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FEDERAL BUDGET 2024

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2024 Canadian Federal Budget Commentary – Tax Initiatives

Introduction

On April 16, 2024 (Budget Day), Canada's Deputy Prime Minister and Minister of Finance, Chrystia Freeland, tabled in the House of Commons the Liberal Government's budget, *Fairness for Every Generation* (Budget 2024).

The most significant announcement in Budget 2024 is the proposed increase to the capital gains inclusion rate from one-half to two-thirds. Such an increase has been the source of pre-budget speculation for so many years that it was both unexpected and anticipated at the same time. The increased inclusion rate applies to all taxpayers, but only for capital gains in excess of $250,000 for individuals. Other related changes for individuals and certain small business owners include an increase to the Lifetime Capital Gains Exemption and the introduction of a new Canadian Entrepreneurs' Incentive that reduces the capital gains inclusion rate on the sale of certain shares. Other significant measures include (i) the introduction of new and enhanced powers to assist the Canada Revenue Agency (CRA) in obtaining information during audits, (ii) additional particulars in respect of the design and implementation of the Clean Electricity Investment Tax Credit and (iii) a number of measures intended to make housing more affordable.

Our commentary on the tax initiatives in Budget 2024 follows. Unless otherwise stated, all statutory references are to the *Income Tax Act* (Canada) (Tax Act).

Headline Tax Change – Capital Gains Inclusion Rate

CAPITAL GAINS INCLUSION RATE

Budget 2024 proposes to increase the capital gains inclusion rate in paragraph 38(a) (and the capital loss inclusion rate in paragraph 38(b)) from one-half to two-thirds, for capital gains realized on or after June 25, 2024. This measure will apply to all capital gains realized by corporations and trusts, but only will apply to individuals in respect of the portion of capital gains realized in the year that exceeds $250,000. Capital gains realized by trusts that are paid or made payable to an

individual beneficiary of the trust and in respect of which a designation is made under subsection 104(21) should be treated as having been realized by the individual for the purposes of applying the $250,000 threshold.

The proposed $250,000 threshold for individuals will be calculated net of the individual's current year capital losses, capital loss carry-forwards and carry-backs, capital gains that qualify for the capital gains deduction, the new Canadian entrepreneurs' incentive and the proposed exemption for dispositions to employee ownership trusts (see below). Where capital losses from a pre-rate change taxation year are carried forward and applied, there will be an adjustment to the inclusion rate to reflect the inclusion rate of the capital gains being sheltered by the carry-forward (allowing for the capital loss to shelter a capital gain of the same amount). Presumably, there would be no adjustment to the inclusion rate where the capital gains of an individual being sheltered in the taxation year of application are less than $250,000, but adjustments would be required where the capital gains being sheltered by the carry-forward exceed $250,000.

The proposed inclusion rate change will be subject to transitional rules applicable to taxation years that begin before June 25, 2024 and that end on or after June 25, 2024, which will identify gains realized on or before June 24, 2024 (referred to as "Period 1" in Budget 2024) and gains realized after June 24, 2024 ("Period 2," per Budget 2024) and apply different inclusion rates to each period. For individuals, the $250,000 threshold will not be prorated for 2024, and so the two-thirds inclusion rate should apply only where the capital gains realized by the individual after June 24, 2024 up to and including December 31, 2024 exceed $250,000.

Consequential on the change to the capital gains inclusion rate, the paragraph 110(1)(d) and (d.1) deductions for employee stock option benefits will be reduced from one-half to one third. However, qualifying employees remain entitled to the one-half deduction to the extent that their combined employee stock option benefits and capital gains realized in a particular taxation year total to $250,000 or less. Budget 2024 does not explain how the deduction for employee stock options and the capital gains inclusion rate will interact in circumstances where the combined employee stock option benefits and capital gains in a particular taxation year exceed $250,000.

Budget 2024 does not provide a specific date for the release of the further design details about this measure and the related consequential amendments.

Business Tax Measures

DENIAL OF MUTUAL FUND CORPORATION STATUS

Many investment funds in Canada are structured as corporations that, if they meet certain requirements in the Tax Act, can qualify as a "mutual fund corporation" (MFC) as defined in subsection 131(8).

MFC status entitles a corporation to a number of benefits under the Tax Act. An MFC can make the election under subsection 39(4) that its gains and losses on the disposition of "Canadian securities" be deemed capital gains or capital losses even if the MFC otherwise would be regarded as a trader or dealer in securities that is not entitled to make the election. In addition, a corporation that would otherwise be a financial institution (e.g., because it is controlled by one or more financial institutions) and subject to the mark-to-market rules in respect of mark-to-market property is specifically excluded from the definition of "financial institution." An MFC can elect that dividends paid by the corporation to its shareholders be "capital gains dividends" to the extent of the MFC's capital gains dividend account. These dividends are treated as capital gains realized in the hands of shareholders, and are not treated as "dividends" or "taxable dividends" for the purposes of section 112 of the Tax Act, including the dividend stop-loss rules.

One of the requirements for a corporation to be an MFC is for it to be a Canadian corporation that is a "public corporation." Generally, public corporation status can be obtained in one of two ways. The first is that a class (or series) of shares is listed on a "designated stock exchange" in Canada. It is not necessary that all shares be listed on a designated stock exchange nor that the listed shares have material value. The second is that (i) the corporation meets certain prescribed conditions in the *Income Tax Regulations* (Canada) (Tax Regulations) relating to the number of its shareholders, the dispersal of ownership of the corporation's shares and the public trading of its shares and (ii) the corporation elects to be a public corporation. Once a corporation qualifies as a public corporation, it continues to be a public corporation until it

meets certain conditions and either it takes the affirmative step of electing not to be a public corporation or the Minister designates that it is not a public corporation.

Budget 2024 states that "[a] corporation can qualify as a mutual fund corporation under the [Tax Act] if a class of its shares is listed on a designated stock exchange in Canada, even if all other shares of the corporation are held by a corporate group and those shares represent all or substantially all of the fair market value of the issued shares of the corporation. This could allow a corporate group to use a mutual fund corporation to benefit from the special rules available to these corporations in an unintended manner." While the Government asserts that using an MFC to defer or avoid taxes can be challenged (presumably under GAAR), Budget 2024 proposes to add a specific rule to deny MFC status to such a corporation for taxation years beginning after 2024.

The proposed rule will provide that a corporation (other than a prescribed labour-sponsored venture capital corporation) is deemed not to be an MFC after a particular time if, at the particular time:

- a person or partnership, or any combination of persons or partnerships that do not deal with each other at arm's length (in either case referred to as "specified persons") own shares of the corporation having an aggregate fair market value (FMV) greater than 10% of the aggregate FMV of all shares of the corporation; and
- the corporation is controlled by or for the benefit of one or more specified persons.

While Budget 2024 referred only to MFCs that are public corporations because they have a class of shares listed on a designated stock exchange, the proposed rule extends to corporations that elect to be public corporations by meeting the prescribed conditions in the Tax Regulations.

Many publicly offered MFCs have a multi-class share structure in which only one class of shares is entitled to votes. This class of shares may be owned by the manager or by a trust for the benefit of the holders of the other shares so that it is not necessary to have annual meetings of all shareholders. In the former case, if the manager (or one or more persons not dealing at arm's length with the manager) owns shares of the corporation having an aggregate FMV greater than 10% of the aggregate FMV of all shares of the corporation, the corporation would be deemed not to qualify as an MFC. Due to the need for a manager to "seed" new funds, this could easily occur.

Accordingly, an exception to the proposed rule is contemplated. The rule does not apply if:

- the corporation was incorporated not more than two years before the particular time; and
- specified persons do not own shares of the corporation with an aggregate FMV of more than $5 million.

The exception appears to be quite narrow.

SYNTHETIC EQUITY ARRANGEMENTS

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, this inter-corporate dividend deduction allows dividends paid on such shares to flow tax-free through a corporate chain so as to mitigate double taxation at the corporate level.

Among other limitations, the inter-corporate dividend deduction is denied in respect of a dividend received on a share of a taxable Canadian corporation where there is, in respect of the share, a dividend rental arrangement (DRA) of the recipient corporation (the DRA rule). The definition of a DRA of a person includes a synthetic equity arrangement (SEA) in respect of a DRA share of the person. Among other things, a DRA share of a person means a share that is owned by the person.

The SEA rules were first introduced as part of Budget 2015. In general, a SEA in respect of a DRA share of a particular person means one or more agreements or other arrangements entered into by the particular person (or by persons that do not deal at arm's length with or are affiliated with the particular person) that have the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit on the DRA share to a counterparty (or group of affiliated counterparties).

Under the current rules, the definition of SEA excludes an agreement traded on a recognized derivatives exchange unless, at the time of entering into the agreement, it is reasonable to consider that the particular person knew or ought to have known that (i) that agreement was part of a series of transactions that provides all or substantially all of the risk of loss and opportunity for gain or profit on the DRA share to a tax-indifferent investor (TII), or (ii) one of the main reasons for entering into the agreement was to obtain the benefit of a deduction in respect of a payment that corresponds to an expected or actual dividend (Exchange-Traded Exclusion). The definition of TII includes a person exempt from income tax under Part I of the Tax Act and a person that is a non-resident of Canada for purposes of the Tax Act.

In addition to the Exchange-Traded Exclusion, the DRA rule currently does not apply to a dividend received on a share where there is, in respect of the share, a DRA of a person that is an SEA and, throughout the period of the SEA, the person establishes that no TII (or group of affiliated TIIs) has all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share (No-TII Exception). A taxpayer is considered to have satisfied the No-TII Exception by obtaining certain representations in writing as set out in the Tax Act.

Budget 2024 proposes to eliminate both the Exchange-Traded Exclusion and the No-TII Exception for dividends received on or after January 1, 2025. Budget 2024 does not contain any draft legislation with respect to these proposals.

CANADA'S CLEAN ECONOMY TAX CREDITS

Budget 2024 continues the Government's commitment to build Canada's clean economy through the introduction of clean economy tax credits.

The previously announced clean economy tax credits are:

- the Investment Tax Credit for Carbon Capture, Utilization, and Storage (CCUS ITC);
- the Clean Technology Investment Tax Credit (CT ITC);
- the proposed Clean Hydrogen Investment Tax Credit (CH ITC);
- the proposed Investment Tax Credit for Clean Technology Manufacturing (CTM ITC); and
- the proposed Clean Electricity Investment Tax Credit (CE ITC).

The CE ITC was announced in Budget 2023 with design and implementation particulars to be provided in Budget 2024. Budget 2024 provides those design and implementation particulars.

Budget 2024 proposes an expansion of the CTM ITC to businesses engaged in polymetallic projects.

In addition, Budget 2024 proposes a new Electric Vehicle Supply Chain Investment Tax Credit (EV ITC).

Budget 2024 also indicates that the Government expects Bill C-59 to receive royal assent before June 1, 2024. Bill C-59 will enact the CCUS ITC, the CT ITC and the prevailing wage and apprenticeship requirements (Labour Requirements) that must be satisfied to maximize the CCUS ITC, the CT ITC, the proposed CH ITC and the proposed CE ITC. Bill C-59 received second reading in the House of Commons on March 18, 2024 and was referred to the House of Commons Standing Committee on Finance.

Clean Electricity Investment Tax Credit

The Government announced its intention to introduce the CE ITC in Budget 2023. The CE ITC is an up to 15% refundable tax credit applicable to investments in eligible property that is acquired and becomes available for use on or after Budget Day. The 2023 FES indicated the Government's intent to differentiate the application of the CE ITC for taxpayers that are publicly owned utilities and taxpayers that are not publicly owned utilities.

Consistent with the Government's timeline set out in the 2023 FES, Budget 2024 announces design and implementation particulars of the CE ITC.

Eligible Entities

Only taxpayers that are Canadian corporations will be eligible to claim the CE ITC; however, unlike the other clean economy tax credits, the CE ITC will be available to both taxable and, subject to meeting certain additional requirements, certain tax-exempt Canadian corporations. Such eligible corporations will be:

- taxable Canadian corporations;
- corporations owned by municipalities;
- corporations owned by Indigenous communities;
- pension investment corporations; and
- provincial and territorial Crown corporations.

For a tax-exempt corporation to claim a CE ITC, it must agree to be subject to the provisions of the Tax Act implementing the CE ITC including the provisions relating to audit, penalties and collections. It must also agree not to assert any immunity or exemption in respect of the CE ITC (presumably this enables recovery of the CE ITC where applicable).

Partnerships

Like the other clean economy tax credits, Budget 2024 proposes that rules for partnerships will be implemented to enable a partner that is an eligible corporation to claim its share of the CE ITC derived from expenditures made by the partnership to acquire eligible property. Budget 2024 proposes that the rules determining entitlement to the CE ITC for partners of partnerships will be consistent with those proposed for the CT ITC in Bill C-59.

Where a partnership acquires property eligible for both the CE ITC and the CT ITC, a partner will be able to claim its reasonable share of either credit for which the partner is otherwise eligible (but not both credits in respect of the same property).

For example, if a partnership with a 50% tax-exempt corporation partner and a 50% taxable Canadian corporation partner incurs expenditures to acquire property that is eligible for both the CE ITC and the CT ITC (and the Labour Requirements are met), the tax-exempt corporation partner should be entitled to claim a credit equal to its reasonable share of the 15% CE ITC to which the partnership would be entitled if it were an eligible entity for purposes of the CE ITC and the taxable Canadian corporation should be entitled to claim a credit equal to its reasonable share of the 30% CT ITC to which the partnership would be entitled if it were a qualifying taxpayer for purposes of the CT ITC.

Equipment Eligible for the CE ITC

The types of property eligible for the CE ITC will be described in part by reference to classes of property described in Schedule II to the Tax Regulations for capital cost allowance (CCA) purposes. Budget 2024 proposes that the following types of equipment are eligible:

- equipment to generate electricity from solar, wind and water energy that is described in subparagraphs (d)(ii), (iii.1), (v), (vi) or (xiv) of Class 43.1 except that a hydro-electric installation will be exempt from the capacity limit prescribed for purposes of Class 43.1;
- “concentrated solar energy equipment” as defined for the purposes of the CT ITC, but limited to equipment used to generate electricity. This is equipment, other than “excluded equipment”, used all or substantially all to generate electricity exclusively from concentrated sunlight. “Excluded equipment” is: (i) auxiliary heating or electrical generating equipment that uses any fossil fuel; (ii) buildings or structures (other than those whose sole function is to support or house concentrated solar energy equipment); (iii) distribution equipment; and (iv) property included in Class 10;
- equipment used to generate electricity, or both electricity and heat, from nuclear fission, as defined for the purposes of the CT ITC, but without generating capacity limits or a requirement to consist of modules that are factory-assembled and transported pre-built to the installation site. This would appear to include reactors, reactor vessels, reactor control

rods, moderators, cooling systems, control systems, nuclear fission fuel handling equipment, containment structures, electrical generating equipment and equipment for the distribution of heat energy but exclude (i) nuclear fission fuel, (ii) equipment for nuclear waste disposal and nuclear waste disposal sites, (iii) transmission equipment, (iv) distribution equipment, (v) property included in Class 10 in Schedule II to the Tax Regulations, or (vi) property that would be included in Class 17 in Schedule II to the Tax Regulations if that Class were read without reference to its paragraph (a.1).

- equipment used exclusively to generate electrical energy or electrical and heat energy, solely from geothermal energy, that is described in subparagraph (d)(vii) of Class 43.1, but excluding any equipment that is part of a system that extracts fossil fuel for sale;
- equipment that is part of a system used to generate electricity or electricity and heat from waste biomass comprising "specified waste materials" (as defined in subsection 1104(13) of the Tax Regulations);
- fixed location electricity storage equipment described in subparagraph (d)(xviii) of Class 43.1 or a pumped hydroelectric energy storage installation described in subparagraph (d)(xix) of Class 43.1 that do not use any fossil fuel in operation;
- equipment comprising an eligible natural gas energy system; and
- equipment and structures used for transmitting electricity between provinces and territories.

Qualifying expenditures may include expenditures to refurbish existing facilities (e.g., nuclear reactors) that otherwise qualify.

Certain Natural Gas Energy Systems Eligible for the CE ITC

Budget 2024 proposes that equipment comprising part of an eligible natural gas energy system will be eligible for the CE ITC. Eligible natural gas energy systems are those that use fuel, all or substantially all of which is natural gas, solely to generate electricity, or electricity and heat, and that use carbon capture to limit emissions.

Eligible natural gas energy systems must not exceed an emissions intensity of 65 tonnes of carbon dioxide per gigawatt hour of energy produced and all of the captured carbon dioxide must be stored in accordance with geological storage requirements generally aligned with those that apply to the CCUS ITC set out in Bill C-59.

The formula used to measure a system's emissions intensity will be consistent with that used in the Regulations *Limiting Carbon Dioxide Emissions from Natural Gas-fired Generation of Electricity* under the *Canadian Environmental Protection Act*, subject to the following two modifications:

- emissions attributable to the combustion of biomass will be included in the total emissions calculation; and
- emissions captured and stored in dedicated geological storage will be removed from the total emissions calculation while emissions captured and used for enhanced oil recovery or other storage or sue will not be removed.

Eligible property composing an eligible natural gas energy system will include:

- equipment that generates both electricity and heat energy;
- heat recovery equipment;
- electrical generating equipment;
- heat generating equipment if it is used primarily to produce heat energy to operate the electrical generating equipment; and
- carbon capture equipment including equipment to prepare and compress captured carbon for transport.

Eligible property will not include buildings and structures, heat rejection equipment, electrical transmission and distribution equipment, fuel handling equipment, or equipment used to transport, store or use carbon dioxide.

Before a taxpayer may make a claim for a CE ITC:

- Natural Resources Canada (NR Can) must review the project plans to determine eligibility of the system and equipment for the CE ITC. Project plans submitted to NR Can must reflect a front-end engineering design study and any other information required by the Minister of Energy and Natural Resources; and
- NR Can must verify equipment eligibility after the expenditures are incurred.

A natural gas energy system will also be subject to the following additional rules:

- a one-time verification of emissions intensity based on a five-year compliance period will be required;
- during the five-year compliance period, annual emissions intensity verification reports prepared by a third party must be submitted to NR Can. The verification reports must be prepared by a Canadian engineering firm with an engineering certificate of authorization, appropriate insurance coverage, and expertise in auditing continuous emissions monitoring systems;
- there will be a full recovery of the CE ITC if the weighted average emissions intensity over the five-year compliance period exceeds 65 tonnes of carbon dioxide per gigawatt hour of energy produced by more than 5%; and
- after the five-year compliance period ends, annual emissions intensity reports must be prepared for the next 15 years. If the annual emissions intensity exceeds the limit of 65 tonnes of carbon dioxide per gigawatt hour of energy produced during any of these years, it will be considered an ineligible use and any CE ITC claimed would be subject to recapture. There does not appear to be a 5% tolerance.

Eligible Inter-Provincial/Territorial Electricity Transmission

Eligible inter-provincial and territorial electrical transmission property is property used to transmit or manage electrical energy that primarily originates in, or is being transmitted to, another province or territory. Property located exclusively in one province or territory is eligible if it is used primarily for the purpose of inter-provincial electricity transmission.

Eligible inter-provincial/territorial electrical transmission property will include:

- electrical transmission equipment;
- electrical transmission structures; and
- related equipment used for managing traded electricity.

Eligible property will not include buildings, electrical distribution equipment, or electrical transmission equipment rated for voltages less than 69 kilovolts.

Labour Requirements

Budget 2024 confirms that the Labour Requirements under section 127.46 (as set out in Bill C-59) will apply to the CE ITC. If a taxpayer does not elect to satisfy the Labour Requirements, the amount of the CE ITC will be reduced to 5% from 15%.

Compliance Requirements

Under the current rules for certain properties described in Class 43.1 or 43.2, all of conditions for inclusion in the Class must be satisfied on an annual basis subject to a limited exception for property that is part of an eligible system previously operated in a qualifying manner. The relieving rule provides that a property is considered to be operated in the required manner during a period of deficiency, failure or shutdown of the system that is beyond the taxpayer's control if the taxpayer makes all reasonable efforts to rectify the problem within a reasonable time according to the circumstances. The 2023 FES stated that a similar relieving rule will apply to property that generates electricity, or electricity and heat, from specified waste material. Budget 2024 expands the application of the relieving rule to systems that generate electricity, or both electricity and heat, from natural gas with carbon capture equipment.

Recapture

The CE ITC will be subject to recapture rules similar to the recapture rules for the CT ITC set out in Bill C-59.

Generally, recapture will occur in relation to property in respect of which a taxpayer claimed a CE ITC if the following conditions are satisfied in a taxation year:

- the taxpayer acquired the property in the year or in any of the preceding 10 calendar years (or, in the case of an eligible natural gas energy system, the previous 20 calendar years);
- the taxpayer became entitled to a CE ITC in respect of all or a portion of the capital cost of the property; and
- in the year, the particular property is (i) converted to an ineligible use, (ii) exported from Canada, or (iii) disposed of without having previously been converted to an ineligible use or exported (i.e., disposed of without having previously been subject to recapture).

Again, we note that for natural gas energy systems, the recapture period is extended to 20 years and the property will be considered to have been put to an ineligible use if, in any of the 15 years after the initial five-year compliance period, the average emissions intensity exceeds the limit of 65 tonnes of carbon dioxide per gigawatt hour of energy produced. Budget 2024 is not clear as to whether the 5% tolerance applicable to the initial five-year compliance period also applies to each of the following 15 years.

Interaction with Other Clean Economy Tax Credits

Budget 2024 states that eligible corporations can only claim one of the CE ITC, CT ITC, CCUS ITC, CH ITC, CTM ITC or the EV ITC if a particular expenditure is eligible for more than one of the credits. Multiple clean economy tax credits may be claimed in respect of the same project to the extent that expenditures are eligible for different credits.

However, Budget 2024 states that an eligible natural gas energy system would not be eligible for the CE ITC in respect of the energy generation equipment and a CCUS ITC in respect of the carbon capture equipment, implying that such a project can only claim one of the credits.

Because a clean economy tax credit generated by partnership expenditures is determined as if the partnership were a taxable Canadian corporation, we expect that legislation to enact Budget 2024 will have to reconcile the statements that an eligible corporation will only be entitled to claim one of the credits with respect to any particular expenditure with the prior statement in Budget 2024 that in the context of a partnership that acquires property that is eligible for both the CE ITC and the CT ITC, a partner will be able to claim its reasonable share of either credit for which the partner is otherwise eligible.

Provincial and Territorial Crown Corporations

Consistent with Budget 2023 and clarifications in the 2023 FES, Budget 2024 confirms that the CE ITC will be available to provincial and territorial Crown corporations. However, Crown corporations will be eligible to claim the CE ITC only in respect of investments made in eligible property situated in designated jurisdictions.

For this purpose, a provincial or territorial jurisdiction will be designated by the Minister of Finance if the relevant provincial or territorial government has:

- made a public commitment to work towards a net-zero electricity grid in the jurisdiction by 2035;
- made a public commitment that Crown corporations will pass through the value of the CE ITC to ratepayers in the relevant jurisdiction by reducing ratepayers' bills; and
- directed Crown corporations that claim the CE ITC to report annually to the public on how the CE ITC has improved ratepayers' bills.

If a Crown corporation does not satisfy the annual reporting obligation, it will be subject to a penalty.

Budget 2024 indicates that the Department of Finance will consult with provinces and territories on the details of the above requirements.

In the 2023 FES it appeared that if a jurisdiction had not satisfied the requirements to be a designated jurisdiction (described above) no taxpayer in such jurisdiction would be entitled to the CE ITC. This clarification is welcome in that the concept of designated jurisdiction is only relevant to a Crown corporation.

Availability of the CE ITC

For taxpayers other than provincial or territorial Crown corporations, the CE ITC will be available in respect of new property that is acquired and becomes available for use on or after Budget Day and before 2035 and that is part of a project that did not begin construction before March 28, 2023. For the purpose of determining availability of the CE ITC, construction will not include obtaining permits or regulatory approval, conducting environmental assessments, community consultations or impact assessment studies, or similar activities. There remains significant uncertainty regarding what will constitute the beginning of construction.

For taxpayers that are provincial or territorial Crown corporations, the availability of the CE ITC will be subject to the same rules as well as the following two requirements:

- if the relevant provincial or territorial government has satisfied all of the conditions for designation by March 31, 2025, and is subsequently designated by the Minister, a Crown corporation investing in that jurisdiction can claim a CE ITC for property that is acquired and becomes available for use on or after Budget Day for projects that did not begin construction before March 28, 2023; and
- if the relevant provincial or territorial government has not satisfied all the conditions for designation by March 31, 2025, a Crown corporation investing in that jurisdiction will not be eligible to claim the CE ITC until the province or territory is designated by the Minister. Once the province or territory is so designated, the CE ITC would be available in respect of property that is acquired and becomes available for use from the date the province or territory is designated, for projects that did not begin construction before March 28, 2023.

Expansion of Application of Clean Technology Manufacturing Investment Tax Credit – Polymetallic Projects

In Budget 2023, the Government announced that it would introduce the CTM ITC as a 30% (subject to gradual phasing-out beginning in 2032) refundable tax credit applicable to investments in eligible property acquired and available for use after December 31, 2023 and before January 1, 2035. Draft legislation to implement the CTM ITC was released on December 20, 2023 (December 20 Proposals).

The December 20 Proposals provided that the use of a property "in a qualifying mineral activity producing all or substantially all qualifying materials" would be a "CTM use". "Qualifying material" was defined to mean lithium, cobalt, nickel, copper, rare earth elements, and graphite.

Since the production of qualifying materials may occur at projects which produce multiple metals (polymetallic projects) including non-qualifying materials, Budget 2024 proposes to modify the CTM ITC to expand eligibility for the credit to businesses engaged in polymetallic projects.

Budget 2024 proposes to modify the meaning of the relevant portion of CTM use by replacing the "producing all or substantially all qualifying materials" requirement (generally regarded as 90% or more) with an "expected to produce primarily qualifying materials" test (which Budget 2024 indicates is generally regarded as 50% or more) which will be measured in terms of the financial value of output. To support this expectation and a claim for the tax credit, a business must submit to the CRA an attestation from an arm's-length qualified engineer or geoscientist for each relevant mine or well site.

As set out in the December 20 Proposals, if a property benefits from the CTM ITC but, within a 10 year period is converted to use in a non-qualifying activity, the tax credit could be subject to recapture. This would occur if the property

were no longer sufficiently used in qualifying mineral activities producing qualifying materials, which could occur because of changes in mineral prices.

Budget 2024 proposes to introduce a safe harbour rule to mitigate against the effects of mineral price volatility on potential recapture. The proposed safe harbour rule will provide that, if the expected production from eligible property when claiming a CTM ITC is calculated using specified five-year historical average mineral prices, the same specified mineral prices will be used to calculate the ratio of qualifying materials produced from the property over the recapture period. Additional design details regarding the safe harbour rule will be provided later.

These changes apply for property that is acquired and becomes available for use on or after January 1, 2024 which is the application date for the CTM ITC.

EV Supply Chain Investment Tax Credit

Budget 2024 announces the Government's intention to introduce the EV ITC to support investments in Canada's electric vehicle industry.

The EV ITC will be a 10% investment tax credit available in respect of the cost of buildings used in the following three segments (qualifying segments) of the Canadian electric vehicle supply chain:

- electric vehicle assembly;
- electric vehicle battery production; and
- cathode active material production.

To be eligible to claim an EV ITC, the taxpayer must either: (1) claim the CTM ITC in all of the qualifying segments; or (2) claim the CTM ITC in two of the qualifying segments and hold at least a qualifying minority interest in an unrelated corporation that claims the CTM ITC in the other qualifying segment. In the second scenario, the unrelated corporation could claim the EV ITC in respect of the cost of buildings used in the other qualifying segment.

The EV ITC will be available in respect of property that is acquired and becomes available for use on or after January 1, 2024.

Budget 2024 proposes to phase out the EV ITC with a reduced rate of 5% for property that becomes available for use in 2033 or 2034, and no credit available for property that becomes available for use after 2034.

Budget 2024 also announces the Government's intention to release design and implementation details for the EV ITC in the 2024 FES and that such design will incorporate elements consistent with the CTM ITC.

CHANGES TO RULES FOR BANKRUPT CORPORATIONS

Budget 2024 proposes to repeal the existing exception to the debt forgiveness rules for bankrupt corporations.

Where they apply, the debt forgiveness rules (contained in section 80) reduce the losses and certain other tax attributes of the debtor by the forgiven amount. One-half of any remaining amount is included in the debtor's income for tax purposes. A debtor that is bankrupt (within the meaning of the *Bankruptcy and Insolvency Act*) at the time a debt is settled is generally excluded from the application of the debt forgiveness rules. Instead, paragraph 128(1)(g) provides that, where a bankrupt corporation is granted an absolute order of discharge, the corporation's losses expire and cannot be deducted in the current or subsequent taxation years.

The Government is proposing that, while bankrupt corporations will now be subject to the debt forgiveness rules, the loss restriction rule will no longer apply. Effectively, bankrupt corporations will be treated in the same manner as other corporations whose commercial debts are forgiven. The Government indicates that this change stems from a concern that some taxpayers have sought to manipulate the bankrupt status of an insolvent corporation in a manner that avoids the debt forgiveness rules while preserving tax losses.

The exception from the debt forgiveness rules will continue to be available to a bankrupt who is an individual. Insolvent corporations will continue to qualify for potential relief from the income inclusion rule via the offsetting deduction in section 61.3.

These proposals will apply where bankruptcy proceedings are commenced on or after Budget Day.

ACCELERATED CAPITAL COST ALLOWANCE FOR PRODUCTIVITY-ENHANCING ASSETS

Budget 2024 proposes to temporarily increase the CCA rate for assets included in Classes 44, 46 and 50 (collectively, productivity-enhancing assets) from 25 %, 30% and 55%, respectively, to a 100% first year deduction for new additions of productivity-enhancing assets. Productivity enhancing assets will generally include patents, data network infrastructure equipment and systems software, and general purpose electronic data-processing equipment and systems software.

Subject to certain restrictions, property will be eligible for the accelerated first year deduction if the property is acquired on or after Budget Day and becomes available for use before January 1, 2027.

Property that is not new property when it is acquired by the taxpayer will be eligible for the accelerated first year deduction only where:

- the property was not previously owned by the taxpayer or any person not dealing at arm's length with the taxpayer; and
- the property was not transferred to the taxpayer on a tax-deferred basis.

Where the short taxation year rule in subsection 1100(3) of the Tax Regulations applies, the accelerated first year deduction will apply in respect of eligible property on a prorated basis and will not be available in the following taxation year for the same property.

No draft legislation was provided for this measure.

HOUSING RELATED MEASURES

Enhanced CCA Rate for Purpose-Built Rental Housing

As previously announced on April 12, 2024, Budget 2024 proposes to temporarily increase the CCA rate for purpose-built rental housing from 4% to 10%. Eligible property will qualify for an accelerated CCA rate if construction begins on or after Budget Day and before January 1, 2031, and if the property is available for use prior to January 1, 2036.

Budget 2024 also proposes that the accelerated investment incentive property rules in subsection 1104(4) of the Tax Regulations will apply to property that qualifies for the accelerated CCA rate and that becomes available for use prior to 2028, meaning that the half-year rule in subsection 1100(2) of the Tax Regulations will not apply to eligible rental properties if construction commences on or before April 16, 2024 and is completed on or before December 31, 2027.

The conditions for purpose-built rental housing to qualify for the accelerated CCA rate will mirror the conditions for eligibility under the enhanced GST New Residential Rental Property rebate in section 256.2 of the *Excise Tax Act* (Canada) (ETA). Specifically, eligible property must: (i) have at least four private apartment units or 10 private rooms or suites; and (ii) at least 90% of the residential units be held for long-term rentals. Budget 2024 indicates that conversions of non-residential real estate and additions to existing residential properties will be eligible for accelerated CCA rate, while renovations of existing residential properties will not qualify.

No draft legislation was provided for this measure.

Interest Deductibility Limit for Purpose-Built Rental Housing

Budget 2024 also proposes to amend the definition of "exempt interest and financing expenses" in proposed subsection 18.2(1) to include, on an elective basis, arm's length interest and financing expenses incurred before January 1, 2036 to build or acquire purpose-built rental housing that qualifies for accelerated CCA and the enhanced GST rebate.

If a taxpayer makes the proposed election, the interest and financing expenses would not be included in the taxpayer's "interest and financing expenses", as defined in proposed subsection 18.2(1), for the purposes of the excessive interest and financing expenses limitation (EIFEL) rules in Bill C-59. Consequently, the limitation on interest deductions in proposed subsection 18.2(2) would not apply in respect of the elected interest expense, although the limitation may continue to apply to the taxpayer's other interest and financing expenses.

No draft legislation was provided for this measure.

CANADA CARBON REBATE FOR SMALL BUSINESSES

The federal fuel charge applies in the provinces of Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador (Non-Agreeing Provinces). Budget 2024 announces the Government's intention to return a portion of fuel charge proceeds from a Non-Agreeing Province to small and medium-sized businesses in that province through the Canada Carbon Rebate for Small Businesses (CCR Tax Credit).

The CCR Tax Credit will be a refundable tax credit paid automatically to small and medium-sized businesses in Non-Agreeing Provinces.

Eligible Corporations

With respect to the fuel charge for years 2019-20 to 2023-24, the CCR Tax Credit will be available to eligible Canadian-controlled private corporations that file a tax return for the 2023 taxation year by July 15, 2024. To be eligible for a CCR Tax Credit for any applicable fuel charge year, the corporation must have employed less than 500 employees throughout Canada in the calendar year in which the fuel charge year begins (e.g., the 2023 calendar year for the 2023-24 fuel charge year).

Budget 2024 proposes that CRA will automatically determine the CCR Tax Credit amount for an eligible corporation and pay the amount to the eligible corporation.

Determining the Amount of CCR Tax Credit

An eligible corporation's credit amount will be determined for each Non-Agreeing Province in which the eligible corporation had employees in the calendar year in which the fuel charge year began. The credit will be equal to the number of employees in that province for that calendar year multiplied by a payment rate set by the Minister for that province for the corresponding fuel charge year.

Budget 2024 indicates that the payment rates for the 2019-20 to 2023-24 fuel charge years will be set by the Minister once information is available from the 2023 taxation year.

MINERAL EXPLORATION TAX CREDIT

As announced on March 28, 2024, and in keeping with annual tradition, Budget 2024 proposes that eligibility for the mineral exploration tax credit in section 127 be extended for one year, for flow-through share agreements entered into on or before March 31, 2025. Draft legislation for this measure was included in the Notice of Ways and Means Motion accompanying Budget 2024.

Select Personal Tax Measures and Other Tax Measures Applicable to Trusts and Registered Plans

ALTERNATIVE MINIMUM TAX

Budget 2024 proposes further revisions to the alternative minimum tax (AMT) rules, building on changes announced in Budget 2023; draft legislation for the previously-announced changes was released on August 4, 2023. Budget 2024 AMT measures will have retroactive effect to January 1, 2024, which is necessary because some of the Budget 2024 proposals

replace the corresponding provisions of the August 4, 2023 draft legislation. Draft legislation for the AMT proposals was included in the Notice of Ways and Means Motion accompanying Budget 2024.

For most individuals, the most significant proposed change concerns the treatment of charitable donation tax credits in calculating the basic minimum tax credit pursuant to section 127.531. Budget 2023 proposed to include only 50% of charitable donation tax credits claimed by an individual in calculating the basic minimum tax credit. Budget 2024 proposes instead to include four-fifths of the charitable donation tax credits claimed by the individual in calculating the basic minimum tax credit. The rationale for this change was not disclosed, but it appears intended to address concerns raised by the charitable sector (among others) that the treatment of donation tax credits proposed in Budget 2023 would negatively impact charitable giving.

Other relieving rules are intended to: (i) allow deductions for the guaranteed income supplement, social assistance, and workers' compensation payments in calculating adjusted taxable income pursuant to section 127.52; (ii) allow individuals to fully claim the logging tax credit in calculating the basic minimum tax credit; and (iii) permit disallowed federal political contribution tax credits, investment tax credits, and labour-sponsored funds tax credits to be eligible for the AMT-carryforward.

For businesses, the most relevant proposals relating to AMT will be the additional exclusions for certain trusts under paragraph 127.55(f). In addition to the exclusions proposed in Budget 2023, Budget 2024 proposes to include in paragraph 127.55(f), and therefore exempt from AMT:

- an employee ownership trust;
- a trust established under a law of Canada or a province, for the benefit of an Indigenous group, community, or people that holds rights under section 35 of the *Constitution Act, 1982*, or under a treaty or settlement agreement between the Crown and an Indigenous group, community, or people, if all or substantially all of the contributions to the trust were made under the relevant, law, treaty, or settlement, or can be traced to those amounts; and
- a trust, all of the beneficiaries of which are a combination of (i) all of the members of an Indigenous group, community, or people that holds rights under section 35 of the *Constitution Act, 1982*; (ii) an Indigenous government described in paragraph 149(1)(c); (iii) a non-profit organization organized and operated primarily for health, education, social welfare, or community improvement of an Indigenous group, community, or people that holds rights under section 35 of the *Constitution Act, 1982*; (iv) a corporation, all of the shares of which are held by an entity described in (ii) or (iii), or by a trust otherwise exempt from AMT because it was created pursuant to a law, treaty, or settlement agreement; or (iv) a trust otherwise exempt from AMT because it was created pursuant to a law, treaty, or settlement agreement.

These proposed changes should ensure that income otherwise exempt from Part I income tax under paragraph 81(1)(a) or subsection 149(1) will not be subject to AMT, which would defeat the rationale for these exemptions.

LIFETIME CAPITAL GAINS EXEMPTION

The capital gains deduction in subsections 110.6(2) and (2.1) creates an exemption for up to $1,016,836 of capital gains realized by individuals on a disposition of a "qualified farm or fishing property" or a "qualified small business corporation share" (QSBC share), as those terms are defined in subsection 110.6(1). This amount has been indexed to inflation since 2014.

Budget 2024 proposes to increase the capital gains deduction limit to $1,250,000 from $1,016,836 for dispositions that occur on or after June 25, 2024. The capital gains deduction limit would not be increased for inflation in 2024 or 2025; indexing is proposed to resume in 2026.

No draft legislation for this measure was included in the Notice of Ways and Means Motion accompanying Budget 2024. There are also no proposed changes to the application of AMT to capital gains eligible for the capital gains deduction versus the August 4, 2023 draft legislation, so without further changes it may be difficult to realize much of the benefit of the increased capital gains deduction.

CANADIAN ENTREPRENEURS' INCENTIVE

In addition to the increased capital gains deduction limit, Budget 2024 proposes a new "Canadian entrepreneurs' incentive" (CEI). This measure appears to be similar in concept to the exemption for "qualified small business shares" in the United States, albeit with an exemption limit less generous than the US$10 million equivalent under US law.

Under the proposed CEI, an eligible individual would be entitled to limit the amount included in their income in respect of up to $2 million of lifetime capital gains from the disposition of qualifying shares to one-half of the prevailing capital gain inclusion rate. The $2 million limit would be phased-in over 10 years, starting at $200,000 beginning on January 1, 2025, and ending at $2 million on January 1, 2034. Budget 2024 indicates that the CEI would be "in addition to" any available capital gains deduction, but the mechanism through which the CEI and the capital gains deduction will interact is unclear. Furthermore, there is no indication that capital gains eligible for the CEI will be excluded from the adjusted taxable income for AMT purposes, so it is likely that much of the potential benefit of the CEI also may be lost to AMT without further revisions.

For a share owned by an individual to qualify for the CEI, the following lengthy list of conditions must be satisfied:

- The share must be a share of a "small business corporation", as defined in subsection 248(1), and must be owned directly by the disposing individual. This is the same requirement found in paragraph (a) of the QSBC share definition in subsection 110.6(1), so any share that qualifies for the capital gains deduction as a QSBC share should satisfy this requirement.
- Throughout the 24-month period preceding the disposition, the issuer corporation must be a "Canadian-controlled private corporation" (CCPC), as defined in subsection 125(7), and more than 50% of the FMV of the assets of the corporation must be attributable to assets used principally in an active business carried on primarily in Canada by the CCPC or a related corporation, shares and debts of "connected" corporations (within the meaning in subsection 186(4)), or some combination thereof. This is the same requirement found in paragraph (c) of the QSBC definition in subsection 110.6(1), so any share that qualifies for the capital gains deduction as a QSBC share should satisfy this requirement.
- The individual must be a "founding investor" of the CCPC "at the time the corporation was initially capitalized." It is unclear who a "founding investor" is or when a corporation is "initially capitalized," as Budget 2024 does not elaborate on these points.
- The individual must hold the share for a minimum of five years prior to the disposition. It is unclear whether this holding period, which is considerably longer than the two-year holding period for the purposes of the capital gains deduction, will include times when the share was held by a person or partnership related to the individual.
- At all times since the initial share subscription, the claimant must directly own shares representing more than 10% of the votes and value of all of the shares of the CCPC. The rationale for this shareholding threshold is not explained in Budget 2024.
- Throughout the 5-year period preceding the disposition, the individual must be engaged in the CCPC's business on a regular, continuous, and substantial basis. The wording of this requirement in Budget 2024 appears to adopt the language in the definition of "excluded business" in subsection 120.4(1), but it is unclear whether the supporting rules in subsection 120.4(1.1) will also apply for this purpose.
- The share cannot be a direct or indirect investment in a professional corporation, a corporation whose principal asset is the reputation or skill of an employee, or a corporation carrying on a business in the financial, insurance, real estate, food, accommodation, arts, recreation, entertainment, consulting, or personal care sectors. This sectoral limitation does not apply to the (more generous) capital gains deduction for QSBC shares, and some shares that qualify for the capital gains deduction may be disqualified from the CEI.

- The share must have been acquired for FMV consideration. There will no doubt be some debate about whether a share has been acquired for FMV consideration in many common situations. For example, is a share issued for nominal consideration on an estate freeze considered to be issued for FMV consideration?

No draft legislation was released for this measure.

QUALIFIED INVESTMENTS FOR REGISTERED PLANS

Budget 2024 announces the launch of a consultation process on the modernization of the qualified investment rules, aiming to improve clarity and consistency as they apply to different registered plans. The specific issues upon which stakeholders are invited to provide comments are the following:

- the harmonization of the qualified investment rules concerned with investments in small businesses as they apply to all different registered savings plans;
- the qualified investment status of annuities that are qualified investments only for purposes of registered retirement savings plans (RRSP), registered retirement income funds (RRIFs) and registered disability savings plans (RDSPs);
- the aptness of certain conditions applicable to certain pooled investment products to meet the definition of qualified investments, including the formal registration process for registered investments; and
- the opportunity to use the qualified investment rules to promote Canadian-based investment.

HOME BUYERS' PLAN

Budget 2024 proposes to increase withdrawal limits under the home buyers' plan (HBP) to $60,000 (from $35,000), applicable to withdrawals made after Budget Day. Eligible home buyers may, under the HBP, make tax-exempt withdrawals from an RRSP to use as a down payment to purchase or build their first home or a home for a specified disabled individual. Eligible home buyers jointly acquiring a house may each make withdrawals from their respective RRSPs; the proposed increase would allow for such eligible home buyers to withdraw amounts totalling $120,000.

Eligible home buyers must reimburse the amounts withdrawn under the HBP to their RRSP over 15 years, starting from the second year following the year where the withdrawal was made, or otherwise incur an income inclusion for the amounts due for repayment within any given year. Budget 2024 proposes to defer the start of the repayment period to the fifth year following the year in which a withdrawal was made, for first withdrawals made between January 1, 2022 and December 31, 2025.

EMPLOYEE OWNERSHIP TRUST TAX EXEMPTION

Budget 2023 proposed to enact rules creating and governing the sale of shares to an "employee ownership trust" (EOT), as that term will be defined in subsection 248(1). Draft legislation was first included in the March 28, 2023 Notice of Ways and Means Motion, and revised draft legislation was included in Bill C-59.

While the EOT rules were intended to facilitate and incentivize share sales to EOTs, the main benefit to a selling shareholder under the March 28, 2023 draft legislation – a 10-year capital gains reserve – would likely not have been a sufficient incentive except in marginal cases. To address this shortcoming, the 2023 Fall Economic Statement (2023 FES) proposed to exempt the first $10,000,000 of capital gains realized by an individual on a qualifying sale to an EOT; no further details were provided at that time. Budget 2024 outlines a framework for the proposed exemption for dispositions to EOTs, although draft legislation was not included.

Budget 2024 proposes that a capital gain realized by an individual (other than a trust) as a result of a disposition to an EOT would qualify for the exemption where the following conditions are met:

- The individual, a trust of which the individual is a beneficiary, or a partnership of which the individual is a member, has disposed of shares of a corporation other than a professional corporation.
- The transaction is a "qualifying business transfer," as that term is proposed to be defined in subsection 248(1).

- The acquiring trust is not already an EOT or a similar trust with employee beneficiaries. It is unclear when a trust would be a "similar trust with employee beneficiaries" as Budget 2024 does not elaborate on this point.
- Throughout the preceding 24 months:
  - The transferred shares were not owned by any person other than the individual, a related person, or a partnership of which the individual was a member. Although not expressly stated in Budget 2024, it should presumably be permissible for the transferred shares to be owned by a trust of which the individual is a beneficiary, given that a disposition by such a trust satisfies the first condition above.
  - Over 50% of the FMV of the assets of the corporation was attributable to assets used principally in an active business. It is unclear what this condition adds, as the proposed definition of "qualifying business transfer" in subsection 248(1) requires that all or substantially all of the FMV of assets of the subject corporation be attributable to assets used principally in an active business.
- At any time prior to the qualifying business transfer, the individual (or the spouse or common-law partner of the individual) was actively engaged in the "qualifying business," as that term is proposed to be defined in subsection 248(1), on a regular and continuous basis for a minimum period of 24 months. It is unclear what the difference would be between "regular and continuous" used in this context and "regular, continuous, and substantial" used in the context of the CEI.
- Immediately after the qualifying business transfer, at least 90% of the beneficiaries of the EOT are resident in Canada.

The proposed $10,000,000 exemption must be shared between all of the vendors who qualify for an exemption in relation to a disposition forming part of a qualifying business transfer, on whatever basis the vendors determine. It appears that this requirement to share the $10,000,000 exemption applies whether or not the vendors deal at arm's length.

Budget 2024 also introduces the concept of a "disqualifying event". There are two proposed disqualifying events: (i) the purchaser trust ceases to be an EOT, for example because the interests of beneficiaries are determined in an impermissible manner; or (ii) at the beginning of two consecutive taxation years of the subject corporation, less than 50% of the FMV of the shares of the subject corporation is attributable to assets used principally in an active business. If a disqualifying event occurs within 36 months of the qualifying business transfer, an exemption claimed by a vendor would be retroactively denied. If a disqualifying event occurs more than 36 months after the qualifying business transfer, the EOT will be deemed to realize a capital gain equal to the total of the exempt capital gains realized by the share vendors.

To qualify for the exemption, the individual, the EOT and, if applicable, any corporation controlled by the EOT that acquires shares from the individual, will need to elect to be jointly and severally liable for any tax payable by the individual if the exemption is denied because of a disqualifying event occurring within 36 months of the qualifying business transfer. Where an election is made, the normal reassessment period will be extended for three years in respect of the exemption.

In calculating an individual vendor's adjusted taxable income for AMT purposes under section 127.52, it is proposed that an exempt capital gain will be included at a rate of 30%. This mirrors the treatment of capital gains sheltered by the capital gains deduction under proposed paragraph 127.52(1)(h).

Finally, Budget 2024 proposes to extend the EOT rules to cover a sale of shares to a worker cooperative, provided that the worker cooperative meets the definition in the *Canada Cooperatives Act*. A disposition to a worker cooperative could be a qualifying business transfer, and an individual vendor could be entitled to claim the proposed capital gains exemption and the 10-year capital gains reserve in proposed subsection 40(1.3).

PENSION FUNDS – ENCOURAGING DOMESTIC INVESTMENT

Following up on the Government's stated goal of encouraging Canadian pension funds to invest more domestically and largely as previewed in the 2023 FES, Budget 2024 announces two key initiatives:

- The Government will create a working group with Canadian pension plans. The group, which will be led by Stephen Poloz (former Governor of the Bank of Canada) and supported by the Deputy Prime Minister and Minister of Finance, will focus on specific areas of investment, including digital infrastructure and artificial intelligence (AI), physical infrastructure, airport facilities, venture capital, and home building (including on public lands). It will also explore the removal of the so-called "30% rule" for domestic investments. Related to this first initiative, Budget 2024 states that the Minister of Transport will release a policy statement this summer with a view to attracting capital from pension plans and others in respect of airport facilities.
- The Government will amend the federal pension regulations to require that large federally-regulated pension plans disclose the distribution of plan investments by jurisdiction and, within each jurisdiction, by asset class, and the Office of the Superintendent of Financial Institutions will be tasked with publicly releasing this information. The Government will continue to engage with the provinces and territories to discuss setting up similar disclosure regimes for large pension plans that are not federally-regulated.

Select Indigenous Measures

TAX JURISDICTION FOR INDIGENOUS COMMUNITIES

Budget 2024 announces the Government's intention to expand opt-in tax jurisdiction frameworks to allow Indigenous governments to exercise their tax jurisdiction with better flexibility. Budget 2024 proposes to produce legislation for an opt-in fuel, alcohol, cannabis, tobacco and vaping (FACT) sales tax framework. This framework is proposed to include sharing arrangements that meet the interests of both Indigenous governments and the Government. The Government intends to work with Indigenous partners over the months following Budget Day to finalize and implement the proposed framework.

Budget 2024 also announces that the Government intends to negotiate additional First Nations Goods and Services Tax agreement with interested Indigenous governments, personal income tax arrangements with self-governing Indigenous governments, and to assist with negotiating similar arrangements between Indigenous governments and provincial and territorial governments.

The Government also intends to investigate other potential tax arrangements that will enable Indigenous communities to benefit from resource development.

INDIGENOUS LOAN GUARANTEE PROGRAM

Budget 2024 states that the number of natural resource and energy projects with potential for Indigenous equity participation is expected to grow significantly with the potential to reach $525 billion in capital investment by 2035.

Budget 2024 builds on the Government's announcements in the 2023 FES by proposing to create the Indigenous Loan Guarantee Program (ILGP).

The ILGP will include up to $5 billion in loan guarantees to facilitate Indigenous access to capital, create economic opportunities and support economic development. Budget 2024 proposes the following parameters for the ILGP:

- Eligible applicants will include Indigenous governments and their wholly-owned and controlled entities.
- Eligible projects will include both natural resource and energy projects.
- It will support projects across Canada.
- Natural Resources Canada will be responsible for intake and capacity building, and Canada Development Investment Corporation will create a new subsidiary to review applications and administer the loan guarantee portfolio.

Budget 2024 also proposes additional funding of $16.5 million to Natural Resources Canada for two years beginning in 2024-25, including $3.5 million to support capacity funding for Indigenous communities and applicants and delivery of the ILGP by Canada Development Investment Corporation.

INDIGENOUS ECONOMIC OPPORTUNITY

Building on previous investments, Budget 2024 proposes to provide additional funding to support Indigenous economic opportunity, including $36 million over three years beginning in 2024-25 to renew support for the Strategic Partnerships Initiatives' Clean Energy program to promote Indigenous communities' participation in clean energy projects.

International Tax Measures

WITHHOLDING FOR NON-RESIDENT SERVICE PROVIDERS

Budget 2024 proposes to provide the CRA with statutory authority to waive the requirement to withhold under Tax Regulation 105, and to increase the circumstances in which such a waiver may be available.

Paragraph 153(1)(g) and Tax Regulation 105 impose a 15% withholding tax on payments made to non-resident persons for services performed in Canada. Tax Regulation 105 withholding tax is not a final tax, but is on account of the non-resident person's potential liability for Canadian income tax. Where the non-resident person is ultimately not liable for Canadian income tax (e.g., because of a tax treaty), the non-resident person is required to file a Canadian income tax return in order to seek a refund. The CRA currently provides waivers of withholding in certain circumstances on an administrative basis. These waivers must generally be applied for on a transaction-by-transaction basis.

Proposed subsection 153(8) will allow the CRA to waive Tax Regulation 105 withholding from payments to a non-resident made during a specified period of time (including in respect of multiple transactions occurring during that period of time) in respect of:

- a business carried on by the non-resident, the income from which is exempt from tax under Part I because of a tax treaty; or
- income from providing services related to international shipping or the operation of an aircraft in international traffic that is exempt under paragraph 81(1)(c).

The provision of a waiver will be subject to any conditions established by the CRA "necessary to reduce compliance risks" (this could include, for example, an undertaking by the non-resident taxpayer to file a Canadian income tax return). If any such conditions ceased to be met, the CRA could revoke the waiver.

These amendments are proposed to come into force on royal assent.

CRYPTO-ASSET REPORTING FRAMEWORK AND THE COMMON REPORTING STANDARD

Crypto-Asset Reporting Framework

Further to the joint statement released by Canada and other participating jurisdictions in November of 2023, Budget 2024 proposes to implement the framework of the Organisation for Economic Co-Operation and Development (OECD) for the automatic exchange of tax information relating to crypto-asset transactions, referred to as the Crypto-Asset Reporting Framework (CARF), in Canada.

The proposed framework will require certain crypto-asset service providers that are resident or carry on business in Canada and provide services in respect of crypto-asset exchange transactions to collect and report information on an annual basis in respect of their customers and crypto-assets. Crypto-asset service providers subject to these reporting rules will include crypto-exchanges, crypto-asset brokers and dealers, and operators of crypto-asset automated teller machines.

Information required to be reported in respect of crypto-assets will include the annual value of:

- exchanges between crypto-assets and fiat currencies;
- exchanges of crypto-assets for other crypto-assets; and

- transfers of crypto-assets (including certain transfers in respect of which the crypto-asset service provider acts as a payment processor for a merchant, where crypto-assets are exchanged for goods or services from the merchant with a value in excess of US$50,000).

Reportable crypto-assets will exclude central bank digital currencies and certain specified electronic money products (e.g., in respect of fiat currencies), which will instead be subject to the Common Reporting Standard (CRS).

Information required to be collected and reported in respect of customers (including Canadian and non-Canadian residents) will include each customer's name, address, date of birth, jurisdiction of residence and taxpayer identification number. This information will also need to be provided in respect of the individuals who control customers that are corporations or other entities.

Common Reporting Standard

Budget 2024 will also introduce certain related changes to CRS, including to expand the scope of CRS to central bank digital currencies and certain specified electronic money products. The Government indicates that there will also be amendments to "ensure effective coordination between the CRS and the CARF and limit instances of duplicative reporting between the two frameworks" as well as to "require that additional information be reported in respect of financial accounts and account holders". For example, based on the OECD's commentary, it is reasonable to expect that the definition of "investment entity" in subsection 270(1) will be amended to include crypto-assets within the categories of investments that would bring an entity within the scope of the CRS. As a further example, a new category of "non-reporting financial institutions", defined in subsection 270(1), may be created to ensure that registered charities do not have an obligation to report under the CRS.

Budget 2024 proposes additional changes to CRS arising from the Global Forum on Transparency and Exchange of Information for Tax Purposes, including to:

- remove Labour-Sponsored Venture Capital Corporations (LSVCCs) from the list of non-reporting financial institutions and treat non-registered LSVCC accounts as excluded accounts where annual contributions do not exceed US$50,000;
- amend the anti-avoidance rule in section 280 to apply where an individual or entity enters into an arrangement or engages in a practice where it is reasonable to consider that the primary purpose is to avoid an obligation – of any person – under the CRS.

These measures are proposed to apply to 2026 and subsequent calendar years, with the first filings under the new rules due in 2027.

INTERNATIONAL TAX REFORM

Budget 2024 confirms the Government's intention to proceed with the implementation of Pillars One and Two in Canada. As described in our commentary to Budget 2023, these measures comprise the two-pillar framework for international tax reform developed by the OECD/Group of 20 Inclusive Framework on Base Erosion and Profit Shifting. The Government also indicates in Budget 2024 that it will proceed with the enactment of the *Digital Services Tax Act* (Canada) (Digital Services Tax), pending the finalization of a multilateral treaty in respect of Pillar One.

Pillar Two

As a reminder, Pillar Two will impose a global minimum tax of 15% on certain large multinational corporations. On August 4, 2023, the Government proposed a new *Global Minimum Tax Act* (Canada) (GMTA) to implement this measure in Canada. The Government indicates that it intends to introduce this legislation in Parliament "soon."

The GMTA will apply to fiscal years beginning on or after December 31, 2023.

Pillar One and the Digital Services Tax

Pillar One will re-allocate taxing rights in respect of the residual profits of certain large multinational corporations on the basis of the location of users and customers. The Government previously agreed to postpone the implementation of a Canadian Digital Services Tax until the end of 2023, pending negotiations of the Pillar One global multilateral solution. However, on July 12, 2023, the Government indicated that it could not support the one-year extension of the moratorium on introducing any new domestic Digital Services taxes until a Pillar One multilateral approach was reached with its international partners. On August 4, 2023 and again in the 2023 FES, the Government reiterated its intention to move forward with the implementation of the Digital Services Tax.

In Budget 2024, the Government once again "reaffirms its commitment to Pillar One" and indicates it will continue to work with the OECD to negotiate a multilateral treatment "as soon as a critical mass of countries is willing". In the meantime, however, the Government repeated its intention to implement the Digital Services Tax. Proposed legislation is currently before Parliament, as part of Bill C-59. Given the Budget 2024 announcement, it is expected that the Digital Services Tax will begin to apply in the 2024 calendar year and include on a retroactive basis in-scope revenues earned on or after January 1, 2022, as reflected in Bill C-59.

Miscellaneous – Tax Enforcement, Administration, Charities and Other Income Tax Measures

AVOIDANCE OF TAX DEBTS

Budget 2024 will extend the application of section 160 (and the analogous rules in other federal statutes, including the section 325 of the ETA to apply to indirect transfers of property to non-arm's-length persons using an intermediary. The amendments to section 160 will also increase the amount of the transferor's tax debts in respect of which the transferee is liable to include any portion retained by an intermediary as a fee.

This extended rule, in proposed subsection 160(7), will apply where:

- a person (the planner) has transferred (directly or indirectly) property to a person (the transferee), or to a person who does not deal at arm's length with the transferee, at the transferee's direction or with their concurrence;
- a tax debtor (the transferor) has transferred (directly or indirectly) property (the particular property) to the planner or any other person; and
- it is reasonable to conclude that one of the purposes of the transaction or series is to avoid joint and several liability of the transferee for the transferor's tax debts.

Where this rule applies:

- the transferor is deemed to have transferred the particular property to the transferee; and
- the transfer of property will be a "section 160 avoidance transaction" under subsection 160.01(1).

The implications of proposed subsection 160(7) applying include the following:

- Where the transferee is a person who does not deal at arm's length with the transferor, or is another person described in subsection 160(1), the transferee and transferor will be jointly and severally liable for the transferor's tax debts in an amount up to the amount by which the FMV of the particular property exceeds the FMV of the consideration for the particular property. By referring to the particular property, rather than the property actually received by the transferee, this effectively includes in the tax debt for which the transferee is liable any portion of the property that is retained by the planner (e.g., as their fee). This overrules prior court decisions, including in *Canada v Microbjo Properties Inc.*, 2023 FCA 157.
- By virtue of the transfer being a "section 160 avoidance transaction", the penalty in subsection 160.01(2) will apply to every person that participates in a "planning activity" (including organizing, creating, selling or promoting a plan) in

respect of a transaction or series that they know (or ought to know) is part of a "section 160 avoidance transaction". The penalty is equal to the lesser of 50% of the tax sought to be avoided and $100,000 plus the gross fees that the person (or a non-arm's-length person) is entitled to in respect of the planning.

These measures are proposed to apply to transactions or series that occur on or after Budget Day. .

NON-COMPLIANCE WITH INFORMATION REQUESTS

Budget 2024 contains a number of measures that enhance the CRA's audit powers and will impose additional consequences on a taxpayer (and in some cases, a corporate group) for failure to comply with information requests.

These measures are proposed to apply to information requests under the Tax Act and certain other tax statutes, including the ETA (e.g., in respect of GST/HST) and will come into force on royal assent.

Notice of Non-Compliance

Budget 2024 introduces a new type of notice, referred to as a "notice of non-compliance", that may be issued by the CRA to a taxpayer that has not complied with an initial requirement or notice to provide information or assistance (i.e., under sections 231.1, 231.2 and 231.6 of the Tax Act). While a notice of non-compliance is outstanding:

- the normal reassessment period of the taxpayer and each person that does not deal at arm's length with the taxpayer will be suspended for any taxation year to which the notice relates; and
- a penalty of $50 will apply each day, to a maximum of $25,000.

The issuance of a notice of non-compliance will be subject to a second review by the CRA upon the request of the taxpayer and, following such review, a statutory right of review by the Federal Court. An assessment of the penalty is subject to the normal CRA objection process and then appealed to the Tax Court of Canada.

Questioning Under Oath

Budget 2024 proposes to provide the CRA with new audit powers to require that documents or information requested (whether orally or in writing) be provided under oath or affirmation, or by affidavit. This power will apply to documents or information requested under section 231.1 or pursuant to a requirement issued under section 231.2 or in respect of foreign-based information or documents under section 231.6. Taxpayers will need to be particularly careful about any information they provide under oath; however, providing information under oath should give the CRA additional comfort about the information they receive from taxpayers, and perhaps help resolve tax disputes earlier at the audit phase.

Penalty for Compliance Orders

Budget 2024 proposes to impose a financial penalty where the CRA successfully obtains a compliance order against a taxpayer. The penalty will be equal to 10% of the total tax payable by the taxpayer in respect of the taxation year(s) to which the order relates. The penalty will apply only if the taxpayer had tax owing in excess of $50,000 for any one taxation year in respect of the compliance order.

The circumstances in which the CRA may seek a compliance order will also be extended to include a failure to comply with a requirement to provide foreign-based information or documents.

Extended Limitation Period

Budget 2024 proposes to extend the reassessment period in all circumstances in which a taxpayer seeks judicial review of a requirement or notice issued by the CRA, including in respect of a review of a notice of non-compliance. The extended reassessment period will apply not only to the taxpayer, but also to each person that does not deal at arm's length with the taxpayer. The reassessment period will be extended for a period of time equal to the time it takes to complete the judicial review.

Enhanced Audit Powers for Foreign-Based Information

Budget 2024 includes additional proposed technical amendments designed to permit the CRA to collect foreign-based information from Canadian taxpayers. For instance, the budget gives the CRA the power to seek a compliance order for the failure to comply with a requirement for foreign-based information or documents (whereas previously the CRA could only seek a compliance order with respect to the CRA's general and domestic audit powers).

REPORTABLE AND NOTIFIABLE TRANSACTIONS PENALTY

Budget 2024 proposes to amend the Tax Act to provide that the criminal offence for failure to file or make a return contained in section 238 (which imposes a fine of up to $25,000 and imprisonment up to a year) will not apply to the failure to file an information return reporting a reportable or notifiable transaction under the expanded mandatory disclosure rules. The mandatory disclosure rules already include specific penalty provisions that apply to such failures. The carve-out from the application of section 238 does not extend to failure to file a return in respect of an uncertain tax treatment.

This amendment will come into force retroactively to the date on which the expanded mandatory disclosure rules came into effect (i.e., on June 22, 2023). Although not expressly stated by the Government, it is apparent that this amendment is an attempt to render moot the issue in *Federation of Law Societies of Canada v. Canada (Attorney General)* (2023 BCSC 2068), in which the British Columbia Supreme Court is considering whether the expanded mandatory disclosure rules apply to lawyers.

CHARITIES AND QUALIFIED DONEES

Under existing subsection 149.1(26), the CRA may register a foreign charity (thereby causing that foreign charity to become a "registered charity", as defined in subsection 248(1), and "qualified donee", as defined in subsection 149.1(1)) for a 24-month period beginning on the date on which the Government of Canada makes a donation to that charity. Budget 2024 proposed to extend this period to 36 months, to create a new annual information return filing requirement, as well as to create a new definition of "registered foreign charity" to describe a charity that has applied for registration under subsection 149.1(26).

Budget 2024 also proposes to amend various provisions requiring the communication of information to or about charities, permitting the CRA to send this information electronically. The receipting rules in section 3501 of the Tax Regulations will also be amended to simplify the requirements for donation receipts – for example, to expressly permit the issuance of official donation receipts electronically.

ANNOUNCED CONSULTATIONS

Budget 2024 announces the launch of numerous consultations, including the following tax-related matters.

New Tax on Residentially Zoned Vacant Land

Aiming to deter speculation by owners of vacant land and foster residential housing development, the Government will start a consultation process in 2024 about potentially creating of a new tax on residentially zoned vacant land.

Research & Development Incentives and Intellectual Property Retention

The Government announced a second phase of consultation regarding a cost-neutral way to modernize the Scientific Research and Experimental Development tax incentives, with a focus on certain technical and policy aspects, including the possible eligibility of Canadian public companies to the enhanced credit. Details on the consultation process are to be released on the Department of Finance Canada website shortly.

SALES AND EXCISE TAX MEASURES

ETA

Student Residences Eligible for Enhanced GST Rental Rebate

On September 14, 2023, the Government proposed to enhance the GST rental rebate to allow the recovery of 100% of the 5% GST (or the 5% federal component of the HST) paid by builders of new qualifying purpose-built rental housing.

Budget 2024 proposes to amend the ETA and its regulations to ensure that the benefits of the enhanced GST rental rebate are effectively available to universities, public colleges and school authorities by permitting these institutions to apply the same GST/HST rules as other builders in respect of the construction of new student housing. Budget 2024 proposes additional relief for universities, public colleges and school authorities operating on a not-for-profit basis by relaxing the requirement that the student housing be leased for a 12-month period (which condition may be difficult to meet in these circumstances). As a result, these not-for-profit educational institutions will generally be eligible to claim the 100% rebate on new student residences that they acquire or construct.

Draft legislation to bring the Budget 2024 proposals into effect has not yet been provided. The proposals would apply to projects that begin construction after September 13, 2023 and before 2031, and that complete construction before 2036.

GST/HST on COVID-19 Related Supplies of Face Masks, Respirators and Face Shields

Budget 2024 proposes to repeal the temporary zero-rating for supplies of face masks, respirators and certain face shields that was implemented as part of the COVID-19 relief measures in 2020. As a result, supplies of these products made on or after May 1, 2024 will be subject to GST/HST at the regular rates.

INDIGENOUS INDIRECT TAX JURISDICTION

As noted above, Budget 2024 proposes to amend the *First Nations Goods and Services Tax Act* to enable Indigenous governments to enact value-added sales taxes on fuel, alcohol, cannabis, tobacco, and vaping (FACT) products within their reserves or settlement lands. The FACT sales taxes are intended to operate in a similar manner to the First Nations Goods and Services Tax and will apply at the same 5% rate on the FACT products. If FACT sales tax applies to a specific FACT product, then the federal GST, or the federal component of HST, would not apply.

OTHER COMMODITY TAXES

Budget 2024 proposes increases to the excise duty rates for tobacco, effective on April 17, 2024, and for vaping products effective on July 1, 2024. In addition, Budget 2024 also proposes the filing of tobacco excise stamp information returns for prescribed persons (effective on the first day of the month after royal assent), and announces other administrative changes.

Previously Announced Measures

Budget 2024 confirms the Government's intention to proceed with various previously announced measures (as modified to take into account consultations, deliberations and legislative developments since their release), including the following:

- legislative proposals released on December 20, 2023, including with respect to the following measures:
  - CH ITC;
  - CTM ITC;
- legislative and regulatory proposals announced in the 2023 FES, including with respect to the following measures:
  - expansion of eligibility for the CT ITC and CE ITC to electricity and heat production from waste biomass;

  - GST/HST joint venture election rules;
  - Underused Housing Tax;
- legislative and regulatory amendments to implement the enhanced (100-percent) GST Rental Rebate for purpose-built rental housing announced on September 14, 2023;
- legislative proposals released on August 4, 2023, including with respect to the following measures (the tabled legislation for much of which we note is included in Bill C-59):
  - CCUS ITC;
  - CT ITC;
  - Labour Requirements;
  - enhancing the reduced tax rates for zero-emission technology manufacturers;
  - flow-through shares and the Critical Mineral Exploration Tax Credit – Lithium from Brines;
  - EOTs;
  - retirement compensation arrangements;
  - intergenerational business transfers;
  - income tax and GST/HST treatment of credit unions;
  - AMT for high-income individuals;
  - tax on repurchases of equity;
  - modernization of the GAAR;
  - EIFEL;
  - the revised luxury tax draft regulations;
  - concessional (i.e., no interest or below market-rate) loans from governments;
- legislative amendments to implement changes discussed in the transfer pricing consultation paper released on June 6, 2023;
- tax measures announced in Budget 2023, including the dividend received deduction by financial institutions (the tabled legislation for which, we note, is included in Bill C-59);
- legislative proposals released on August 9, 2022, including with respect to substantive CCPCs (the tabled legislation for which, we note, is included in Bill C-59);
- legislative amendments to implement rules for hybrid mismatch arrangements, as announced in Budget 2021 (the tabled legislation for the first tranche of which, we note, is included in Bill C-59).

As in prior years, Budget 2024 also reaffirms the Government's commitment to implement other technical amendments to "improve the certainty and integrity of the tax system."