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FEDERAL BUDGET 2023

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2023 CANADIAN FEDERAL BUDGET COMMENTARY – TAX MEASURES

INTRODUCTION

On March 28, 2023 (Budget Day), Canada's Deputy Prime Minister and Minister of Finance, Chrystia Freeland, delivered her third budget in the House of Commons (Budget 2023). Budget 2023 is titled "A Made-in-Canada Plan: Strong Middle Class, Affordable Economy, Healthy Future" and is stated to deliver: (i) targeted inflation relief, (ii) stronger public health care, (iii) "significant investments to build Canada's clean economy, create good middle class careers and usher in a new era of economic prosperity," and (iv) a responsible fiscal plan.

Budget 2023 sets out a number of measures that are relevant to businesses and their owners, including: (i) specific proposals to strengthen the general anti-avoidance rule (GAAR), (ii) a host of new "clean and green" measures, including numerous investment tax credit regimes, (iii) particulars of a new 2% tax on equity repurchases in respect of "public corporations" announced in the 2022 Fall Economic Statement (2022 FES) and expanded in Budget 2023 to also apply to certain trusts and partnerships, (iv) new rules to facilitate the purchase of businesses by employees, (v) measures to deny the dividend received deduction for financial institutions on shares that are mark-to-market property, (vi) changes to the intergenerational business transfer framework, and (vii) affirmations of the Government's intention to proceed with various previously announced international and other tax measures. Budget 2023 does not increase personal or corporate tax rates, nor does it increase the capital gains inclusion rate. It does, however, introduce changes to the alternative minimum tax (AMT) so that the "wealthiest" Canadians pay their "fair" share.

Our commentary, which focuses on the tax measures in Budget 2023 that are most relevant to businesses and their owners, is below.

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

BUSINESS TAX MEASURES

TAX ON REPURCHASE OF EQUITY

In the 2022 FES, the Government announced a tax on equity repurchases by public corporations. Budget 2023 expands on that proposal to require any "covered entity" to pay a tax of 2% of the amount by which the fair market value of the "equity" repurchased, redeemed or cancelled in a taxation year exceeds the fair market value of equity issued in the year. In addition to the many circumstances to which this measure could apply, Budget 2023 expressly confirms it is intended to cover both normal course issuer bids and substantial issuer bids. The netting concept applies for each taxation year of the covered entity.

For these purposes, "covered entity" includes: (i) Canadian-resident corporations the shares of which are listed on a designated stock exchange, (ii) real estate investment trusts (REITs) and (iii) specified investment flow-through (SIFT) trusts and SIFT partnerships. A partnership or a trust that would be a SIFT if its assets were located in Canada is also treated as a covered entity. Further, "equity" means shares of a corporation, income or capital interests in a trust, or interests as a member of a partnership, as the case may be.

There are several exceptions, such that the measure generally ignores transactions in respect of equity of a covered entity where the equity is:

- "substantive debt," defined to mean equity that is non-voting, non-convertible or exchangeable, yielding a fixed% of the issue price and having a redemption entitlement not exceeding the issue price;
- issued otherwise than solely for cash or under an equity compensation arrangement (such that only these types of equity issuances reduce the net amount that is subject to the 2% tax); or
- repurchased under certain reorganizations, such as certain amalgamations, liquidations, share-for-share exchanges and butterfly transactions.

There is also a *de minimis* exception that ensures the tax does not apply to a covered entity in a taxation year where the fair market value of equity repurchased in the year is less than $1 million (pro-rated for short taxation years), without regard to any equity issuances.

The exceptions may not cover all possible reorganization scenarios. For example, the reorganization exception may not prevent the tax from applying to share redemptions that occur in the course of taxable spin-offs that do not qualify as butterfly transactions.

The measure is protected by several anti-avoidance rules. One such rule requires a transaction that increases the amount of an equity issuance or that decreases the amount of an equity repurchase to be ignored if it is reasonable to consider that the primary purpose of the transaction is to reduce exposure to the tax.

Another anti-avoidance rule can cause the tax to apply to transactions that achieve economic results similar to a redemption, cancellation or repurchase. Conceptually similar to the debt parking rules, certain acquisitions of shares or units of a covered entity by a "specified affiliate" can be subject to the tax. A specified affiliate is a corporation, trust or partnership where the covered entity controls the affiliate or owns directly or indirectly a majority of its equity. The acquisition of equity of a covered entity by such a specified affiliate may be deemed to have been a repurchase of equity by the covered entity itself.

This measure applies to transactions that occur after December 31, 2023.

DIVIDEND RECEIVED DEDUCTION BY FINANCIAL INSTITUTIONS

Budget 2023 proposes to deny the inter-corporate dividend deduction in respect of dividends received by a financial institution (FI) on shares that are mark-to-market property (MTM property) of the FI. In general, subject to certain rules, a corporation is entitled to deduct, in computing its taxable income for a taxation year, dividends received by the corporation

on shares of taxable Canadian corporations. In effect, the provision allows dividends on such shares to flow tax-free through a corporate chain so as to mitigate double taxation at the corporate level.

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

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

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

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

The proposed measure applies in respect of dividends received after 2023.

INCOME TAX AND GST/HST TREATMENT OF CREDIT UNIONS

A "credit union" is currently defined in subsection 137(6) as a corporation, association or federation incorporated or organized as a credit union or cooperative credit society that meets certain requirements, including that all or substantially all (i.e., at least 90%) of its revenue be derived from specified sources (Revenue Test). Where the Revenue Test is not met, the rules that generally govern credit unions for income tax and GST/HST purposes would cease to apply (even if the credit union's governing legislation permits revenue from other sources). In response to the evolution of credit unions as "full-service financial institutions that offer a comprehensive suite of financial products and services" and to avoid unforeseen tax consequences where the Revenue Test is not met, Budget 2023 proposes to amend the definition of credit union to eliminate the Revenue Test applicable for taxation years ending after 2016.

BUILDING CANADA'S CLEAN ECONOMY

To help build Canada's clean economy, Budget 2023 proposes a number of new investment tax credits, provides details of previously announced investment tax credits and proposes enhancements to certain existing investment tax credits. These tax credits are:

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

A taxpayer will be able to claim only one of the foregoing investment tax credits if a particular property could be eligible for more than one credit, but it is possible that a project could include properties that are entitled to different credits.

Budget 2023 confirms that a taxpayer can claim the CH Tax Credit, the CTI Tax Credit, the CEI Tax Credit or the CTM Tax Credit without affecting its claim for the Atlantic Investment Tax Credit, but does not comment on the interaction of the CCUS Tax Credit and the Atlantic Investment Tax Credit.

Clean Hydrogen Investment Tax Credit

In the 2022 FES, the Government announced its intention to introduce the CH Tax Credit. Budget 2023 proposes that the CH Tax Credit apply in respect of eligible equipment that is acquired and becomes available for use (in accordance with the available for use rules applicable to depreciable property) in an eligible project after Budget Day.

The CH Tax Credit will be a refundable tax credit claimed at the following rates based on assessed carbon intensity (CI) of the hydrogen that is produced (measured in kg of carbon dioxide equivalent per kg of hydrogen):

- 40% for CI less than 0.75 kg;
- 25% for CI greater than or equal to 0.75 kg but less than 2 kg; and
- 15% for CI greater than or equal to 2 kg but less than 4 kg.

Budget 2023 proposes to phase out the CH Tax Credit gradually, with property that becomes available for use in 2034 eligible for one-half of the applicable credit and no credit available for property that becomes available for use after 2034.

Budget 2023 does not state whether the CH Tax Credit (or CTI Tax Credit discussed below) will be refundable to tax-exempt entities. By contrast, Budget 2023 provides that the CEI Tax Credit will be available to taxable and tax-exempt entities, whereas draft legislation released on August 9, 2022 relating to the CCUS Tax Credit provided that tax-exempt entities are not entitled to the CCUS Tax Credit.

Measuring CI

The developer of a hydrogen project must assess the CI of the hydrogen to be produced by the project using the Government's Fuel Life Cycle Assessment Model (LCA Model) maintained by Environment and Climate Change Canada and submit the assessment to the Government for verification. Once the assessment is verified, the expected CI of the produced hydrogen is used to determine the CH Tax Credit rate. The CH Tax Credit is subject to a clawback or recovery based on the actual CI of the hydrogen produced by the project, as determined by assessment of the project after the start of operations, as discussed below.

Projects Eligible for CH Tax Credit

The CH Tax Credit is available in respect of projects where hydrogen is the only by-product of the production process or makes up substantially all of the by-products of the production process. For the purpose of determining whether hydrogen constitutes all or substantially all of a project's production, any carbon dioxide that is captured, stored or used, or excess electricity that is generated and sold to the grid (subject to certain limitations), is ignored.

The CH Tax Credit will be available in respect of the cost of purchasing and installing "eligible equipment" for a project producing hydrogen either from electrolysis or from natural gas if carbon capture, utilization and storage (CCUS) is used to abate the resulting emissions.

The Government intends to review eligibility for the CH Tax Credit for other low-carbon hydrogen production processes going forward.

Equipment Eligible for CH Tax Credit

The CH Tax Credit is available in respect of the cost of equipment if all or substantially all of the use of the equipment is to produce hydrogen through electrolysis of water including: (i) electrolyzers, rectifiers and other ancillary electrical equipment, (ii) water treatment and conditioning equipment, and (iii) equipment used for hydrogen compression and on-site storage.

The CH Tax Credit will also be available in respect of the cost of equipment required to produce hydrogen from natural gas with emissions abated using CCUS, excluding equipment already described in Class 57 or Class 58 which is eligible for the CCUS Tax Credit. This will include equipment if all or substantially all of its use is to "produce hydrogen from natural gas through natural gas reformation, including auto-thermal reformers, steam methane reformers, pre-heating equipment, shift reactors, purifiers, water treatment and conditioning equipment, and equipment used for hydrogen compression and on-site storage." The production of carbon dioxide will not count in determining whether the equipment is all, or substantially all, used to produce hydrogen if the carbon dioxide is captured through a CCUS process.

The following will also be eligible for the CH Tax Credit:

- oxygen production equipment used in hydrogen production if the resulting carbon dioxide is captured by a CCUS process;
- equipment that produces heat or power from natural gas or hydrogen;
- dual-use power or heat production equipment if more than 50% of the energy balance is expected to be primarily (i.e., more than 50%) used to support the CCUS process or hydrogen production that is eligible for the CH Tax Credit; and
- property required to convert clean hydrogen to clean ammonia but only at a rate of 15%.

To be eligible for the CH Tax Credit, the equipment must be made available for use in Canada.

Expenses incurred in the development of a hydrogen project that do not relate to the acquisition or installation of equipment (e.g., feasibility studies, front-end engineering design studies and operating expenses) do not qualify for the CH Tax Credit.

Applying for the CH Tax Credit and Compliance Requirements

In order to apply for the CH Tax Credit, Budget 2023 requires that a front-end engineering design study for the hydrogen production project be submitted. An initial CI assessment of the project will be made based on the design of the project using the LCA Model and whether the project design "can reasonably be expected to achieve the modelled outcomes." If a project undergoes a significant redesign, it must be re-assessed.

The CH Tax Credit is subject to a clawback or recovery based on the actual CI of the hydrogen produced by the project, as determined by subsequent assessment after the project commences operations. The Government intends to release further guidance on the process for this assessment at a later date. Where a project fails to meet the CI of hydrogen at which it was initially assessed, the CH Tax Credit is subject to recovery equal to the difference between the amount of the CH Tax Credit claimed based on the assessed CI and the amount of the CH Tax Credit that would apply based on the actual CI observed during the operations phase. A full recovery of the CH Tax Credit applies if the project produces hydrogen from natural gas without the resulting emissions being abated by CCUS.

Expansion of Clean Technology Investment Tax Credit

The 2022 FES announced the Government's intention to introduce the CTI Tax Credit. The CTI Tax Credit is a 30% refundable tax credit applicable to investments in eligible property that is acquired and becomes available for use on or after Budget Day.

Budget 2023 expands the property eligible for the CTI Tax Credit to include certain geothermal energy systems, but does not provide any further details about the credit to supplement what was announced in the 2022 FES. Specifically, property

eligible for the credit will include property acquired and available for use on or after Budget Day that is described in subparagraph (d)(vii) of Class 43.1 and that is used primarily for the purpose of generating electrical and/or heat energy solely from geothermal energy. Equipment used for geothermal energy projects that also produce fossil fuels (including oil and gas) is not eligible for the CTI Tax Credit.

Budget 2023 modifies the phase-out of the CTI Tax Credit. The Government now proposes to phase it out gradually, with property that becomes available for use in 2034 eligible for only a 15% credit and no credit available for property that becomes available for use after 2034.

As noted above, Budget 2023 does not specify whether the CTI Tax Credit will be refundable to tax-exempt entities.

Clean Electricity Investment Tax Credit

Budget 2023 announces the Government's intention to introduce the CEI Tax Credit to support investments in clean electricity in Canada.

The CEI Tax Credit will be a 15% refundable investment tax credit that may be claimed by both taxable and tax-exempt entities.

The credit will be available in respect of costs incurred in refurbishing existing facilities as well as new projects, and will apply to investments in:

- non-emitting electricity generation systems (wind, concentrated solar, solar photovoltaic, hydro (including large-scale), wave, tidal, nuclear (including large-scale and small modular reactors));
- abated natural gas-fired electricity generation (subject to an emission intensity threshold compatible with a net-zero grid by 2035);
- stationary electricity storage systems that do not use fossil fuels in operation, including batteries, pumped hydroelectric storage, and compressed air storage; and
- equipment for the transmission of electricity between provinces and territories.

The CEI Tax Credit will be available as of Budget Day 2024 in respect of projects that commenced construction on or after Budget Day. The CEI Tax Credit will not be available after 2034.

Budget 2023 also states that the Government will engage with "provinces, territories, and other relevant parties to develop the design and implementation details of the [CEI Tax Credit]" and that it will "conduct targeted consultations on the possibility to introduce reciprocal treatment in light of some of the eligibility conditions associated with certain tax credits under the U.S. *Inflation Reduction Act*".

Labour Requirements for the CH Tax Credit, the CTI Tax Credit and the CEI Tax Credit

Budget 2023 confirms the Government's intention to apply certain labour requirements to the availability of the CH Tax Credit, CTI Tax Credit and CEI Tax Credit. The labour requirements will apply to work performed on or after October 1, 2023 and the Government states that it wants to receive feedback as it prepares draft legislative proposals.

Specifically, the maximum tax credit rate for the various clean energy tax credits will be available only if the taxpayer satisfies the labour requirements and a reduced rate will apply if the labour requirements are not satisfied as follows:

- the variable rate up to a maximum 40% under the CH Tax Credit (depending on the applicable CI tier) will be reduced by 10%;
- the 30% rate under the CTI Tax Credit will be reduced to 20%;
- the 15% rate under the CEI Tax Credit will be reduced to 5%; and
- the rate during the phase-out periods of the CTI Tax Credit and the CH Tax Credit will be reduced by 10% (to a minimum of 0%).

The labour requirements will apply only in respect of workers whose duties are primarily of a physical or manual nature (*i.e.*, not workers whose duties are administrative, clerical, supervisory or executive). The labour requirements will include a "prevailing wage requirement" that will require workers to be compensated at a level that meets or exceeds the relevant wage. The labour requirements will also include an "apprenticeship requirement" that requires not less than 10% of the total labour hours on a subsidized project to be performed by registered apprentices.

A mechanism will be created that will permit a taxpayer to pay corrective remuneration to workers (with interest) and penalties to cure any non-compliance and be deemed to have met the labour requirements.

An exemption from the labour requirements will be available with respect to the application of the CTI Tax Credit to the acquisition of zero-emission vehicles and the acquisition or installation of low-carbon heat equipment.

Budget 2023 also announces the Government's intention to apply labour requirements to the availability of the CCUS Tax Credit. Additional details regarding this measure are to be announced at a later date.

Clean Technology Manufacturing Investment Tax Credit

The CTM Tax Credit will be a refundable tax credit for investments in clean technology manufacturing and processing or investments in critical mineral extraction and processing. It will be equal to 30% of the capital cost of "eligible property" that is associated with "eligible activities" and that is acquired and becomes available for use on or after January 1, 2024.

Eligible Property

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

Eligible Activities

Eligible activities will be:

- processing or recycling nuclear fuels and heavy water;
- extracting (and certain processing related to) critical minerals for clean technology (*i.e.*, lithium, cobalt, nickel, graphite, copper and rare earth elements);
- manufacturing the following:
  - certain solar, wind, water or geothermal energy equipment;
  - nuclear energy equipment and nuclear fuel rods;
  - electrical energy storage equipment for use in providing grid-scale storage or ancillary services;
  - equipment for air and ground source heat pump systems;
  - zero-emission vehicles (including converting an on-road vehicle);
  - batteries, fuel cells, recharging systems and zero-emission vehicle hydrogen refuelling stations (unless, in the case of property used in the production of battery cells or modules, such production benefits from direct support through a Special Contribution Agreement with the Government);
  - equipment for the production of hydrogen from electrolysis; and
  - upstream components, sub-assemblies and materials that are purpose-built for or "designed exclusively to be integral to" eligible clean technology manufacturing and processing activities.

The CTM Tax Credit will be gradually phased out starting with property that becomes available for use in 2032 and fully phased out for property that becomes available for use in 2034.

The Government did not specify whether the CTM Tax Credit will be refundable to tax-exempt entities.

Carbon Capture, Utilization and Storage Investment Tax Credit

In Budget 2021, the Government announced its intention to introduce an investment tax credit for investments in CCUS projects. Following a consultation period that ended on December 2, 2021, Budget 2022: (i) announced the CCUS Tax Credit, (ii) stated that the CCUS Tax Credit would be available to taxpayers incurring eligible expenses on or after January 1, 2022, and (iii) proposed that the CCUS Tax Credit be made available for expenses incurred in a taxation year to acquire or install eligible equipment used in an eligible CCUS project that results in carbon dioxide being used for an eligible use. The Government subsequently released draft legislation in respect of the CCUS Tax Credit on August 9, 2022.

Budget 2023 announces new details regarding the CCUS Tax Credit in response to consultations following the release of the August 9, 2022 draft legislation. The CCUS Tax Credit is now expected to "apply to eligible expenses incurred after 2021 and before 2041" and revised legislative proposals are expected to be released "in the coming months".

Eligible Equipment

Eligible equipment is equipment that is put to use in Canada solely to capture, transport, store or use carbon dioxide in an eligible project. Equipment that captures carbon dioxide in Canada, compresses it and transports it to another jurisdiction to be stored will be considered to be used in Canada.

Eligible Project

An eligible project is a new project that meets the following conditions:

- captures carbon dioxide directly from the ambient air (Direct Air Capture) or captures carbon dioxide that would otherwise be released into the atmosphere;
- prepares the carbon dioxide for compression;
- compresses and transports the carbon dioxide;
- stores or uses the captured carbon dioxide in a manner that satisfies the storage requirements; and
- is not connected with electricity generation facilities that are required to reduce emissions under the *Reduction of Carbon Dioxide Emissions from Coal-fired Generation of Electricity Regulations* and the *Regulations Limiting Carbon Dioxide Emissions from Natural Gas-fired Generation of Electricity.*

It was not clear from Budget 2022, and is still not clear, what constitutes a new project.

For geological carbon dioxide storage, the storage requirement is that the project must be located in a jurisdiction where there are sufficient regulations to ensure that carbon dioxide is, according to Environment and Climate Change Canada determinations, permanently stored (as of Budget 2022, only Alberta and Saskatchewan qualified). For concrete storage projects, the storage requirement is that the process used by the project is approved by Environment and Climate Change Canada and 60% of the carbon dioxide injected into the concrete is successfully mineralized and locked into the resulting concrete.

Eligible Use

Eligible uses are:

- the storage of carbon dioxide in underground geological formations in eligible jurisdictions; or

- the storage of carbon dioxide in concrete that meets the 60% mineralization requirement as validated by a qualified third party.

The use of carbon dioxide to enhance oil and gas recovery is not an eligible use. If a portion of the eligible expense will not be utilized for an eligible use, the CCUS Tax Credit is reduced by the% of carbon dioxide that will be put to the ineligible use.

CCUS Tax Credit Rates

The rate of the CCUS Tax Credit depends on the type of expense and when the expense is incurred. Between January 1, 2022 and December 31, 2030, the following rates apply:

- 60% for expenses related to Eligible Equipment used in Direct Air Capture projects;
- 50% for expenses related to Eligible Equipment used in projects other than Direct Air Capture projects; and
- 37.5% for expenses related to eligible transportation, storage and use equipment.

Between January 1, 2031 and December 31, 2040, the rates are one-half of those rates described above.

Expansion of CCUS Tax Credit

Budget 2023 outlines the following changes to the CCUS Tax Credit.

- Dual use equipment producing heat or power, or that uses water, and that is used for CCUS together with another process will now be eligible for the CCUS Tax Credit (on a pro-rated basis based on the proportion of energy balance or material balance of the equipment supporting the CCUS process over the first 20 years of the project) provided that the following conditions are satisfied:
  - the equipment meets all other conditions for the availability of the CCUS Tax Credit;
  - where the equipment produces heat or power, more than 50% of the energy balance must be expected to be used to support either the CCUS process or hydrogen production eligible for the CH Tax Credit; and
  - any carbon dioxide emissions resulting from equipment producing heat or power must be used, or must be captured and stored.
- With respect to expenses incurred on or after January 1, 2022, the Province of British Columbia is added to the list of eligible jurisdictions for “dedicated geological storage”.
- Instead of obtaining approval from Environment and Climate Change Canada that the process for using and storing carbon dioxide in concrete meets the minimum 60% mineralization requirement, a taxpayer’s process must be validated by a “qualified third party” by having their process for carbon dioxide storage evaluated against the ISO 14034:2016 standard “Environmental management – Environmental technology verification” (ISO 14034:2016). For this purpose, a “qualified third party” is proposed to mean a person accredited as a “verification body” under ISO 14034:2016 and ISO/IEC 17020:2012 “Conformity assessment — Requirements for the operation of various types of bodies performing inspection”, the Standards Council of Canada, the ANSI National Accreditation Board (U.S.), or any other accreditation organization that is a member of the International Accreditation Forum.

CCUS Tax Credit for Refurbishment Costs

Budget 2023 includes a proposal that CCUS Tax Credits related to “eligible refurbishment costs” (Refurbishment Tax Credits) incurred once a project is in the operations phase be calculated based on the average expected eligible use ratio for the five-year period in which the refurbishment costs are incurred and in each subsequent five-year period that they contribute to the useful life of the project.

Projects will be eligible for Refurbishment Tax Credits only over the first 20 years of the project. During that 20-year period, the total eligible refurbishment costs are capped at 10% of the aggregate pre-operational costs that were eligible for the CCUS Tax Credit.

The Government proposes that Refurbishment Tax Credits will generally be recovered in the same manner as credits claimed during the construction phase, subject to a shorter recovery period since refurbishment costs are incurred in the operations phase of the project. If the portion of carbon dioxide going to ineligible uses in a particular five-year period is more than 5% higher than the weighted average stated in the project plan for that period, the Refurbishment Tax Credits will be recalculated based on the actual determination of the amount of carbon dioxide going to eligible uses instead of ineligible uses. Where the 10% minimum eligible use threshold is not met in any year during a particular five-year period then Refurbishment Tax Credits in respect of the project will be prohibited in any subsequent five-year period.

Flow-through Shares and Critical Mineral Exploration Tax Credit

Canadian exploration expense (CEE) includes certain expenses incurred by a taxpayer for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada. Canadian development expense (CDE) includes certain expenses incurred by a taxpayer in respect of a mine in bringing a new mine in a mineral resource into production and the cost of rights to explore for minerals in a mineral resource.

Lithium is a critical mineral for the purposes of the 30% non-refundable investment tax credit for flow-through critical mineral mining expenditures (CMETC) which applies to certain CEE incurred by a principal-business corporation in conducting mining exploration activity primarily targeting critical minerals and renounced to a subscriber for a flow-through share.

Budget 2023 proposes to include lithium from brines as a mineral resource.

Accordingly, eligible exploration and development expenses incurred in relation to lithium brine deposits can qualify as CEE or CDE and can be renounced to flow-through share subscribers and, in the case of CEE, may entitle the subscriber to the CMETC.

Eligible expenses related to lithium from brines made after Budget Day would qualify as CEE and CDE. The expansion of the eligibility for the CMETC to lithium from brines will apply to flow-through share agreements entered into after Budget Day and before April 2027.

EXPANSION OF REDUCED CORPORATE INCOME TAX RATE FOR ZERO-EMISSION TECHNOLOGY MANUFACTURERS

In Budget 2021, the Government announced a temporary measure to reduce corporate income tax rates for certain zero-emission technology manufacturers. In Budget 2023, the Government proposes to extend the reduced tax rates for zero-emission technology manufactures by three years with the gradual phase-out now starting in taxation years beginning in 2032 (previously taxation years beginning in 2029) and fully phased-out for taxation years beginning after 2034 (previously taxation years beginning after 2031).

Budget 2023 expands the activities eligible for the reduced corporate income tax rates for zero-emission technology manufacturers to include certain nuclear manufacturing and processing activities. Specifically, the following activities will now qualify for such reduced rates:

- nuclear energy equipment and nuclear fuel rod manufacturing;
- nuclear fuel processing or recycling; and
- heavy water processing or recycling.

INTERNATIONAL TAX MEASURES

INTERNATIONAL TAX REFORM

As described in our commentary to Budget 2022, 138 members of the Organisation for Economic Co-operation and Development (OECD)/Group of 20 (G20) Inclusive Framework on Base Erosion and Profit Shifting (the Inclusive Framework) have developed a two pillar plan for international tax reform. Pillar One will reallocate residual taxing rights, and Pillar Two will implement a global minimum tax of 15%, in each case in respect of the profits of certain large multinational enterprises (MNEs).

Update on Pillar One (Reallocation of Taxing Rights) and the Digital Services Tax

Budget 2023 states that the Inclusive Framework countries, including Canada, are working with the OECD to develop model rules and a multilateral convention to implement the changes to the international tax regime necessary to allow for the formulary allocation of the residual profits of certain large MNEs using a new nexus threshold generally based on where users/customers are located (instead of the current permanent establishment threshold under the existing bilateral treaty network).The goal is for the multilateral convention to be signed by mid-2023 so that it can go into effect in 2024.

While the Government indicates that it remains hopeful that the international community will complete the steps necessary to implement Pillar One, Budget 2023 confirms that the previously announced digital services tax (DST) could come into force on January 1, 2024 unless the Pillar One multilateral convention has come into force by that date. As a reminder, the DST will apply retroactively to in-scope revenues earned on or after January 1, 2022. It is intended that revised legislative proposals will be released for public comment before the DST comes into effect.

Update on Pillar Two (Global Minimum Tax)

Budget 2023 reiterates the Government's commitment to enact domestic legislation to implement the global minimum tax rules set out in Pillar Two. There are three key components of the global minimum tax:

- the income inclusion rule (IIR) provides the jurisdiction in which the ultimate parent entity of a MNE is located with the primary right to impose a top-up tax on the MNE to ensure it pays tax at an effective rate of at least 15% on the income it earns in any jurisdiction;
- the undertaxed profits rule (UTPR) is a secondary rule that applies when the jurisdiction in which the ultimate parent entity is located has not implemented an IIR. The UTPR allows other countries in which the MNE has a presence to impose a top-up tax, allocated by formula among those jurisdictions, to ensure the MNE pays the 15% minimum tax on its global income even though its home country has not adopted the IIR; and
- the domestic minimum top-up tax allows a jurisdiction to impose a top-up tax on low taxed income of its domestic entities. If such a top-up tax meets certain design requirements, it will be a "qualified" domestic minimum top-up tax that will prevent the IIR or UTPR from applying to the extent that the domestic minimum top-up tax applies.

Canada intends to implement the IIR and a domestic minimum top-up tax effective for fiscal years of in-scope MNEs that begin on or after December 31, 2023 and a UTPR effective for fiscal years that begin on or after December 31, 2024. Proposed legislation for the IIR and the domestic minimum tax will be released for comment in the next few months, with draft UTPR legislation to follow. The Government states that the Canadian draft legislation will "closely follow" the OECD model rules and commentary and administrative guidance on the model rules, and will consider the comments received during Pillar Two public consultation process launched in Budget 2022.

One new announcement in Budget 2023 is that the Government intends to share a portion of the income it realizes from international tax reform with the provinces and territories.

SELECT REGISTERED PLANS, TRUSTS AND PERSONAL TAX MEASURES

ALTERNATIVE MINIMUM TAX FOR HIGH-INCOME INDIVIDUALS

Continuing the refrain in Budget 2021 and Budget 2022, Budget 2023 proposes several changes to the alternative minimum tax (AMT) to better target high-income individuals and "ensure the wealthiest Canadians pay their fair share".

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

Budget 2023 proposes to:

- increase the AMT rate to 20.5% from 15% ;
- increase the basic exemption amount for individuals and GREs to approximately $173,000 (i.e., the start of the fourth federal tax bracket), subject to indexation; and
- broaden the AMT tax base by, among other things:
  - increasing the AMT capital gains inclusion rate from 80% to 100% (with capital loss carryforwards and allowable business investment losses applying at a 50% rate);
  - including 100% of employee stock option benefits;
  - including 30% of capital gains on donations of publicly listed securities (i.e., mirroring the current treatment of capital gains subject to the lifetime capital gains exemption);
  - disallowing 50% of various deductions such as deductions for CPP and QPP, employment expenses (other than those to earn commission income), moving expenses, child care expenses, disability supports, interest and carrying charges to earn income from property, non-capital loss carryovers and prior year limited partnership losses; and
  - disallowing 50% of most non-refundable tax credits.

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

The measures are proposed to come into force for taxations years that begin after 2023, and additional details are expected to be released later this year.

EMPLOYEE OWNERSHIP TRUSTS

Budget 2023 proposes amendments to the Tax Act to introduce a new form of trust, referred to as an employee ownership trust (EOT), with a view to facilitating the purchase of businesses by employees , to be effective January 1, 2024.

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

- the five year capital gains reserve will be extended to 10 years in respect of the disposition of the shares of the qualifying business to the EOT; and
- shareholder loans from the qualifying business to the EOT for the purpose of facilitating the transfer will benefit from a longer repayment period (15 years) under the shareholder loan regime.

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

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

- it must be a trust resident in Canada (other than a deemed resident trust);
- the beneficiaries of the EOT must include and be limited to all qualifying employees (essentially an employee of a qualifying business controlled by the trust, excluding certain employees who have or have had a significant interest in the business and certain probationary employees);
- distributions of income to the beneficiaries must be determined in the same manner, having regard only to any combination of length of service, remuneration, and hours of service;
- it may not prefer certain beneficiaries over others;
- it may not distribute shares of any qualifying business to any beneficiary;
- its trustees must be elected by the beneficiaries and meet certain conditions including in respect of independence from the qualifying business; and
- all or substantially all of the fair market value of its assets must be attributable to shares of qualifying businesses directly or indirectly controlled by the EOT.

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

STRENGTHENING THE INTERGENERATIONAL BUSINESS TRANSFER FRAMEWORK

Section 84.1 provides for a specific anti-avoidance rule that is intended to prevent taxpayers from converting corporate distributions into lower-taxed capital gains by effectively recharacterizing the capital gain arising on a non-arm's length disposition of shares of a corporation resident in Canada as a dividend. However, this provision had the effect of limiting intergenerational business transfers. To overcome this, private member's Bill C-208, which came into force on June 29, 2021, implemented an exception to the application of section 84.1, with respect to certain intergenerational transfers of "qualified small business corporation" shares (QSBC Shares) or "shares of the capital stock of a family farm or fishing corporation" as defined in subsection 110.6(1) (SCSFFC Shares and together with QSBC Shares, Subject Shares).

In Budget 2022, the Government announced the launch of a consultation process regarding the rules enacted by Bill C-208 in response to perceived circumstances in which the exception to section 84.1 could apply without a "genuine intergenerational business transfer" (*e.g.*, where the parent did not cease to control the underlying business after the Subject Shares were transferred). Budget 2023 proposes to amend section 84.1 effective for dispositions of shares that occur on or after January 1, 2024, by introducing safeguards that the Government intends to ensure that the exception in section 84.1 for intergenerational business transfers does not apply where the business is not transferred to the next generation.

As amended by Bill C-208, paragraph 84.1(2)(e) provides that the anti-avoidance rule in section 84.1 does not apply to a disposition of Subject Shares of a corporation (Subject Corporation) by a natural person (Transferor) to another corporation (Purchaser Corporation) where the following conditions are met:

- the shares of the Subject Corporation are Subject Shares;
- the Purchaser Corporation is controlled by one or more adult children of the Transferor (which includes for the purpose of section 84.1 the Transferor's "grandchildren, step-children, children-in law, nieces and nephews, and grandnieces and grandnephews"); and
- the Purchaser Corporation does not dispose of the Subject Shares within 60 months of purchase.

Budget 2023 proposes to amend section 84.1 by retaining the first two conditions and requiring that the Transferor and the Transferor's child(ren) jointly elect for the transfer to qualify as one of the following two transfers (each including its own additional specific conditions):

- an immediate intergenerational business transfer under proposed subsection 84.1(2.31) based on arm's length sale terms (subject to a three year test); or
- a gradual intergenerational business transfer under proposed subsection 84.1(2.32) based on traditional estate freeze characteristics (subject to a five to ten year test).

To qualify as an immediate intergenerational business transfer the following conditions must be met:

- immediately before the disposition time, the Transferor (either alone or together with their spouse or common-law partner), must control the Subject Corporation, and no other person or group of persons may control the Subject Corporation;
- at the disposition time the Purchaser Corporation is controlled by one or more of the Transferor's adult children, and the shares disposed of by the Transferor are Subject Shares;
- at all times after the disposition time, the Transferor (either alone or together with their spouse or common-law partner), must not control the Subject Corporation, the Purchaser Corporation, or any other person or partnership (a relevant group entity) that carries on, at the disposition time, an active business (relevant business) that is relevant to the determination of whether the Subject Shares are QSBC Shares or SCSFFC Shares;
- at all times after the disposition time, the Transferor (either alone or together with their spouse or common-law partner) does not own, directly or indirectly:
  - 50% or more of any class of shares of the Subject Corporation or the Purchaser Corporation, other than shares of a "specified class" (as defined in subsection 256(1.1) and referred to herein as non-voting preferred shares); or
  - 50% or more of any class of equity interest, other than non-voting preferred shares, in any relevant group entity;
- within 36 months of the disposition time and at all times thereafter, the Transferor (and the Transferor's spouse or common-law partner) does not own, directly or indirectly:
  - any shares, other than non-voting preferred shares, of the Subject Corporation or the Purchaser Corporation; or
  - any equity interest, other than non-voting preferred shares, in any relevant group entity;
- during the period of time from the disposition time until 36 months after the disposition time, the Transferor's children retain legal control of the Subject Corporation and the Purchaser Corporation, are actively engaged in a relevant business of the Subject Corporation or a relevant group entity, and any relevant business of the Subject Corporation and any relevant group entity is carried on as an active business; and
- within 36 months of the disposition time (or such greater period of time as is reasonable in the circumstances), the Transferor (and the Transferor's spouse or common-law partner) must transfer management of each relevant business of the Subject Corporation and any relevant group entity to the children and must permanently cease to manage any relevant business of the Subject Corporation or a relevant group entity.

The gradual intergenerational business transfer provides the flexibility of a more gradual transfer period but requires the Transferee to remain involved in the transferred business for a longer period of time. To qualify as a gradual intergenerational business transfer the following conditions must be met:

- immediately before the disposition, the Transferor (either alone or together with their spouse or common-law partner), controls the Subject Corporation, and no other person or group of person controls the Subject Corporation;
- at the disposition time, the Purchaser Corporation is controlled by one or more of the Transferor's adult children, and the shares disposed by the Transferor are Subject Shares;

- at all times after the disposition, the Transferor (either alone or together with their spouse or common-law partner) does not own, directly or indirectly:
  - 50% or more of any class of shares of the Subject Corporation or the Purchaser Corporation, other than non-voting preferred shares; or
  - 50% or more of any class of equity interest, other than non-voting preferred shares, in any relevant group entity;
- within 36 months of the disposition time and at all times thereafter, the Transferor (and the Transferor's spouse or common-law partner) does not own:
  - any shares, other than non-voting preferred shares, of the Subject Corporation or the Purchaser Corporation; or
  - any equity interest, other than non-voting preferred shares, in any relevant group entity;
- within 10 years of the initial sale (the Final Sale Time), the Transferor (and their spouse or common-law partner) reduce the economic value of their debt and equity interests in the Subject Corporation, the Purchaser Corporation and any relevant group entity to:
  - where the Transferor disposes of SCSFFC Shares, 50% of the value of all interests in the Subject Corporation, the Purchaser Corporation and any relevant group entity immediately before the disposition time; or
  - where the Transferor disposes of QSBC Shares, 30% of the value of all interests in the Subject Corporation, the Purchaser Corporation and any relevant group entity immediately before the disposition time;
- during the period of time from the disposition time until the later of 60 months after the disposition time and the Final Sale Time, the Transferor's children retain legal control of the Subject Corporation and the Purchaser Corporation, are actively engaged in a relevant business of the Subject Corporation or a relevant group entity, and any relevant business of the Subject Corporation and any relevant group entity is carried on as an active business; and
- within 60 months of the disposition time (or such greater period of time as is reasonable), the Transferor must transfer management of the Business to the children and permanently cease to manage the Business.

Budget 2023 also proposes to replace the rules introduced by Bill C-208 pertaining to subsequent share transfers by the Purchaser Corporation and the lifetime capital gains exemption with relieving rules applicable to a subsequent arm's length share transfer or upon the death or disability of a child. The Government states there will be no cap on the value of the shares transferred under these relieving rules.

To better assist the Canada Revenue Agency (CRA) in monitoring compliance with the amended rules applicable to intergenerational business transfers, the Government proposes to extend the limitation period for reassessing the Transferor's liability for tax that may arise on the transfer by three years in the case of an immediate intergenerational business transfer and by ten years in the case of a gradual intergenerational business transfer. The Government also proposes to provide a 10 year capital gains reserve for genuine intergenerational business transfers that are effected under the amended rules.

REGISTERED EDUCATION SAVINGS PLANS

Budget 2023 increases the withdrawal limit from registered education savings plans (RESPs) for beneficiaries who are enrolled in eligible post-secondary education programs. This change is effective as of Budget Day.

Budget 2023 will also create additional flexibility for divorced or separated parents to open a joint RESP for their children or to move a pre-existing joint RESP to a different promoter.

RETIREMENT COMPENSATION ARRANGEMENTS

Budget 2023 introduces provisions to assist employers that sponsor retirement compensation arrangements (RCA) that are not pre-funded by the employer. Such RCAs generally must be secured by letters of credit (or surety bonds) issued by a financial institution which require certain fees or premiums to be paid by the RCA to the issuer. For an RCA that is

supplemental to a registered pension plan, Budget 2023 will exempt such letter of credit (or surety bond) fees or premiums from the refundable RCA tax and will create a mechanism for an RCA to recover refundable tax previously paid by an RCA in respect of letter of credit (or surety bond) fees or premiums.

REGISTERED DISABILITY SAVINGS PLANS

Normally, only a formal guardian or legal representative of a registered disability savings plan (RDSP) beneficiary can establish the RDSP and be the plan holder. Budget 2023 will extend certain temporary measures to permit parents, spouses, and common-law partners of the beneficiary to establish an RDSP and will expand the RDSP rules to permit brothers and sisters of a beneficiary to fill that role.

MISCELLANEOUS – GAAR, TAX ENFORCEMENT, ADMINISTRATION AND OTHER TAX MEASURES

CHANGES TO THE GENERAL ANTI-AVOIDANCE RULE

Budget 2023 includes proposals to amend the GAAR following the consultation process that occurred in 2022. While draft legislation is included in the Notice of Ways and Means Motion, there is no coming into force provision and Budget 2023 invites comments by May 31, 2023, following which revised proposals will be released and the application date will be announced.

The proposals include significant revisions to the GAAR, including:

- inserting a pre-amble that attempts to deal with “interpretive issues and ensure the GAAR applies as intended”;
- lowering the avoidance transaction threshold from “the main purpose” to “one of the main purposes”;
- layering an economic substance rule on to the misuse and abuse analysis; and
- imposing a penalty equal to 25% of the tax benefit and extending the reassessment period by three years unless, in each case, the taxpayer notified the CRA of the transaction as described below.

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

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

More noteworthy is the introduction of an economic substance test to the misuse and abuse analysis. Pursuant to the proposed legislation, the following non-exhaustive list of factors “tend to indicate” a transaction lacks economic substance:

- “all or substantially all of the opportunity for gain or profit and risk of loss of the taxpayer – taken together with those of all non-arm’s length taxpayers – remains unchanged, including because of (i) a circular flow of funds, (ii) offsetting financial positions, or (iii) the timing between steps in the series”;
- at the time the transaction is entered into, it is reasonable to conclude that “the expected value of the tax benefit exceeded the expected non-tax economic return (which excludes both the tax benefit and any tax advantages connected to another jurisdiction)”; and

– it is reasonable to conclude that "the entire, or almost entire, purpose for undertaking or arranging the transaction or series was to obtain the tax benefit."

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

Budget 2023 also proposes that a penalty of 25% of the tax benefit be imposed on transactions that are subject to the GAAR unless the transaction was disclosed to the CRA pursuant to subsection 237.3(2) (i.e., as part of the reportable transaction rules) or pursuant to proposed subsection 237.3(12.1) (i.e., a new optional disclosure rule introduced for this purpose). Since a tax benefit now includes a tax attribute that has not been used to reduce tax, the proposal deems these tax benefits to be nil for purposes of the penalty. In a further effort to encourage disclosure, the normal reassessment period is proposed to be extended by three years for GAAR reassessments unless the transaction was previously disclosed to the CRA in accordance with section 237.3. Quebec included similar penalty and extended reassessment provisions when it reformed its GAAR a decade ago, but there has not yet been a published court decision in which such penalties have been imposed, making it difficult to predict the impact of these changes from Quebec's experience.

BENEFICIAL OWNERSHIP REGISTRY

In Budget 2022, the Government committed to amend the Canada Business Corporations Act by the end of 2023 to provide for a publicly searchable beneficial ownership registry of federal corporations. The registry is intended to be scalable so that it can also be used to access information provided by provinces and territories. While an initial round of amendments to the Canada Business Corporations Act was made in 2022, further amendments are to be made to that statute and others pursuant to Bill C-42 in order to implement the registry.

Budget 2023 confirms the Government's commitment to implementing the registry and working with the provincial and territorial governments to implement a national approach.

CUSTOMS TARIFF MEASURES AND ADDITIONAL SALES AND EXCISE TAX MEASURES

TARIFF AND DUTY MEASURES

Rate Adjustments

The automatic indexing of alcohol excise duties to the consumer price index rate of inflation under the *Excise Act* was scheduled to cause a 6.3% increase to alcohol excise duties on April 1. Budget 2023 proposes to impose a temporary one year cap limiting the inflation adjustment to 2% for 2023.

Budget 2023 also proposes to increase the Air Travellers Security Charge by 32.85%.

Quarterly Reporting for all Cannabis Licensees

As of the quarter commencing April 1, 2023, Budget 2023 proposes that all licensed cannabis producers are to report and remit excise duties based on a calendar quarter basis rather than a monthly basis. This represents an expansion of the relieving measures that were proposed in Budget 2022, which previously applied only to smaller licensed cannabis producers.

Extension of Tariff Relief

Budget 2023 proposes to update and extend the "General Preferential Tariff" and "Least Developed Country Tariff" programs 10 years past the current expiration date, until the end of 2034.

GST/HST ON PAYMENT CARD CLEARING SERVICES

In response to the Federal Court of Appeal decision in *Canadian Imperial Bank of Commerce v. The Queen*, 2021 FCA 10 (CIBC Visa Decision), Budget 2023 proposes to add new exclusionary paragraph (r.6) to the definition of "financial service" to, in the Government's view, "clarify" that payment card clearing services are taxable for GST/HST purposes. The proposal takes effect on Budget Day and may have retroactive implications for businesses, including banks and other financial institutions that acquire these services.

Budget 2023 proposes that new paragraph (r.6) applies to exclude from the definition of "financial service" the supply of payment card clearing services for which the consideration became due or was paid after March 28, 2023. Budget 2023 also proposes that new paragraph (r.6) applies when the consideration became due or was paid on or before March 28, 2023 unless, subject to certain exceptions, the supplier did not charge, collect or remit any amount as or on account of GST/HST either in respect of the supply of a payment card clearing service or in respect of any other supply that includes the service.

Budget 2023 extends the time in which the Minister may make an assessment in respect of the proposed amendment to the later of the day that is one year after the day on which the amendment receives royal assent and the last day of the period otherwise allowed for making the assessment.

For a number of years, several businesses that acquired payment card clearing services from a network operator (e.g., Visa and Mastercard) took the position that the services were exempt financial services for GST/HST purposes, which interpretation was confirmed by the reasoning of the Federal Court of Appeal in the CIBC Visa Decision. These businesses generally filed rebate claims for GST/HST paid or self-assessed in error. The retroactive application of the proposed amendment may complicate outstanding disputes in a number of ways, including by introducing disputes relating to the retroactive application of this amendment.

PREVIOUSLY ANNOUNCED MEASURES

Budget 2023 confirms the Government's intention to proceed with various previously announced measures (as modified to take into account consultations and deliberations since their release), including the following:

- proposals with respect to excessive interest and financing expenses limitations (EIFEL);
- reporting rules for digital platform operators;
- tax measures announced in the 2022 FES for which legislative proposals have not yet been released, including:
    - automatic advance for the Canada Workers Benefit;
    - investment tax credit for clean technologies;
    - extension of the residential property flipping rule;
- legislative proposals released on August 9, 2022, including with respect to the following measures:
    - borrowing by defined benefit pension plans;

  - reporting requirements for registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs);
  - fixing contribution errors in defined contribution pension plans;
  - the CCUS Tax Credit;
  - hedging and short selling by Canadian financial institutions;
  - substantive CCPCs;
  - mandatory disclosure rules;
  - electronic filing and certification of tax and information returns;
- legislative proposals released on April 29, 2022 with respect to hybrid mismatch arrangements;
- legislative proposals released February 4, 2022 with respect to the GST/HST treatment of cryptoasset mining;
- legislative proposals tabled on December 14, 2021 to introduce the Digital Services Tax Act;
- the transfer pricing consultation announced in Budget 2021; and
- measures confirmed in Budget 2016 relating to the GST/HST joint venture election.

As in prior years, Budget 2023 also reaffirms the Government's commitment to implement other technical amendments to "improve the certainty and integrity of the tax system".