April 7, 2022

Budget 2022—housing ambitions funded by big finance

News & Views

Finance Minister Chrystia Freeland tabled the 2022 Federal Budget on April 7, 2022. Housing and affordability took the main stage with numerous measures aimed at tackling housing access, affordability, and improvements. There are no broad-based tax increases on individuals or corporations. The capital gains inclusion rate remains at 50% and there's no real change to the principal residence exemption.

The main revenue-generating measures of this budget are targeted at banks and life insurer groups: a one-time *Canada Recovery Dividend* is a tax of 15% on 2021 taxable income over $1 billion, payable over five years; and a permanent tax increase of 1.5% to 16.5% on income in excess of $100 million applying to taxation years after budget day and prorated for a taxation year including budget day.

Personal tax measures

Housing affordability

To tackle housing affordability, numerous measures are aimed at providing relief to a broad array of Canadians, including renters and those seeking home ownership. This summary will focus mainly on the tax measures. One non-tax measure of interest is a federal review of large corporate ownership of residential housing—presumably targeting real estate investment trusts (REITs)—with further details on the review to be released in the upcoming months, and potential implementation to be announced before the end of 2022.

Tax-Free First Home Savings Account

This budget proposes a new registered savings vehicle for eligible first-time homeowners: the Tax-Free First Home Savings Account (FHSA). The FHSA will give first-time home buyers the ability to save up to $40,000. This account will be unique in that contributions will be tax deductible—similar to a registered retirement savings plan (RRSP)—but qualifying withdrawals (including investment earnings) will be non-taxable—similar to a tax-free savings account (TFSA). Amounts withdrawn to make a qualifying first home purchase won't be subject to tax; however, amounts that are withdrawn for any other purpose will be taxable.

To open an FHSA, the accountholder must be a Canadian resident over the age of 18 years. As well, they can't have lived in a home that they owned either at any time in the year the account is opened or during the preceding four calendar years. There'll be a

$40,000 lifetime limit on contributions with an annual contribution limit of $8,000, which can't be carried forward to subsequent years.

Unused FHSA funds could be transferred to an RRSP, or to a registered retirement income fund (RRIF), if applicable. These transfers won't reduce RRSP contribution room and won't be taxable at the time of transfer, but when funds are withdrawn, they'll be taxable as income like normal RRSP or RRIF withdrawals. As well, transfers from an RRSP to an FHSA can be made on a tax-free basis (subject to the $40,000 lifetime and $8,000 annual contribution limits). These transfers won't restore an individual's RRSP contribution room.

Since this is a *first home* savings account, the non-taxable withdrawals must be for a single property during the FHSA holder's lifetime. Once the first non-taxable withdrawal has been made, the FHSA must be closed within a year and another FHSA can't be opened. Further details are to come with contributions starting in 2023.

The home buyers' plan (HBP), which allows individuals to withdraw up to $35,000 tax free from an RRSP to purchase or build a home, will continue to be available. However, an individual will not be permitted to make both an FHSA withdrawal and an HBP withdrawal in respect of the same qualifying home purchase.

First-Time Home Buyer's Tax Credit

For qualifying homes purchased on or after January 1, 2022, the First-Time Home Buyer's Tax Credit (HBTC) is proposed to double—to $10,000. The increased credit would provide up to $1,500 in direct support to first-time home buyers. Spouses or common-law partners can split the value of the credit as long as the combined total doesn't exceed $1,500 in tax relief. The HBTC eligibility requirements remain the same.

Other housing tax credits

The budget proposes a new refundable tax credit: the Multigenerational Home Renovation Tax Credit, which will provide up to $7,500 in support for constructing a secondary suite for a senior or an adult with a disability (so they may live with a qualifying relation). Starting in 2023, this refundable credit would allow families to claim 15% of up to $50,000 in eligible renovation and construction costs incurred to construct a secondary suite.

Lastly, the Home Accessibility Tax Credit is a non-refundable tax credit that provides recognition of eligible home renovations for an eligible dwelling of a qualifying individual. The value of the credit is 15% of the lesser of eligible expenses and $10,000. Budget 2022 proposes to increase the annual expense limit of this tax credit to $20,000. This measure would apply to expenses incurred in 2022 and subsequent taxation years.

Restrictions on foreign ownership

Budget 2022 announces the government's intention to prohibit foreign entities and individuals from acquiring non-recreational, residential property in Canada for a period of two years. These restrictions won't apply to Canadian citizens, permanent residents, refugees, international students on the path to permanent residency (in certain circumstances), and individuals on work permits who are residing in Canada. Moreover, non-resident, non-Canadians who own homes that are being underused or left vacant would be subject to the Underused Housing Tax once it's in effect.

Anti-flipping measures

Also proposed are new deeming rules on residential property flipping. Any person who sells a residential property they've held for less than 12 months would be considered to be flipping properties and be subject to full taxation of their profits as deemed business income (i.e., instead of a capital gain) and the principal residence can't be claimed. Exemptions would apply for dispositions due to certain circumstances, which can include death, disability, serious illness, the birth of a child, change in employment or work location, insolvency, separation, or divorce. Where the new deeming rule doesn't apply, it remains a question of fact whether profits from the disposition are taxed as business income. These anti-flipping measures will apply to residential properties sold on or after January 1, 2023.

Revisiting minimum tax

The Alternative Minimum Tax (AMT), introduced in 1986 to prevent high-income individuals (including trusts) from paying little or no income tax, hasn't been substantially updated. Budget 2022 announces the government's commitment to examine a new minimum tax regime to make sure that all Canadians pay "their fair share" of tax. Details will be in the 2022 fall economic update.

Reporting requirements for RRSPs and RRIFs

Financial institutions are currently required to report annually to the Canada Revenue Agency (CRA) the payments out of and contributions to each RRSP and RRIF that they administer. However, they must file a comprehensive annual information return in respect of each TFSA that they administer, which includes the fair market value (FMV) of property held in the account.

Budget 2022 proposes to require financial institutions to annually report to CRA the total FMV, determined at the end of the calendar year, of property held in each RRSP and RRIF that they administer. This information would assist CRA regarding qualified investments held by RRSPs and RRIFs.

Further, this more comprehensive reporting could help CRA understand the trading activity on RRSPs and RRIFs and whether that activity constitutes carrying on a business for trading. CRA has taken this approach with TFSAs for a number of years and could be looking for information to support a similar approach with RRSPs and RRIFs.

Medical expense tax credit for surrogacy and other expenses

Budget 2022 proposes to broaden the Medical Expense Tax Credit (METC) definition of *patient* to recognize surrogate mothers or donors. This would allow medical expenses and certain reimbursements with respect to a surrogate mother or donor to be eligible for the METC. The budget also proposes that fees paid to fertility clinics and donor banks to become a *parent* be eligible under the METC. The measure would apply to expenses incurred in 2022 and subsequent years.

Phasing out flow-through shares for oil, gas, and coal activities

Budget 2022 proposes to eliminate the flow-through share regime for oil, gas, and coal activities by no longer allowing oil, gas, and coal exploration or development expenditures to be renounced to a flow-through share investor—effective for expenditures renounced under flow-through share agreements entered into after March 31, 2023.

Corporate tax measures

Small business deduction

Small business may receive preferential tax treatment through the *small business deduction*. This rate reduction results in a lower corporate income tax rate of 9%, compared to the general corporate income tax of 15%, which applies up to $500,000 per year of qualifying active business income (i.e., the *business limit*) of a Canadian-controlled private corporation (CCPC).

This business limit is reduced on a straight-line basis when:

- the combined taxable capital employed in Canada of the CCPC and its associated corporations is between $10 million and $15 million; or
- the combined *adjusted aggregate investment income* of the CCPC and its associated corporations is between $50,000 and $150,000.

Budget 2022 proposes to extend the range over which the business limit is reduced based on the combined taxable capital employed in Canada from $10 million to $50 million (up from $15 million). This change would allow more medium-sized CCPCs to benefit from the small business deduction and increase the amount of qualifying active business income that's eligible for the small business deduction. This measure applies to taxation years that begin on or after April 7, 2022.

Substantive CCPCs

Budget 2022 addresses two macro issues relating to foreign entities being used as part of Canadian tax planning.

Deferring tax using non-CCPCs

To maintain tax neutrality between earning investment income personally or through a CCPC, investment income earned by a CCPC is taxed at a rate similar to what's paid by individuals. There are integration mechanisms such as Part IV tax on portfolio dividends and refundable taxes under Part I for other passive income that are ultimately recovered by the corporation once a taxable dividend is paid to the shareholder.

Taxpayers have been engaging in planning to avoid being a CCPC (commonly referred to as *non-CCPC planning*, or in the budget documents as *substantive CCPCs*). This type of planning resulted in other investment income being taxed at the general rate for active business income rather than the rate for investment income in a CCPC, providing greater tax deferral. Also, when dividends were paid by substantive CCPCs, they were treated as eligible dividends.

Budget 2022 proposes targeted amendments to align the taxation of investment income earned and distributed by substantive CCPCs to that of CCPCs. These measures include using the same anti-deferral mechanisms, including investment income being subject to the refundable Part I tax regime and having the subsequent distribution of this income being treated as non-eligible dividends.

The amendments in Budget 2022 create a test that contains an extended definition of *control* that would aggregate the shares owned, directly or indirectly, by Canadian resident individuals—this would deem a corporation to be controlled by a Canadian resident individual if Canadian individuals own, in aggregate, sufficient shares to control the corporation. These new rules are also supported by targeted anti-avoidance rules and a one-year extension of the normal reassessment period under certain circumstances.

This measure would apply to taxation years that end on or after April 7, 2022. There are no changes to the capital dividend account (CDA) for substantive CCPCs. Life insurance proceeds received by these entities can credit the CDA.

Deferring tax using foreign affiliates

The foreign accrual property income (FAPI) rules are designed to prevent Canadian taxpayers from gaining tax deferral through earning investment income through *foreign affiliates*. These FAPI rules allow for a deferral advantage to CCPCs, substantive CCPCs, and individuals. Budget 2022 proposes to eliminate this tax-deferral advantage. To maintain integration, the budget also proposes to create CDA for a portion of the repatriated earnings from foreign affiliates made to CCPCs or substantive CCPCs. These measures would apply to taxation years that begin on or after April 7, 2022.

Intergenerational business transfers

A consultation process was announced to follow up on Bill C-208, which was enacted June 29, 2021. This allows a carve-out from an anti-avoidance rule that would recharacterize capital gains as dividends when certain intergenerational business transfers are made. The enacted legislation deems that the taxpayer deals at arm's length with the purchaser corporation when these three criteria are met:

- the purchaser corporation is controlled by one or more of the taxpayer's children or grandchildren
- the children or grandchildren are 18 years of age or older
- the purchaser corporation doesn't dispose of the purchased shares within 60 months.

There are many gaps in the existing legislation that the government intends to fix while remaining committed to facilitating intergenerational business transfers. The effective date of any amendments will be the date of release of final draft legislation, expected in the fall, after the consultation period. It should be noted that extensive submissions have already been made at the time of the 2017 private company proposals.

General Anti-Avoidance Rule (GAAR)

GAAR is applied to prevent abusive tax avoidance transactions while not interfering with legitimate commercial and family transactions. Where a transaction is subject to GAAR, the CRA can determine the amount of a tax attribute, such as the adjusted cost base of property or paid-up capital of a share. Budget 2022 enables GAAR to apply to transactions that affect tax attributes that haven't yet become relevant to the computation of tax. This measure applies to notices of determination issued on or after budget day.

Charitable measures

Annual disbursement quota for registered charities

Registered charities are generally required to expend a minimum amount each year, referred to as the *disbursement quota* (DQ). Budget 2022 proposes to increase the DQ rate from the current 3.5% to 5% for the portion of property not used in charitable activities or administration that exceeds $1 million. Also, amendments will be made to clarify that administration and management expenses won't qualify as expenditures for a charity's DQ.

These measures would apply to charities in respect of their fiscal periods beginning on or after January 1, 2023.

Charitable partnerships

Budget 2022 proposes greater flexibility for charities by allowing them to make qualified disbursements to organizations that aren't qualified donees provided they meet certain accountability requirements (to make sure their disbursements will be used for charitable purposes). These changes would apply as of Royal Assent of the enacting legislation.

Previously announced measures

The government listed numerous previously announced tax and related measures that it intends to proceed with. Some items of note, which we've covered in Budget 2021—the other shoe hasn't dropped ... yet and elsewhere, include:

- legislative proposals relating to new luxury cars and aircraft over $100,000 and new boats over $250,000
- expanded eligibility for the disability tax credit
- inclusion of postdoctoral fellowship income as earned income for RRSP purposes
- fixing RRSP contribution errors in defined contribution pension plans
- enhanced reporting requirements for certain trusts
- allocation to redeemers methodology for mutual fund trusts
- penalty taxes applicable to non-qualified investments in registered accounts
- mandatory disclosure rules.

Conclusion

A lot more detail will have to follow. Budget 2022 didn't provide legislation for most of the items discussed here.

Important disclosure

The commentary in this publication is for general information only and should not be considered legal, tax or other professional advice to any party. Individuals should seek the advice of professionals to ensure that any action taken with respect to this information is appropriate to their specific situation.

04/2022

" "" "