have satisfied the “reasonable efforts” requirement, regardless of the number of apprenticeship hours actually worked at the designated work site, where, at least every four months, the claimant posts a job advertisement (meeting certain conditions) seeking apprentices, communicates with a trade union and at least one secondary or post-secondary school to facilitate the hiring of apprentice positions, and receives confirmation from the trade union that the union has provided as many apprentices as possible. Additionally, the claimant must review and consider all applications received in response to the advertisement and take reasonable steps to ensure that other applications are reviewed and considered, and attest that it has complied with the aforementioned requirements.

Our detailed review of the Labour Requirements can be found **here**. The more detailed review includes a description of the penalties and consequences of a claimant electing to satisfy the Labour Requirements but failing to do so. Please refer to the detailed review for a summary of these consequences. However, notably, the penalty for falling short of apprenticeship hours was reduced in Bill C-59 from $100 per hour of shortfall (as specified in the August 4 Proposals) to $50 per hour of shortfall.



EXPANSION OF THE REDUCED CORPORATE INCOME TAX RATE FOR ZERO EMISSION TECHNOLOGY

In the 2021 federal budget, the Government announced a temporary measure to reduce corporate income tax rates for certain zero-emission technology manufacturers. Budget 2023 proposed to extend the reduced tax rates for zero-emission technology manufactures by three years and to expand the activities eligible for the reduced corporate income tax rates. The August 4 Proposals included proposed legislation to implement those changes and they were included in the tabled legislation introduced by Bill C-59.

If Bill C-59 is enacted, the corporate income tax rates for certain zero-emission technology manufacturers will be amended as follows:

- the reduced rates will be gradually phased-out starting in taxation years beginning in 2032 (previously taxation years beginning in 2029) and be fully phased-out for taxation years beginning after 2034 (previously taxation years beginning after 2031);
- activities eligible for the reduced corporate income tax rates for zero-emission technology manufacturers will be expanded to include:
    - nuclear energy equipment and nuclear fuel rod manufacturing;
    - nuclear fuel processing or recycling; and
    - heavy water processing or recycling.

SUBSTANTIVE CCPC

In Budget 2022, Finance introduced proposals to address planning strategies involving the loss of Canadian-controlled private corporation (CCPC) status that Finance considered inconsistent with the policy underlying the anti-deferral rules for CCPC investment income (Substantive CCPC Rules). Draft legislation for the Substantive CCPC Rules was released on August 9, 2022, and portions of this proposed legislation were included in Bill C-59. The Substantive CCPC Rules will apply to taxation years that end on or after April 7, 2022.

The Substantive CCPC Rules included in Bill C-59 centre on the new concept of a "substantive CCPC". A private corporation that is not a CCPC will be a substantive CCPC if it is controlled, legally or factually, by individuals resident in Canada. For example, a private corporation could be a substantive CCPC if, but for a non-resident or public corporation having a right to acquire shares of the private corporation, it would have qualified as a CCPC.

A substantive CCPC will be subject to refundable tax on its aggregate investment income in the same manner as a CCPC. However, substantive CCPCs will not be entitled to any tax benefits applicable to CCPCs, including the small business deduction and the enhanced credit for scientific research and experimental development. Substantive CCPCs will still maintain a low-rate income pool balance rather than a general rate income pool balance, and will continue to be subject to a four-year normal reassessment period rather than the three-year normal reassessment period for CCPCs.

The Substantive CCPC Rules include an anti-avoidance rule that deems a corporation to be a substantive CCPC where it is reasonable to consider that one of the purposes of an arrangement, transaction, or series of transactions is to avoid the refundable tax on that corporation's aggregate investment income. The Substantive CCPC Rules also provide for a one-year extension to the normal reassessment period of a taxpayer who received a taxable dividend from a corporation allowing for consequential

assessments of Part IV tax because of the assessment of the dividend payer entitling the dividend payer to a dividend refund.

The Substantive CCPC Rules contained in Bill C-59 are consistent with the August 9, 2022 draft legislation. However, Bill C-59 does not include the proposed rules addressing investment income generated by controlled foreign affiliates of CCPCs and substantive CCPCs, via amendments to the "relevant tax factor" and "capital dividend account" definitions, which were included in the August 9, 2022 proposals. We understand that Finance is still considering submissions received on this point and that revised legislative proposals will follow in 2024 (or later).

INTERGENERATIONAL BUSINESS TRANSFERS

In 2021, Bill C-208 amended section 84.1, ostensibly to permit intergenerational transfers of qualified small business corporation shares (QSBC shares) or shares of a family farm or fishing corporation (FFC shares) in the same manner as an arm's length sale. Bill C-208 was a private member's bill that was not drafted with the assistance of Finance and, unfortunately, applied (or did not apply) in a manner broader than intended by its drafters.

Almost immediately following enactment, Finance signalled that further amendments would be forthcoming to permit the intergenerational business transfers contemplated by Bill C-208, with less potential for abuse. In Budget 2023, Finance released a first draft of the new intergenerational business transfer rules. An updated version of the new intergenerational business transfer rules was included in Bill C-59, with application to dispositions occurring on or after January 1, 2024.

The proposed amendments provide that, if the relevant conditions are satisfied, the transferor and a corporation controlled by one of more children of the transferor will be deemed to deal at arm's length, such that section 84.1 will not apply to deem the transferor to receive a dividend if the transferor receives non-share consideration. The transferor will also be entitled to a 10-year capital gains reserve rather than the 5-year reserve applicable to most other dispositions.

The transferor and transferee child (or children) must jointly elect for the transfer to qualify as an "immediate intergenerational business transfer" or a "gradual intergenerational business transfer". Generally, the following requirements must be satisfied for a transfer to qualify as an immediate or gradual intergenerational business transfer:

1. The transferor must not have previously relied on the intergenerational business transfer rules;
2. The transferor must be an individual (other than a trust), the transferee must be a corporation controlled by one or more children of the transferor, and the transferred shares must be QSBC shares or FFC shares;
3. After the disposition, the transferor, together with their spouse or common-law partner, does not control any relevant corporation;
4. After the disposition, the transferor, together with their spouse or common-law partner, does not own 50% or more of the equity interests in any relevant corporation, excepting certain non-voting preferred shares;
5. Within 36 months of the disposition, the transferor and the transferor's spouse or common-law partner do not own shares of any relevant corporation, excepting certain non-voting preferred shares; and
6. Subject to certain deeming rules, throughout the 36-month period following the disposition, one or more children must control the transferee corporation, one or more children must be actively engaged in the target corporation's business, and that business must be carried on as an active business.

The main difference between an immediate intergenerational business transfer and a gradual intergenerational business transfer is that the former requires the immediate transfer of legal and factual control of the business and the target corporation, whereas the latter requires only the immediate transfer of legal control of the target corporation. A gradual intergenerational business transfer also gives the transferor and the transferor's spouse an additional 24 months to transition the management of the target business to their children. However, one of the trade-offs is that a gradual intergenerational business transfer requires the reduction of the transferor's economic interests in the target corporation over 10 years; there is no corresponding requirement for an immediate intergenerational business transfer.

Relieving rules allow for a transfer to continue to qualify as an intergenerational business transfer where: (a) shares of the target corporation are subsequently sold between children of the transferor or to arm's length parties; (b) a transferee child dies or becomes disabled; or (c) the business of the target corporation ceases to be carried on due to a sale of the assets to satisfy debts owed to the target corporation's creditors.

There is an extended reassessment period for immediate intergenerational business transfers and gradual intergenerational business transfers of three and ten years, respectively. The transferor and transferee children will also be jointly and severally liable for any tax that becomes payable as a result of the requirements for an intergenerational business transfer not being met.

The principal difference between the Budget 2023 draft legislation and the Bill C-59 tabled legislation is the elimination of the requirement that the transferor (either alone or together with their spouse) control the target corporation immediately before the disposition time. This change is intended to permit intergenerational business transfers where the transferor is a minority shareholder of the target corporation.

ALTERNATIVE MINIMUM TAX

Budget 2023 proposed several changes to the AMT to better target high-income individuals and "ensure the wealthiest Canadians pay their fair share". The August 4 Proposals included draft legislation to implement this proposal including certain changes to what was proposed in Budget 2023. The AMT amendments were not included in Bill C-59. The new AMT rules are proposed to apply to taxation years beginning after 2023.

Currently, individuals and certain trusts are subject to AMT if their federal income tax payable as otherwise determined for a particular taxation year is less than their "minimum amount" for that year. In general, the minimum amount is computed by (i) applying the flat rate of 15% against the amount by which the taxpayer's "adjusted taxable income" for the year exceeds the taxpayer's basic exemption ($40,000 in the case of an individual or graduated rate estate and nil in other circumstances), and (ii) deducting from the amount computed in (i) the taxpayer's basic minimum tax credit for the year determined under section 127.531.

If enacted as drafted in the August 4 Proposals, the AMT rules will be amended to:

— increase the AMT rate to 20.5% from 15%;

— increase the basic exemption amount for individuals and graduated rate estates to approximately $173,000 (i.e., the start of the fourth federal tax bracket), subject to indexation; and

— broaden the AMT tax base by, among other things:

— increasing the AMT capital gains inclusion rate from 80% to 100% (with capital loss carryforwards and allowable business investment losses applying at a 50% rate);

— including 100% of employee stock option benefits;

— including 30% of capital gains on donations of publicly listed securities (i.e., mirroring the current treatment of capital gains subject to the lifetime capital gains exemption);

— disallowing 50% of various deductions such as deductions for CPP and QPP, employment expenses (other than those to earn commission income), moving expenses, child care expenses, disability supports, interest and carrying charges to earn income from property, non-capital loss carryovers and prior year limited partnership losses; and

— disallowing 50% of most non-refundable tax credits.

Trusts that are currently exempt from AMT (e.g., mutual fund trusts, master trusts and employee life and health trusts) will continue to be exempt, and the Government is examining whether to exempt additional types of trusts.

We may see further changes to the rules as the new AMT rules were not included in Bill C-59.

EMPLOYEE OWNERSHIP TRUSTS

Budget 2023 proposed amendments to the Act to introduce a new form of trust, referred to as an EOT, with a view to facilitating the purchase of businesses by employees, to be effective January 1, 2024. Draft legislation was released with Budget 2023. The August 4 Proposals included revised draft legislation. The Fall

Economic Statement announced further revisions to the EOT rules that will provide for an exemption of the first $10 million of capital gains realized on the sale to an EOT for at least the 2024, 2025 and 2026 taxation years ($10 million Capital Gains Exemption). Provisions implementing the EOT rules, other than the $10 million Capital Gains Exemption, were included in Bill C-59.

Certain benefits will be available in respect of qualifying business transfers of a controlling interest in a qualifying business to an EOT:

— the five year capital gains reserve will be extended to 10 years in respect of the disposition of the shares of the qualifying business to the EOT;

— shareholder loans from the qualifying business to the EOT for the purpose of facilitating the transfer will benefit from a longer repayment period (15 years) under the shareholder loan regime; and

— as described above (but not included in Bill C-59) the $10 million Capital Gains Exemption.

EOTs will be taxable and will generally attract the same tax treatment as other personal trusts, but will be exempt from the 21-year deemed disposition rule under the Act.

An EOT will need to satisfy certain conditions, generally including the following:

— it must be a trust resident in Canada (other than a deemed resident trust);

— the beneficiaries of the EOT must include and be limited to all qualifying employees (essentially an employee of a qualifying business controlled by the trust, excluding certain employees who have or have had a significant interest in the business and certain probationary employees);

— distributions of income to the beneficiaries must be determined in the same manner, having regard only to any combination of length of service, remuneration, and hours of service;

— it may not prefer certain beneficiaries over others;

— it may not distribute shares of any qualifying business to any beneficiary;

— its trustees must be elected by the beneficiaries and meet certain conditions including in respect of independence from the qualifying business; and

— all or substantially all of the FMV of its assets must be attributable to shares of qualifying businesses directly or indirectly controlled by the EOT.

A qualifying business is generally a CCPC, all or substantially all of the FMV of the assets of which are attributable to assets used in an active business carried on primarily in Canada by the corporation (or certain of its subsidiaries), other than through a partnership. A qualifying business (and qualifying business transfer) must also meet certain conditions relating to the independent governance of the business and EOT.

PILLAR TWO

The members of the Inclusive Framework announced in October 2021 the desire to proceed with the Two-Pillar Solution to Address Tax Challenges Arising from the Digitalisation of the Economy. Pillar One is intended to reallocate income of large multinational enterprises to jurisdictions in which they have revenue and customers but little (if any) physical presence. Pillar Two intends to ensure that multinational enterprises pay tax on their consolidated accounting income at a minimum effective rate of 15%.

The process of getting the 140 members of the Inclusive Framework to agree to and implement Pillar Two is far more advanced than the process in relation to Pillar One. The OECD released the Model GloBE Rules and related commentary for Pillar Two in March 2022. The OECD published administrative guidance packages concerning the intended application of Pillar Two in December 2022, February 2023, and July 2023. The OECD also published a standardized information return and implementation handbook in July 2023 and October 2023, respectively. A number of countries, such as the United States, China, and India, have provided no indication that they will enact Pillar Two legislation in the near-term future.

GMTA

Following statements in Budget 2022 and Budget 2023 that the Government intended to implement Pillar Two with effect from January 1, 2024, Finance released the draft GMTA in August 2023. While the GMTA is based on the Model GloBE Rules, the structure of the GMTA differs from the Model GloBE Rules and some of the provisions of the GMTA codify portions of the commentary and the administrative guidance; the result is that cross-referencing the GMTA provisions with the OECD publications requires a 10-page table of concordance.

In its operation, the GMTA is the same as the Model GloBE Rules. Where a Canadian corporation is the ultimate parent entity for a multinational group, there is a five-step process that must be followed:

1. Identify which entities are constituent entities of the multinational group and whether the multinational group is within the scope of the GMTA. The multinational group should be in scope if the revenues shown in its consolidated financial statements exceed €750,000,000 in two of the four preceding fiscal years.

2. Determine the GloBE income or loss of each constituent entity. The entity's GloBE income or loss should be its accounting income, subject to statutory adjustments.

3. Determine the covered taxes payable by the constituent entity on its GloBE income. Covered taxes generally include income taxes, withholding taxes, and capital taxes. There are rules that allocate or reallocate GloBE income or covered taxes in various circumstances including, but not limited to, flow-through entities and taxes paid by shareholder entities under controlled foreign company regimes.

4. Calculate the jurisdictional effective tax rate for each jurisdiction in which one or more constituent entities is located. If the effective tax rate is less than the 15% minimum rate, a top-up amount must be determined unless the jurisdiction has a qualified domestic minimum top-up tax (QDMTT) that qualifies as a safe harbour QDMTT, in which case the top-up amount is deemed to be nil. The substance-based income exclusion amount, based on the cost of tangible assets and payroll of constituent entities located in a particular jurisdiction, factors in at this stage.

5. Impose tax on the top-up amount. If the jurisdiction with a top-up amount has a QDMTT, that jurisdiction will impose the tax. If the jurisdiction with a top-up amount does not have a QDMTT, the Canadian parent will pay the top-up amount under the income inclusion rule (IIR).

There are two notable points of uncertainty and controversy in the draft GMTA. First, the GMTA directs that the provisions of that statute be interpreted consistently with the Model GloBE Rules, commentary, and administrative guidance, as published by the OECD and amended from time to time. It is arguable that the incorporation by reference into the GMTA of OECD commentary and administrative guidance over which Parliament has no control represents an unconstitutional abdication of Parliament's authority to exercise sovereignty over persons creating delegated legislation. Nevertheless, Finance proposing a dynamic incorporation of OECD publications into Canadian tax legislation is not limited to the GMTA; recent examples of similar drafting can be found in the Hybrid Mismatch Rules and the common reporting standard.

Second, the GMTA proposes to incorporate a general anti-avoidance rule (GMTA GAAR) based on the GAAR, including the proposed amendments contained in Bill C-59. The GMTA and the Model GloBE Rules are based on an international consensus and are meant to be applied consistently. Including the proposed GMTA GAAR could allow the CRA to assess tax under the GMTA in a manner that is inconsistent with that international consensus. Inconsistent applications of Pillar Two rules are especially problematic in situations where structures or arrangements could be treated differently in relevant jurisdictions, potentially resulting in double taxation. While we understand that Finance does not intend for the GMTA GAAR to apply in circumstances where the perceived abuse is occurring in a jurisdiction with a safe harbour QDMTT, many relevant jurisdictions (most notably, the United States) will not have a safe harbour QDMTT.

TRANSFER PRICING CONSULTATION

Budget 2023 confirmed the Government's intention to proceed with the previously announced transfer pricing consultation. In the 2021 federal budget, the Government announced its 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. This announcement was a response to the Supreme Court of Canada's decision on February 18, 2021 to dismiss the Government's application for leave to appeal the Federal Court of Appeal's decision in *Canada v. Cameco Corporation* (2020 FCA 112), which affirmed the Tax Court of Canada's decision not to apply Canada's domestic transfer pricing rules to certain long-term uranium purchase contracts between the corporate taxpayer and its Swiss subsidiary. The Government believes that the *Cameco* decision may encourage the inappropriate shifting of corporate profits outside of Canada (thereby reducing the Canadian tax base), and stated that the intention of the consultation process would be to allow stakeholders to comment on possible measures to improve Canada's domestic transfer pricing rules. Further commentary from our Firm on the *Cameco* decision can be found **here**.

On June 6, 2023, Finance released a consultation paper (Transfer Pricing Paper) and draft proposed legislative amendments seeking feedback on specific proposals to amend Canada's transfer pricing rules. The Government announced a formal consultation period between June 6, 2023 and July 28, 2023.

The Transfer Pricing Paper indicated the Government's discontent with transfer pricing jurisprudence since 1997 and that the Government intends to amend the transfer pricing rules in order to provide more detailed guidance regarding the application of the arm's length principle. The Transfer Pricing Paper relies heavily on the OECD's transfer pricing guidelines as "accepted international standards". The proposed amendments seek to more clearly establish the starting point of the comparison in applying the arm's length principle as well as to provide guidance on how the comparison should be carried out.

UPDATED CRA GUIDANCE: REMOTE WORK ARRANGEMENTS AND EMPLOYER SOURCE DEDUCTIONS

On January 1, 2024, a new CRA administrative policy will take effect to determine an employee's province of employment (POE) for employer payroll deduction purposes. This new policy provides updated guidance in determining an employee's POE where a full-time remote work arrangement is in place in respect of an employee.

For employees resident in Canada, the updated guidance provides that an employee is considered to be reporting for work at an establishment of the employer if one of the following applies:

1. Where a full-time remote work agreement is in place, the employee can reasonably be considered "attached to an establishment of the employer"; or
2. The employee reports for work physically at the establishment, in which case there is no minimum amount of time the employee has to report to that place.

Under the first test, a full-time remote work agreement exists where the following arrangements are made:

— the agreement is either temporary or permanent;

— the employer directs or allows the employee to perform their employment duties remotely on a full-time basis; and

— the employment duties are performed by the employee at one or more locations that are not an establishment of the employer.

If the above arrangements are in place, it must then be determined if the employee is reasonably considered to be "attached to an establishment of the employer". The primary indicator for this determination is whether the employee would, but for the full-time remote work agreement, physically come to work to carry out the functions related to their employment duties at a particular establishment of the employer. A number of secondary indicators may assist in determining whether an employee carries out the functions related to their employment duties at a particular establishment of the employer:

— the employee would attend in-person meetings, through any type of communication, at that establishment;

— the employee receives or would receive work-related material or equipment or associated instructions and assistance at that establishment;

— the employee receives or would receive instructions from their employer regarding their duties, through any type of communication, at that establishment;

— the employee would be supervised, as indicated in the contractual agreements between the employer and the employee, from that establishment; or

— the employee would report to that establishment based on the nature of the duties performed by the employee.

Generally, all the above indicators should be reviewed together to determine whether the employee is reasonably considered to be "attached to an establishment of the employer". To be considered "reasonable", the determination of an employee's POE based on the above indicia must be supported by the facts and circumstances of the employee's employment situation.

OTHER TAX PROPOSALS AND TECHNICAL AMENDMENTS

Other key new proposals and draft legislation implementing previously announced proposals in 2023 include the following.

Other previously announced tax and related measures and technical amendments were included in the August 4 Proposals. The Government confirmed in the Fall Economic Statement that it intends move forward with the following measures not discussed above:

- flow-through shares and the critical mineral exploration tax credit – lithium from brines;
- registered compensation arrangements;
- the income tax and GST/HST treatment of credit unions;
- enhancements to the vaping product taxation framework;
- tax-exempt sales of motive fuels for export;
- extending the quarterly duty remittance option to all licensed cannabis producers;
- revised luxury tax draft regulations to provide greater clarity on the tax treatment of luxury items.

See **our Firm's commentary on Budget 2023** and the **Fall Economic Statement** for background information on these proposed measures.

INCOME TAX CASES

In this section, we review the following decisions of the Supreme Court of Canada (SCC), Federal Court of Appeal (FCA), Tax Court of Canada (TCC) and Quebec Court (QC):

- *Deans Knight Income Corp. v. Canada*, 2023 SCC 16 (*Deans Knight*);
- *Foix v. The King*, 2023 FCA 38 (*Foix*);
- *Québecor Inc c. Le Roi*, 2023 CCI 142 (*Québecor*);
- *Gaudreau v. The King*, 2023 TCC 115 (*Gaudreau*); and
- *Kone Inc. c. Agence du revenu du Québec*, 2022 QCCQ 9892 (*Kone*).

Although not discussed in detail herein, two additional decisions released in 2023 that are averse to taxpayers and should be on their radar when assessing (i) whether parties are dealing at arm's length and (ii) who is the beneficial owner of a property.

First, *Canada v. Microbjo Properties Inc.* (2023 FCA 157) represents a rare instance where unrelated taxpayers seeking to share a tax benefit were considered not to be dealing at arm's length. In recent history, Canadian courts were generally of the view that tax accommodation between unrelated parties did not amount to a non-arm's length relationship.

Second, *Husky Energy Inc. v. The King* nuances the principles laid down in *Prevost Car Inc. v. R.* (2009 FCA 57) and applied in *Velcro Canada Inc. v. R.* (2012 TCC 57). In particular, the Court took into account the economic result of the transactions entered into and their ultimate beneficiary for the purposes of determining who was the beneficial owner of a dividend.

DEANS KNIGHT – SCC APPLIES GAAR TO SUPPLEMENT A WELL-ESTABLISHED SPECIFIC ANTI-AVOIDANCE PROVISION

Overview

On May 26th, 2023, the SCC released its much anticipated decision in *Deans Knight*. A majority held that the GAAR in section 245 applied such that the taxpayer's use of tax attributes to shelter income from a new business abused subsection 111(5), even though it did not undergo a change in *de jure* control.

The decision has several important implications for taxpayers and is likely to create further uncertainty as to when the GAAR might apply:

- First, the majority held that the GAAR is not limited to unforeseen tax strategies. Even where Parliament knew about a specific tax strategy (i.e., loss trading), implemented a specific anti-avoidance rule to prevent that strategy (i.e., subsection 111(5)), and the taxpayer complied with the text of that rule, the GAAR can still apply.
- Second, taxpayers should beware of overly relying on the text of the statute where the GAAR might apply, even when that text is simple and clear. The text is the means by which Parliament sought to achieve the objective of a particular provision, but it is not always exhaustive of that objective. Extrinsic aids, including legislative history, plays a significant role in determining the object, spirit, and purpose of the provisions at issue.

Background

The taxpayer was a public corporation with unused non-capital losses and other deductions (Tax Attributes). In face of financial difficulties, the taxpayer entered into arrangements with Matco Capital Ltd. (Matco) to monetize its Tax Attributes. Importantly, although Matco acquired a majority equity interest and a significant voting interest in the taxpayer, neither Matco nor anyone else acquired *de jure* control of the taxpayer. Had there been an acquisition of *de jure* control, subsection 111(5) would have prevented the use of the Tax Attributes even if the GAAR did not apply.

Decision of the Court

The majority held that, for purposes of the GAAR analysis, the relevant question is whether the transactions frustrated or defeated the object, spirit, or purpose of subsection 111(5). It also confirmed that the object, spirit and purpose of the provision is "to prevent corporations from being acquired by unrelated parties in order to deduct their unused losses against income from another business for the benefit of the new shareholders."

Although subsection 111(5) applies a *de jure* control test to determine when a taxpayer is restricted from using losses to reduce its income, the majority held that the *de jure* control test does not encapsulate all circumstances that Parliament intended to prevent. Even in the absence of a change in *de jure* control, the following factors demonstrated that the taxpayer frustrated the object, spirit, and purpose of subsection 111(5): (i) compensation was paid for the use of tax attributes, (ii) contractual rights were granted to oversee the makeup of the board of directors, (iii) "veto" rights were granted, and (iv) significant equity in the taxpayer was held by the new owner.

The majority also clarified that the GAAR was designed to apply to foreseen and not just unforeseen tax planning (thereby clarifying a statement of the Supreme Court in *Canada v. Alta Energy Luxembourg S.A.R.L.* (2021 SCC 49)).

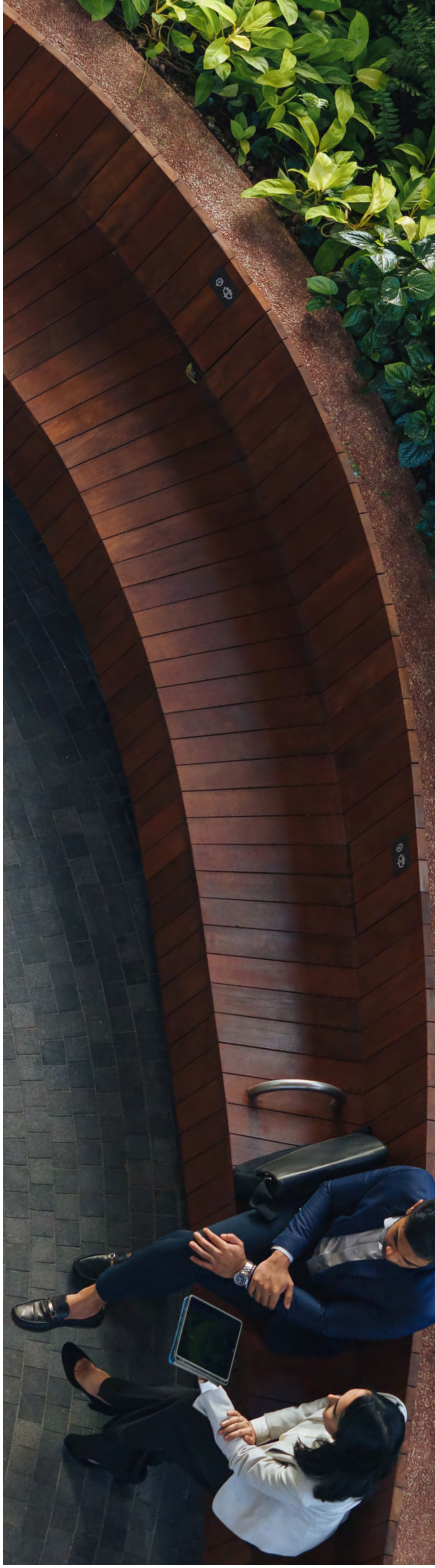
In a strongly worded dissent, Justice Côté held that the transactions were not abusive, finding that Parliament has always intended that the acquisition of *de jure* control be the triggering event for whether the loss restriction rules apply.

FOIX - SURPLUS STRIPPING, THE TIMING OF DISTRIBUTIONS AND SUBSECTION 84(2)

On February 20, 2023, the FCA in *Foix* dismissed three appeals from the TCC, thereby affirming reassessments under subsection 84(2). The taxpayer sought leave to appeal to the SCC on April 21, 2023.

The issue at the heart of the appeals was the breadth of subsection 84(2). Generally speaking, subsection 84(2) is intended to tax, as a deemed dividend, distributions "in any manner whatever" made by a Canadian resident corporation on the "winding-up, discontinuance or reorganization" of its business, except to the extent the distribution represents a return of paid-up capital.

The FCA decision in *Foix* reaffirms that subsection 84(2) is interpreted broadly, can apply to hybrid asset-share transactions, and raises questions as to how the timing of distributions in surplus stripping transactions impacts its application.



FCA Decision

Through a series of steps the TCC described as "indirect, structured, simultaneous and inter-related", a group of corporations (the EMC Group) purchased Watch4Net Solutions Inc. (W4N) in a hybrid asset-share transaction. The parties wanted to distribute W4N's excess cash prior to the closing, such that it would be taxed as additional sale proceeds and not as dividends.

The total purchase price of W4N's assets and shares was approximately $70,000,000, which was paid in a combination of promissory notes and cash. However, due to the non-payment of a particular promissory note (the Balance Note) which was owned by W4N, the amounts actually disbursed were closer to $50,000,000.

Since one corporation in the EMC Group owed the money under the Balance Note to W4N, but a different corporation in EMC Group ultimately acquired all of W4N's shares, the EMC Group effectively reacquired the Balance Note, which was left unpaid and became internal to the EMC Group as an outstanding debt. The appellants argued that subsection 84(2) did not apply because W4N had not been impoverished, which is one of the conditions for the application of subsection 84(2).

The FCA held that subsection 84(2) applied to the transactions. The FCA explained that:

— the TCC found that the amount that was to be used to pay the Balance Note was in fact used to pay for W4N's shares – put another way, the FCA stated that the "nonpayment of the debt in the course of the hybrid sale freed up the necessary funds to defray the cost of W4N's shares"; and

— the view of W4N's accountant was that the Balance Note would never be paid, and that EMC U.S. had no interest in paying it given its amount exceeded W4N's operational needs.

In such circumstances, the FCA held that it was open to the trial judge to find as a fact that the debt evidenced by the Balance Note was used to "fund" the cost of W4N's shares, thereby impoverishing W4N, to whom the debt was owed. Put differently, the Balance Note represented excess cash out of W4N that was distributed to the sellers. The FCA emphasized that subsection 84(2) should be read broadly, and the focus should not be exclusively on the legal characterization of the transactions.

QUÉBECOR - A TAXABLE WIND-UP TO UTILIZE A TRAPPED CAPITAL LOSS IS NOT ABUSIVE

On October 3, 2023, the TCC released its decision in *Québecor*. In 2005, Québecor sold shares of Abitibi Consolidated Inc. (Abitibi) to a subsidiary (3662527), and reacquired them shortly thereafter. Those transactions were completed to increase the adjusted cost base of the Abitibi shares. The Minister relied on the GAAR to negate the adjusted cost base increase and to tax a gain on the subsequent disposition of the Abitibi shares as part of its merger with Bowater Inc. (Bowater) a few years later.

In allowing Québecor's appeal, the Tax Court of Canada found that:

1. A corporate group can move a property with an accrued capital gain to use a capital loss trapped in a subsidiary.
2. It is not abusive to elect to proceed with a taxable wind-up (subsection 88(2)) instead of a tax-free wind-up (subsection 88(1)).

The Minister is appealing the decision to the FCA.

Key Facts

In a series of transactions, Québecor temporarily transferred its Abitibi shares (which had a large accrued gain) to 3662527 on a rollover basis. When Québecor reacquired the shares, this time as part of a taxable transfer, their adjusted cost base was increased up to FMV.

3662527 was then wound-up after the transactions, which triggered an accrued capital loss on its shares of Vidéotron Telecom Ltd. (Vidéotron). Those losses became available because 3662527's wind-up occurred under subsection 88(2), which deemed all its properties to have been disposed of at FMV rather than at cost (disposition at cost would have been the tax consequence of a wind-up under subsection 88(1)). The wind-up occurred under subsection 88(2) because a different subsidiary, 9101-0827 Québec Inc. (9101), had purchased all of the shares of another class of 3662527 as part of the same series of transactions. The capital gain realized by 3662527 on its sale of the Abitibi shares back to Québecor was fully shielded by the capital loss on the Vidéotron shares.

Ultimately, as part of Abitibi's merger with Bowater, Québecor exchanged its Abitibi shares for shares of the resulting corporation. The new shares received by

Québecor were worth half of the Abitibi shares' adjusted cost base, such that a capital loss resulted for Québecor from the amalgamation. An additional capital loss resulted from the ultimate disposition of those shares, for no consideration, pursuant to an arrangement with Bowater's creditors.

Utilizing Capital Losses in a Non-Consolidated Tax System

The TCC found that it was not abusive to complete certain corporate steps in order to secure the tax treatment associated with one kind of wind-up over another. The object, spirit and purpose of section 88 is to create two wind-up regimes available to Canadian corporations: the first regime authorizes the tax-free transfer of assets from a subsidiary to a parent, whereas the second regime requires such a transfer to be taxable. The Minister failed to demonstrate that Parliament intended to prevent corporations from arranging their affairs to, in effect, choose whether to wind-up under subsection 88(1) or (2).

The Court also found that the purpose of subsection 85(1) is to allow tax to be deferred by transferring a latent capital gain to another corporation. Thus, it is not abusive to transfer property within a group of corporations in order to utilize accrued capital losses. 3662527 owned shares with a significant accrued capital loss (its shares in Vidéotron). The Court confirmed that there was no abuse of the subsection 85(1) rollover provision on the transfer of an asset to 3662527 with an accrued gain (the shares in Abitibi) in order to benefit from the accrued loss.

Lastly, the Court's comments are consistent with the principal enunciated in *Donohue* that it was not Parliament's intention to prevent a corporate group from realizing multiple losses from a single economic source. When 3662527 was wound-up, there were two losses: the capital loss when it sold its own shares in Vidéotron (the inside loss), and the capital loss to Québecor Media on the disposition of shares in 3662527 (the outside loss).

The Court stated that none of the relevant transactions which allowed two losses to be triggered were abusive, as the Canadian tax system also allows gains/losses to be triggered at multiple levels of a corporate structure.

GAUDREAU - TAX PLANNING DOCUMENTS ARE DISCOVERABLE (UNLESS PRIVILEGED)

In the *Gaudreau* decision, the TCC ordered a taxpayer to disclose a tax memorandum prepared by an accounting firm. This decision serves as an important reminder that, in Canada, tax advice received from accountants is not protected by privilege. This case is also a reminder of the importance of legal privilege in a transactional context.

Gaudreau concerns a tax memorandum prepared by the taxpayer's accountants. The CRA assessed the taxpayer on the basis that the relevant transaction was subject to the specific anti-avoidance rule found in subsection 84(2) (also discussed in the *Foix* case, above).

The taxpayer opposed the disclosure of the memorandum as part of the TCC's discovery process, arguing the lack of relevance to the issue under appeal because the memorandum contained no mention of subsection 84(2). The TCC rejected the taxpayer's position and ordered the disclosure of the memorandum, highlighting the broad interpretation of the relevance criterion applicable to evidence in the pre-trial examination context. Given such broad interpretation, legal privilege is noteworthy as an exception to the disclosure rules, provided the privilege has not been waived.

Although privilege can be easily waived by disclosure to third parties, there are contexts where privileged documents may be shared. For example, it may be possible to share privileged documents between the seller and the buyer to a transaction, whether directly or via respective counsel. The privilege relating to such documents may be preserved based on the common interest of the parties in completing the transaction. Given the risks involved, the importance of establishing strict protocols between the parties in respect of the exchange of privileged documents, including tax advice, cannot be overstated.

The taxpayer filed a Notice of Appeal to the FCA on August 29, 2023.

KONE - REPO TRANSACTIONS ARE NOT LOANS

The QC decision in *Kone* is further authority for the well-established proposition that economic substance has limited impact in the Canadian tax landscape. In the *Kone* decision, repo transactions were structured so as to effectively qualify as loans for U.S. tax purposes, but not for Canadian tax purposes. The QC held that the repo transactions could not be recharacterized as loans for Canadian tax purposes simply due to their economic similarity.

Facts

In order to finance upcoming acquisitions, a Canadian entity within an international group issued $400,000,000 in notes. Pursuant to the group's financing strategy, those funds were ultimately made available to a foreign affiliate that would complete the acquisitions. For that purpose, instead of making further intra-group loans, repo transactions were entered into whereby newly issued preferred shares of another foreign affiliate in the group were purchased by an operating Canadian entity, subject to a repurchase agreement. The shares were in fact repurchased a few years later, for the same consideration, plus all undeclared cumulative dividends accrued in respect of such shares. The resulting gain was deemed to be a dividend paid out of exempt surplus, such that there was no tax.

The repo transactions were treated as loans for U.S. tax purposes. Accordingly, the payment of the cumulative dividends on the preferred shares gave rise to an interest deduction for U.S. tax purposes (they were treated as interest, based on the repo's economic substance). The Quebec Revenue Agency (QRA) challenged the transactions both on the basis of sham and GAAR, alleging that the repo transactions were "equivalent to loans".

The Decision

In Canada, the absence of economic substance does not amount to a sham. Sham requires an intent to deceive the tax authorities. Even though the repo transactions were designed and documented precisely to obtain a divergent tax result in both Canada and the U.S., the U.S. "substance over form" doctrine did not impact the QC's conclusion on sham, or determination of the legal effect of the transactions.

In respect of the GAAR analysis, the QC concluded that there was no abuse of the Quebec equivalent to section 17 (the only section allegedly abused according to the QRA). Because that provision targets loans, the QC ruled that its abuse could not be based on the fact that the tax treatment of fundamentally different transactions (i.e., an acquisition and a disposition) was more beneficial. The purpose of the GAAR is not to recharacterize transactions, including based on their alleged economic substance.

The Government filed a Notice of Appeal to the Quebec Court of Appeal on February 10, 2023.

COMMODITY/INDIRECT TAX – LEGISLATION

There were numerous legislative initiatives and developments with respect to the goods and services tax/harmonized sales tax (GST/HST), Quebec sales tax (QST), and the provincial sales tax (PST) imposed by British Columbia, Saskatchewan and Manitoba in 2023.

RETROACTIVE LEGISLATION

The most significant amendments of 2023 were those that were enacted retroactively in order to negate specific court decisions that the government did not agree with.

GST/HST – Payment card clearing services

In response to the Federal Court of Appeal decision in *Canadian Imperial Bank of Commerce v. The Queen*, 2021 FCA 10, which ruled that services supplied by Visa to CIBC were exempt financial services for GST/HST purposes, Budget 2023 proposed to add new exclusionary paragraph (r.6) to the definition of "financial service" in subsection 123(1) of the *Excise Tax Act* (Canada) to, in the Government's view, "clarify" that payment card clearing services (such as the ones provided by Visa) are taxable for GST/HST purposes.

While paragraph (r.6) applies to payment card clearing services if any consideration for the supply becomes due, or is paid without becoming due, after Budget Day (i.e., March 28, 2023), it also applies to the supply of payment card clearing services made before March 28, 2023, unless, subject to certain exceptions, the supplier did not charge, collect or remit any amount as or on account of GST/HST either in respect of the supply of a payment card clearing service or in respect of any other supply that includes the service.

Budget 2023 also extended the time the Minister has to make an assessment in respect of the proposed amendment to the later of the day that is one year after the day on which the amendment receives Royal Assent and the last day of the period otherwise allowed for making the assessment. The proposed amendment received Royal Assent on June 22, 2023.

British Columbia PST – Cloud Software and Services

In June 2023, the BC Ministry of Finance issued PST Notice 2023-005 – *Notice to Providers and Purchasers of Cloud Software and Services* to inform taxpayers of the Government's intent to introduce legislation to overturn the B.C. Supreme Court decision in *Hootsuite Inc. v. British Columbia (Finance)*, 2023 BCSC 358 (*Hootsuite*), which found that cloud storage and cloud computing services were not taxable for BC PST purposes in certain circumstances. The BC Ministry of Finance's position prior to the *Hootsuite* decision was that these cloud storage and cloud computing services were taxable. The BC Ministry of Finance intends to amend the BC PST legislation as part of Budget 2024, the effect of which will retroactively support how the BC Ministry of Finance administered PST prior to the *Hootsuite* decision.

GOODS AND SERVICES TAX RENTAL REBATE

On September 14, 2023, the Canadian Government announced an enhancement to the GST Rental Rebate (GST Rental Rebate). The enhanced GST Rental Rebate will provide full relief in respect of the 5% GST (or 5% federal component of the HST) paid by builders and purchasers of new "purpose-built rental housing". The enhancement increased the GST Rental Rebate from 36% to 100% of the GST paid and removed the existing phase out thresholds, which in general, incrementally reduced the rebate for rental units with values between $350,000 and $450,000 and fully eliminated the rebate for rental units with value of $450,000 or more. Given housing costs in major Canadian cities, the $450,000 was a significant barrier to the rebate. As a result of the enhancement, all new residential housing that meets the conditions will qualify for a 100% rebate of the 5% GST with no restriction related to the value of the rental units.

Some provinces have also agreed to extend the rental rebate to the provincial portion of the HST in their province. The Governments of Ontario, Nova Scotia, Newfoundland and Labrador, and Prince Edward Island announced that they will remove or waive the provincial portion of the HST on qualifying new purpose-built rental housing.

JOINT VENTURE ELECTION

The Fall Economic Statement included legislative proposals introducing new rules for the GST/HST joint venture election. It appears that the proposed rules are intended to replace the existing joint venture election rules on a go-forward basis. The key elements of the proposed legislation include:

— allowing the joint venture to engage in any activity as long as all or substantially all of the joint venture's activities are commercial activities;

— all electing joint venture participants will be required to be registered for GST/HST purposes; and

— updated deeming measures to better align with tax accounting.

Stakeholders have until March 15, 2024, to make submissions to the Department of Finance on these proposals.

UNDERUSED HOUSING TAX

The Underused Housing Tax (UHT) is a federal tax equal to 1% of a residential property's value, applied annually to certain owners of underused or vacant residential property in Canada. The tax, which is imposed under the UHTA, came into effect on January 1, 2022, and generally applies to non-resident, non-Canadian owners, although some Canadian owners can be subject to the UHT.

The Fall Economic Statement included draft legislation amending the UHTA to make it easier for affected owners to comply. The draft legislation eliminates the filing requirements for certain owners by adding "specified Canadian corporations", partners of "specified Canadian partnerships" and trustees of "specified Canadian trusts" to the definition of "excluded owners". The draft legislation also expands the definitions of "excluded owner", "specified Canadian partnership" and "specified Canadian trust" to provide UHT filing and tax relief in respect of a broader range of Canadian ownership structures. The elimination of filing requirements for certain owners will apply for 2023 and subsequent years.

The Government also proposed:

— a new UHT exemption for 2023 and subsequent calendar years for properties held as accommodation for employees, if the property is located outside of a census metropolitan area or a census agglomeration with 30,000 or more residents;

— technical amendments to provide, among other things, that: (i) condominiumized apartment buildings are not "residential property" for UHT purposes; and (ii) for 2024 and subsequent calendar years, an individual or couple can only claim the UHT "vacation property" exemption for a single property in a calendar year; and

— to lower the minimum penalty for individuals and corporations who fail to file a UHT return by the filing deadline from $5,000 to $1,000 for individuals and from $10,000 to $2,000 for corporations, effective in respect of 2022 and subsequent calendar years.

Notwithstanding that the deadline to file 2022 UHT returns was extended

multiple times, the Fall Economic Statement suggests that the deadline to file 2023 UHT returns will not be extended beyond April 30, 2024.

CANADIAN DIGITAL SERVICES TAX 2024

Since November 2020, Canada has intended to impose DST, which would be implemented as of January 1, 2024 with retroactive effect to January 1, 2022 if the OECD's Pillar One regime of the Inclusive Framework was not in place by December 31, 2023. On July 11, 2023, the members of the Inclusive Framework agreed to extend the moratorium on the implementation of new domestic DSTs to January 1, 2025. However, the Minister of Finance responded the next day reiterating Canada's intention to proceed with the DST as scheduled and Finance released a revised draft the DSTA as part of the August 4 Proposals.

On November 30, 2023, Bill C-59, which contains the DSTA and *Digital Services Tax Regulations* (DSTR), was tabled for first reading in the House of Commons. Bill C-59 provides that the coming into force date of the DSTA and DSTR will be the day fixed by order of the Governor in Council, which date will not be earlier than January 1, 2024. As we enter 2024, given that Pillar One was not implemented, it appears that Canada is moving forward with its DST. However, as of the date of this publication, no date has been fixed for the coming into force of the DSTA and DSTR, and Bill C-59 remains at second reading in the House of Commons.

A high level of overview of the DST is set out below.

Overview of the DST

Under the DSTA both Canadian and non-Canadian taxpayers will be subject to the DST in respect of their in-scope Canadian digital services revenue if they meet two conditions:

- The taxpayer, or a consolidated group of which the taxpayer is a member, earned at least €750,000,000 in total global revenue in the prior calendar year (Global Revenue Threshold); and
- The taxpayer or the consolidated group earned at least CAD$20,000,000 of in-scope digital services revenue in the prior calendar year (In-Scope Revenue Threshold).

Where the above conditions are satisfied, the DST will apply at a rate of 3% on the taxpayer's taxable Canadian digital services revenue earned in the particular calendar year beginning January 1, 2022. However, DST only applies to the taxpayer's Canadian digital services revenue above CAD$20,000,000 in the calendar year.

The DST applies to taxable Canadian digital services revenue, which is derived from four different revenue streams that are sourced to online users in Canada: (i) online marketplace services revenue; (ii) online advertising services revenue; (iii) social media services revenue; and (iv) user data revenue. Whether revenue is sourced

to users in Canada is generally based on the revenue's association with Canadian users through data available to the taxpayer in the normal course of its business (e.g., an address on file for the user or IP address data). The DSTA contains detailed definitions and exclusions for each revenue stream along with complex application rules to determine the revenues derived from Canadian users, as well as further provisions to determine a taxpayer's taxable digital services revenue.

A taxpayer must register under the DSTA if the taxpayer or its consolidated group meets the following three conditions:

- the taxpayer or its consolidated group had digital services revenue in a particular calendar year;
- the taxpayer or its consolidated group had total revenue of at least €750,000,000 in the particular calendar year; and
- the taxpayer or its consolidated group had Canadian digital services revenue of at least CAD$10,000,000 (Registration Threshold) in the particular calendar year.

Taxpayers may be required to register under the DSTA and file returns even if they are not required to pay DST in a given year. Taxpayers who fail to register within the times prescribed under the DSTA are subject to penalties while taxpayers who fail to file and pay DST within the prescribed time are subject to interest and penalties. If a taxpayer is a member of a consolidated group, each member of the consolidated group is generally jointly and severally liable for unpaid DST.

The 2023 amendments to the draft DSTA include *inter alia*, enhancements to the anti-avoidance rules, special rules applicable to partnerships, a new "in-scope period" in respect of taxpayers who join a consolidated group in the year and an election to use a simplified method to calculate DST owing for years prior to the first year of application.

Finally, in the latest version of the DSTA in Bill C-59, certain threshold amounts, including the Global Revenue Threshold, the In-Scope Revenue Threshold, and the Registration Threshold have been moved from the DSTA to the DSTR, which also contains the rules for calculating interest payable by or to the Minister of National Revenue. By moving these thresholds to the DSTR, the Government will have greater flexibility to revise the thresholds as it may do so without having to amend the DSTA itself.

OTHERS

The BC Ministry of Finance issued a request for consultation on the application of PST to partnerships. BC is currently the only Canadian jurisdiction that does not treat partnerships as separate legal persons for sales tax purposes. Subject to public support, BC could introduce legislation to amend the *Provincial Sales Tax Act* (British Columbia) to deem partnerships to be separate legal persons for PST purposes. The deadline to provide feedback was December 29, 2023.

Part 2 - Outlook for 2024

BILL C-59

It is expected that Bill C-59, including legislation implementing the expanded GAAR, the EIFEL Rules, the EOT Rules, the CTI Tax Credit, the CCUS Tax Credit, the Labour Requirements, the tax on repurchases of equity, the intergenerational business transfer framework, the dividend received deduction for financial institutions, the substantive CCPC rules, the Hybrid Mismatch Rules and the DSTA, will receive Royal Assent in 2024.

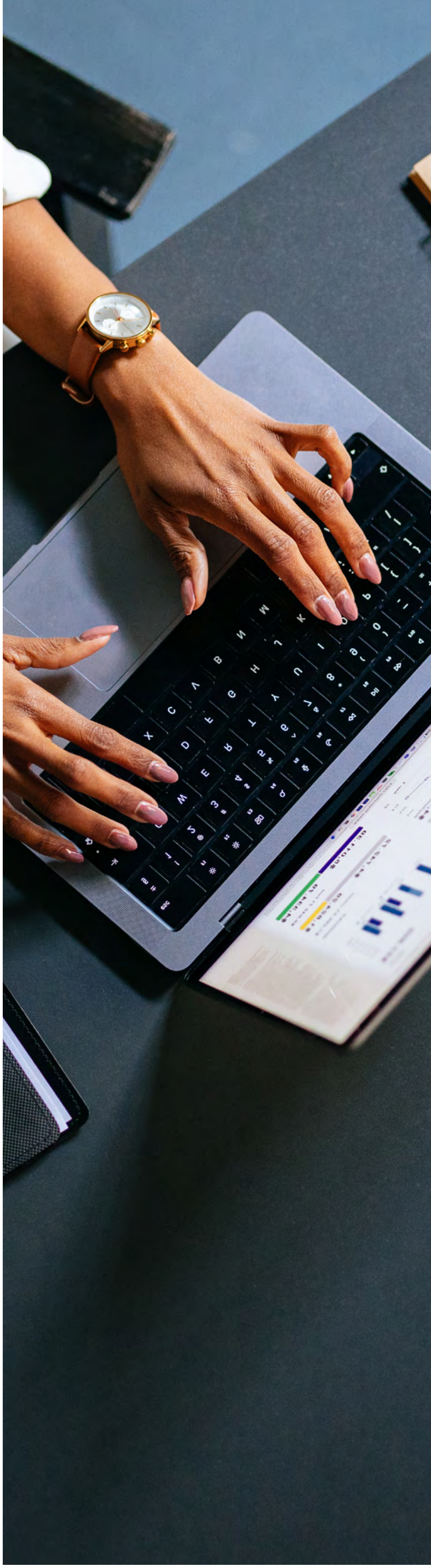
PILLAR TWO

Although the GMTA is intended to apply to taxation years of a qualifying multinational group that begin on or after December 31, 2023, Finance has yet to release revised draft legislation. Revised draft legislation will need to include far greater detail than the current draft GMTA. Finance will need to include related amendments to the Act addressing the interaction of the GMTA and domestic regimes such as the foreign affiliate and foreign accrual property income regimes.

Once the GMTA is enacted, it would be extremely helpful for the CRA to issue its own administrative guidance and release a draft GMTA return. The first GMTA returns should not be due until June 30, 2026, for multinational groups with calendar year fiscal periods and that are in-scope in 2024. Therefore, administrative guidance is likely not immediately forthcoming. Having administrative guidance available as soon as possible will be valuable for in-scope multinational groups as we expect that the preparation of the GMTA returns will be a difficult undertaking.

At the Inclusive Framework level, considerable work remains for 2024 notwithstanding that the IIR is to apply for fiscal years starting on or after December 31, 2023 and the UTPR is to apply for fiscal years starting on or after December 31, 2024. Among other things, a multilateral dispute process must be developed, and peer review processes for a jurisdiction's QDMTT and safe harbour QDMTT must be initiated. A multilateral convention to implement the subject to tax rule in bilateral tax treaties with developing nations was released in October 2023 but countries will need to sign and ratify this convention.

Beyond the Inclusive Framework, implementation of Pillar Two legislation remains ongoing in many countries. European Union (EU) members are required by the Pillar Two EU Directive to enact an IIR with effect in fiscal years starting on or after December 31, 2023 and a UTPR in effect for fiscal years starting on or after December 31, 2024, and EU member states will likely comply. However, many other jurisdictions that have signalled an intention to adopt Pillar Two have yet to release draft legislation or provided implementation details. It is also possible that some jurisdictions will defer their Pillar Two effective dates, especially if significant progress is not made towards implementation in other countries by the end of 2023.



CLEAN ECONOMY TAX CREDITS

Clean Technology Investment Tax Credit

The Fall Economic Statement proposed to expand the property eligible for the CTI Tax Credit to support the generation of electricity, heat, or both electricity and heat (i.e., cogeneration), from waste biomass. The Government indicated it intends to commence draft legislation consultations regarding this expanded eligibility in summer 2024 and to introduce legislation in the House of Commons in fall 2024.

The expanded CTI Tax Credit will only be available in respect of eligible waste biomass equipment that is acquired and becomes available for use on or after November 21, 2023.

Clean Electricity Investment Tax Credit

The Fall Economic Statement indicated that, for taxpayers except for publicly-owned utilities, details regarding the CEI Tax Credit will be published in early 2024 and draft legislation consultations will be launched in summer 2024. For publicly-owned utilities, consultations with provinces and territories will be launched in 2024. For all taxpayers, the Government targets to introduce legislation in the House of Commons in fall 2024.

The CEI Tax Credit will be available as of Budget Day 2024 in respect of projects that commenced construction on or after Budget Day 2023 and before January 1, 2034.

Clean Hydrogen Investment Tax Credit

The Fall Economic Statement indicated the Government intends to introduce legislation implementing the CH Tax Credit in Parliament in early 2024. The December 20 Proposals included proposed draft legislation and Finance initiated a public consultation process.

Clean Technology Manufacturing Investment Tax Credit

The Fall Economic Statement indicated the Government's intent to introduce legislation in Parliament in early 2024. The December 20 Proposals included proposed draft legislation and Finance initiated a public consultation process.

The CTM Tax Credit will apply to property that is acquired and becomes available for use on or after January 1, 2024.

TRUST REPORTING RULES

The new trust reporting rules are applicable to trusts for taxation years ending on or after December 30, 2023. The first filing deadline for these new rules will be March 30, 2024 for trusts with taxation years ended December 31, 2023.

We expect that the breadth of the new trust reporting rules will encompass relationships that were not expected by Finance or the CRA when contemplating the rules. We expect continued consultation, administrative guidance and potentially amendments to the rules will follow.

HYBRID MISMATCH

The 2021 federal budget announced two packages of legislation that would be introduced in respect of any-hybrid mismatches. Provisions implementing the first package of rules were included in Bill C-59.

Draft legislation for the second package of proposals remains outstanding.

SUBSTANTIVE CCPC

The Substantive CCPC Rules contained in Bill C-59 are consistent with the August 9, 2022 draft legislation. However, Bill C-59 does not include the proposed rules addressing investment income generated by controlled foreign affiliates of CCPCs and substantive CCPCs, via amendments to the "relevant tax factor" and "capital dividend account" definitions, which were included in the August 9, 2022 proposals. We understand that Finance is still considering submissions received on this point and that revised legislative proposals will follow in 2024 (or later).

ALTERNATIVE MINIMUM TAX

Proposals to amend the AMT rules were included in the August 4 Proposals but were not included in Bill C-59. We expect further changes to the rules and to see revised draft legislation in 2024.

EMPLOYEE OWNERSHIP TRUSTS

Provisions implementing the EOT rules were included in Bill C-59 other that the $10 million Capital Gains Exemption that was announced in the Fall Economic Statement. Draft legislation implementing the $10 million Capital Gains Exemption is expected in 2024.

TRANSFER PRICING CONSULTATION

Although the formal consultation period ended on July 28, 2023, continued consultation on the modernization of Canada's transfer pricing framework based on the Transfer Pricing Consultation Paper is expected throughout 2024. When Finance issued its consultation paper to amend the GAAR, it took 11 months from the consultation period's closing to the proposed legislation's release. Draft legislation proposing to amend section 247 could be released in 2024. However, given the volume of new tax legislation coming into effect on January 1, 2024 and the degree to which the complex transfer pricing rules are to be changed, it is possible that there is no further development in this area in 2024.

TAX MEASURES PREVIOUSLY ANNOUNCED BY THE GOVERNMENT

Significant other tax measures announced by the Government in Budget 2023 remained outstanding at the close of the 2023 year. We expect that the Government will seek to advance these tax measures in 2024.

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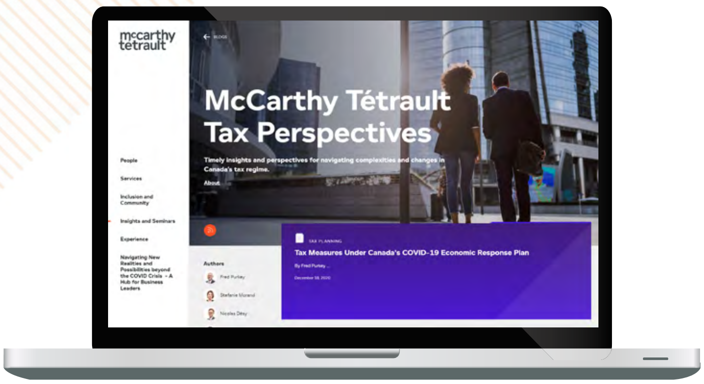

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