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# 2021 Federal budget analysis

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**This year's federal budget, titled *Recovery Plan for Jobs, Growth, and Resilience*, didn't introduce measures that directly impact life insurance products, living benefits products or wealth products. Personal and corporate tax rates were unaffected as well. This article summarizes the budget highlights and tax-related measures which may be of interest to advisors.**

## Budget highlights

The Liberal government's first budget in two years highlights spending measures to "finish the fight against COVID-19", reduce our carbon footprint and provide new early learning and childcare programs to families. The deficit for the 2020-21 fiscal year is projected to hit $354.2 billion. Notable spending measures include:

- **Childcare and early learning** – $30 billion over five years and $8.3 billion a year thereafter to build an early learning and childcare system across Canada.
- **Green stimulus** – $17.6 billion in spending over at least 5 years across dozens of programs to facilitate a green recovery to create jobs, build a clean economy and fight and protect against climate change.
- **COVID-19 business support** – Canada Emergency Wage Subsidy and the Canada Emergency Rent Subsidy and Lockdown Support are extended to September 25 and potentially later until November 20. The total cost of extending these measures will be $12 billion in 2021-22. The Budget also introduces a new Canada Recovery Hiring Program to help qualifying employers hire employees as the economy reopens by providing up to $1,129 per week for employees hired between June 6, 2021 and November 20, 2021.
- **Workers support** – A 12-week extension of the Canada Recovery Benefit and a 4-week extension of the Canada Recovery Caregiving Benefit at a cost $2.5 billion over two years, starting in 2021-22.
- **Seniors support** – Increased Old Age Security (OAS) payments discussed in more detail below. The OAS measures represent $12 billion in spending over five years, beginning in 2021-22.

## Tax measures of interest

The following tax measures introduced in the budget may be of interest to advisors.

**Interest deductibility limits**

Finance is concerned our current interest deductibility rules may allow foreign companies to erode our tax base by using certain cross border strategies.

The budget introduces a new set of rules to limit interest deductibility in certain situations. The budget proposes a so-called “earnings-stripping” rule consistent with those of other G7 countries. The new rule would limit the amount of net interest expense that a corporation may deduct in computing its taxable income to no more than a fixed ratio of “tax EBITDA”, which is inter alia a corporation’s taxable income before taking into account interest expense, interest income and income tax, and deductions for depreciation and amortization. Tax EBITDA excludes, among other things, tax-free inter-corporate dividends, interest paid between members of a Canadian corporate group and interest that isn’t deductible under existing tax rules.

Exemptions from the new earnings-stripping rule are available for:

- Canadian-controlled private corporations and associated corporations with taxable capital employed in Canada of less than $15 million; and·
- Groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $250,000 or less.

Interest denied under the earnings-stripping rule would be able to be carried forward for 20 years or back for three years.

The new earnings-stripping rule would also apply to trusts, partnerships and Canadian branches of non-resident taxpayers.

**Digital Service Tax**

The Liberal government plans to formalize the Digital Service Tax ("DST") first introduced in the 2020 Fall Economic Statement. Namely, companies with gross revenue of €750 million or more that provide online services to Canadians will be charged a 3% tax on revenue derived in Canada. The DST is intended to be interim in nature – it would apply as of January 1, 2022 until an acceptable multilateral approach comes into effect. The DST is expected to generate $3.4 billion over a five-year period. The new measures would apply to services provided by companies such as Google, Facebook, Amazon, Netflix, and more. Canada is joining a growing list of countries who have introduced a DST.

**Luxury tax**

The budget proposes to introduce a new tax on the sale of new luxury cars and personal aircraft priced over $100,000, and boats priced over $250,000, effective January 1, 2022. The tax would apply at the point of purchase if the price (excluding GST/HST and provincial sales tax) is above the $100,000 or $250,000 price threshold, respectively. The tax applies whether the item is purchased outright, financed, or leased.

For vehicles and aircraft priced over $100,000, the amount of the tax would be the lesser of 10% of the full value of the vehicle or the aircraft, or 20% of the value above $100,000.

For boats priced over $250,000, the amount of the tax would be the lesser of 10% of the full value of the boat or 20% of the value above $250,000.

The GST/HST would apply to the final sale price, inclusive of the proposed tax.

**Foreign owned residential real estate**

As a measure aimed at cooling the hot housing market, the budget proposes an annual 1% tax on the value of foreign owned residential real estate that's vacant or underused. This tax would be levied annually beginning in 2022. This measure follows the foreign buyers' taxes previously introduced in British Columbia and Ontario.

Moreover, beginning in 2023, all foreign homeowners will be required to file an annual declaration for the prior calendar year with respect to each Canadian residential property they own. The requirement to file this declaration would apply irrespective of whether the owner is subject to tax in the year. The declaration would require the owner to declare the current use of each property.

The government expects to see $700 million in revenue over four years.

**Mandatory disclosure rules**

To reduce tax evasion and tax avoidance, the budget proposes to enhance and expand the mandatory income tax disclosure rules and will seek public consultation on the following.

Under the current rules, a transaction is a reportable transaction if it is an “avoidance transaction” as defined under the Income Tax Act (Canada) and bears at least two of the three listed hallmarks. A reportable transaction must be reported to Canada Revenue Agency (“CRA”) by June 30 of the calendar year following the year in which the transaction became a reportable transaction. The budget proposes having to bear only one (instead of two) of the listed hallmarks and expanding the definition of an “avoidance transaction.”

The budget proposals also include new requirements for taxpayers to report “notifiable transactions” and for specified corporate taxpayers to report “uncertain tax treatments” to the CRA within specified time limits, provided certain conditions are met. In general, a notifiable transaction would include a transaction that the CRA has found to be abusive and a transaction identified as transaction of interest. An uncertain tax treatment is generally a tax treatment used, or planned to be used, in a company’s income tax return and there’s uncertainty whether the tax treatment will be accepted as filed.

The proposals regarding the new mandatory disclosure rules will also include a delay in the start of the normal reassessment period (i.e., generally 3 or 4 years, depending on the taxpayer, from the notice of assessment date) until the taxpayer has complied with the reporting requirements. In addition, the proposals include the levy of penalties for failure to comply with the reporting requirements. In some cases, the penalties can apply to both the taxpayer and to advisors and promoters.

**Avoidance of tax debts**

The budget proposes new rules and penalties to target complex planning that’s done solely to avoid the current tax debt avoidance rule which is meant to prohibit taxpayers from avoiding their tax liabilities by transferring their assets to non-arm’s length persons. The penalties may apply to both the developers and promoters of such planning.

## Increasing Old Age Security for Canadians 75 and Over

Seniors aged 75 and older as of June 2022, who qualify for the OAS pension are being targeted to receive a one-time payment of $500 in August 2021. This additional amount is a taxable amount to the recipient, but because it’s not paid under the Old Age Security Act, this amount won’t be subject to the recovery tax (clawback).

The budget proposes to introduce legislation to increase regular OAS payments for this same group by 10% on an ongoing basis as of July 2022. These additional amounts will be taxable and will be subject to recovery tax, if applicable.

## Tax measures that were not addressed in the budget

While widely speculated to be included in the budget, the following tax measures were not addressed:

- An increase in the capital gains inclusion rate
- Measures that affect the principal residence exemption
- Tax measures helping intergenerational transfers of businesses
- Measures targeting capital gains planning
- A wealth tax

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