April 19, 2021

2021 Federal Budget Review

On April 19, Finance Minister Chrystia Freeland presented her first Federal Budget from the minority Liberal government in the House of Commons. Since the government did not introduce a budget in 2020 because of the uncertainty of the COVID-19 pandemic, this was the first Federal Budget in more than two years.

The Budget, entitled "Budget 2021: Recovery Plan for Jobs, Growth, and Resilience" was highlighted as a plan to bridge Canadians and Canadian businesses through the COVID-19 pandemic and towards a robust recovery. It proposes to extend business and income support measures through to the fall, and to make investments to create jobs and help businesses. The Budget announced over $100 billion of new spending and anticipates a deficit of $354.2 billion for fiscal 2020-21 and a deficit of $154.7 billion for fiscal 2021-22, before returning to more modest amounts thereafter.

As expected, the Budget provided a detailed account of pandemic spending and outlined continued pandemic support for Canadians and Canadian businesses, including an extension of the Canada Emergency Wage Subsidy (CEWS), the Canada Emergency Rent Subsidy (CERS), including the Lockdown Support, the Canada Recovery Benefit (CRB), and the Canada Recovery Caregiving Benefit (CRCB), as well as the addition of the Canada Recovery Hiring Program (CRHP), a new subsidy program to encourage the hiring of new employees.

The Budget also expanded on many of the key themes announced in the Liberal government's Throne Speech and the 2020 Fall Economic Statement, including a green economy, and child care and early learning, with the aim of reducing fees for parents with children in regulated child care by 50% on average, by 2022, and a stated goal of reaching $10 per day on average, by 2026 (everywhere outside of Quebec, which has its own system). Other notable themes of the Budget include affordable housing, skills training and establishing a federal minimum wage of $15 per hour, revitalizing Canada's tourism and hospitality sector and support for women, Black Canadians, and other underrepresented entrepreneurs who face barriers to launching and owning businesses.

From a personal and small business tax perspective, which is the focus of this review, the Budget did not introduce any broad-based tax increases (nor any changes to capital gains inclusion rates or to the principal residence exemption), but did introduce a national tax on vacant property owned by non-residents and a luxury tax on new cars and private aircraft worth more than $100,000 and pleasure boats worth more than $250,000. The Old Age Security (OAS) pension was also proposed to be enhanced for seniors age 75 and older.

In addition to the extension of pandemic relief programs, business measures included a proposal to allow Canadian small businesses to fully expense up to $1.5 million in capital investments in a broad range of assets, including digital technology and intellectual property. As in prior budgets, a focus on tax fairness remains, with measures proposed to combat tax evasion, shine a light on beneficial ownership arrangements, and close specific tax loopholes for multinational corporations.

The most significant income tax measures affecting individuals and Canadian private companies are summarized below. Note that the measures introduced are only proposals at this stage and may not ultimately be enacted into law. Readers are cautioned to consult with their tax advisors for specific advice on how they may be affected by these proposals.

Summary of Personal Income Tax Proposals

Improving Access to the Disability Tax Credit

The government acknowledged that its programs and services that provide support to Canadians with disabilities are often complex and can be difficult to navigate for users, so it intends to develop a new disability benefit following consultations with stakeholders.

The government also announced that it is proposing to take further steps to expand the eligibility criteria for mental functions and life-sustaining therapy required to access the Disability Tax Credit, and other related support measures like the Registered Disability Savings Plan and the Child Disability Benefit. Specifically, the Budget proposes to update the list of mental functions of everyday life that is used for assessing eligibilty for the Disability Tax Credit and also proposes to recognize more activities in determining time spent on life-sustaining therapy and to reduce the minimum required frequency of therapy to qualify for the Disability Tax Credit, effective for 2021 and subsequent taxation years.

OAS Enhancement

The government plans to provide a one-time payment of $500 in August 2021 to OAS pensioners who will be 75 or over as of June 2022. The Budget further proposes to increase regular OAS payments for pensioners 75 and over by 10% on an ongoing basis as of July 2022.

Luxury Tax

Initially announced in the Liberal government's last election campaign, the Budget proposes to introduce a targeted 'luxury tax' on the sale, for the personal use, of new luxury cars and private aircraft with a retail sales price over $100,000, and on boats over $250,000. Specifically, it is proposed that all new passenger vehicles typically suitable for private use be included in the tax base with some specific exclusions for certain off-road vehicles, such as all-terrain vehicles, snowmobiles and other motor homes designed to provide temporary living or accommodations. Any large aircraft typically used in commercial activities, such as those equipped for the carriage of passengers and having a certified maximum carrying capacity of more than 39 passengers, also are proposed to be excluded. As well, floating homes, commercial fishing vessels and cruise ships would fall outside of the scope of the new tax.

The tax would be calculated as the lesser of 20% of the value above the threshold ($100,000 for luxury cars and private aircraft, and $250,000 for boats) or 10% of the full value of the luxury car, boat, or private aircraft. This measure would come into force on January 1, 2022.

Tax on Unproductive Use of Canadian Housing by Foreign Non-resident Owners

As originally announced in its 2020 Fall Economic Statement, the government has proposed in the Budget a national, tax-based measure targeting the unproductive use of domestic housing owned by non-residents. Specifically, the Budget proposes to introduce a new national 1% tax on the value of non-resident, non-Canadian owned residential real estate considered to be vacant or underused.

Beginning in 2023, all owners of residential property in Canada, other than Canadian citizens or permanent residents of Canada, would be required to file an annual declaration as to the current use of the property with the Canada Revenue Agency (CRA) in respect of each Canadian residential property they own. The requirement to file this declaration would apply irrespective of whether the owner is subject to tax on the property for the year. In the declaration, the owner would be required to report information such as the property address, the property value and the owner's interest in the property with significant penalties to apply for any failure to file.

In the coming months, the government will release a consultation paper to provide stakeholders with an opportunity to comment on the parameters of the proposed tax. These parameters would include, for example, the definition of residential property, the value on which the tax would apply, how the tax would apply where a property is owned by multiple individuals and/or non-individuals, potential exemptions and compliance and enforcement mechanisms.

This tax would be levied annually beginning in 2022.

Extension of the Canada Recovery Benefit (CRB) and Canada Recovery Caregiving Benefit (CRCB)

As outlined in our publication entitled Update on Canada's COVID-19 Economic Response Plan, the CRB provides eligible workers with $500 per week for those not eligible for EI and who are not employed or self-employed due to COVID-19, or had their employment/self-employment income reduced by at least 50% due to COVID-19. Although the benefit was originally provided to a maximum of 26 weeks, the Federal government had recently proposed to extend the maximum duration of the CRB to 38 weeks.

To continue to support workers through a transition away from emergency income supports and position Canadians for the recovery, the Budget proposes to provide up to 12 additional weeks of CRB to a maximum of 50 weeks. The first 4 of these additional 12 weeks will be paid at $500 per week, however, the remaining 8 weeks of this extension will be paid at a lower amount of $300 per week claimed. All new CRB claimants after July 17, 2021 would also receive the $300 per week benefit, available up until September 25, 2021.

The Budget also proposes to extend the CRCB by an additional 4 weeks, to a maximum of 42 weeks, at $500 per week, in the event that caregiving options, particularly for those supporting children, are not sufficiently available in the interim as the economy begins to safely reopen.

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Other Personal Tax Measures

These include:

- expanded access to the travel component of the Northern Residents Deductions for 2021 and subsequent taxation years;
- the expansion of "earned income" for Registered Retirement Savings Plan purposes to include postdoctoral fellowship income (applicable for 2021, or for postdoctoral fellowship income received in the 2011 to 2020 taxation years, where the taxpayer submits a request in writing);
- allowing individuals the option to claim a deduction in respect of the repayment of a COVID-19 benefit amount in computing their income for the year in which the benefit amount was received rather than the year in which the repayment was made (available for benefit amounts repaid at any time before 2023);
- enhancements to the Canada Workers Benefit to increase the income level at which the benefit is reduced, to further supplement the earnings of low- and modest-income workers and improve their work incentives, effective for 2021 and subsequent taxation years; and
- increasing EI sickness benefits from 15 to 26 weeks.

Proposals Affecting Canadian Private Companies

Extension of Canada Emergency Wage Subsidy (CEWS)

As outlined in our publication entitled Update on Canada's COVID-19 Economic Response Plan, the Federal government introduced this temporary wage subsidy in March 2020 to support businesses facing revenue losses and to help prevent layoffs. The CEWS was originally instituted for a twelve-week period (from March 15 to June 6, 2020), but was subsequently extended to December 19, 2020, and more recently extended to June 2021. The original subsidy provided employers with 75% of an employee's pre-crisis weekly earnings, to a maximum of $847 per week (based on a maximum weekly benefit of $1,129 per employee).

In early March 2021, the government further extended the CEWS until June 5, 2021, with a maximum base subsidy of 40% and a maximum top-up wage subsidy rate of 35% during this timeframe, for a maximum combined wage subsidy rate of 75%. The Budget proposes to extend the wage subsidy until September 25, 2021, but also proposes to gradually decrease the subsidy rate, beginning July 4, 2021, in order to ensure an orderly phase-out of the program as vaccinations are completed and the economy reopens. Furthermore, only employers with a decline in revenues of more than 10% would be eligible for the wage subsidy as of July 4, 2021.

The Budget also proposes to require that any publicly listed corporation receiving the wage subsidy and found to be paying its top executives more in 2021 than in 2019, will need to repay the equivalent in wage subsidy amounts received for any qualifying period starting after June 5, 2021 and until the end of the wage subsidy program.

Extension of the Canada Emergency Rent Subsidy (CERS)

As outlined in our publication entitled Update on Canada's COVID-19 Economic Response Plan, the CERS program seeks to deliver direct, targeted, and accessible rent support to qualifying organizations affected by COVID-19. The CERS, which mirrors the CEWS eligibility criteria and calculations, provides a subsidy for eligible fixed property expenses, including rent and interest on commercial mortgages.

In early March 2021, the government further extended the CERS under the current maximum rent support of 90% (i.e., maximum 65% base subsidy and a 25% top-up rate) until June 5, 2021. The Budget seeks to extend the CERS, including the Lockdown Support, from June 6, 2021 to September 25, 2021, but proposes to gradually phase out the base subsidy rates starting on July 4, 2021. Furthermore, only organizations with a decline in revenues of more than 10% would be eligible for the base rent subsidy as of July 4, 2021.

Canada Recovery Hiring Program (CRHP)

The Budget proposes to introduce the new CRHP for eligible employers that continue to experience qualifying declines in revenues relative to before the pandemic. This proposed subsidy would offset a portion of the extra costs employers take on as they reopen, either by increasing wages or hours worked, or hiring more staff. Specifically, the CRHP would provide eligible employers with a subsidy of up to 50% on the incremental remuneration paid to eligible employees between June 6, 2021 and November 20, 2021, in comparison to a baseline period from March 14 to April 10, 2021. An eligible employer would be permitted to claim either the CHRP or the CEWS for a particular qualifying period, but not both.

Employers eligible for the CEWS would generally be eligible for the CHRP. However, a for-profit corporation would be eligible for the hiring subsidy generally only if it is a Canadian-controlled private

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corporation. Other eligible employers would include individuals, non-profit organizations, registered charities, and certain partnerships. An application for the hiring subsidy for a qualifying period would be required to be made no later than 180 days after the end of the qualifying period.

The CRHP would provide an alternative support for businesses affected by the pandemic to help them hire more workers as the economy reopens. Since this hiring program would be in place until November 2021, employers could shift to this new support from the CEWS once it ceases in September.

Other Corporate Tax Measures

Other notable corporate tax measures proposed in the Budget include:

- *Immediate expensing of certain property*: The Budget proposes to provide temporary immediate expensing, of up to $1.5 million per tax year, in respect of certain capital property acquired by a Canadian-Controlled Private Corporation (CCPC) on or after Budget day in the year it becomes available for use prior to January 1, 2024. Please note that this proposal does not include 'long lived assets' such as buildings or other intangibles in specific Capital Cost Allowance (CCA) classes, and is shared among associated corporations.
- *Income tax rate reductions for zero-emission technology manufacturers:* The Budget proposes a temporary measure to reduce corporate income tax rates for qualifying zero-emission technology manufacturers. Specifically, taxpayers would be able to apply reduced federal income tax rates on eligible zero-emission technology manufacturing and processing income to 7.5% (where such income would normally be taxable at the general corporate rate of 15%), and 4.5% (where such income would normally be taxable at the small business tax rate of 9%). These rate reductions would go into effect on January 1, 2022 and be gradually phased out starting January 1, 2029, slowly increasing back to their original rates and eliminated by January 1, 2032.
- *Accelerated CCA claims for Clean Energy Equipment:* The Budget proposes to expand the eligibility for various types of clean energy equipment that can access accelerated CCA claims where the assets become available for use on or after Budget day.
- *Interest deductibility limits:* The Budget proposes that, starting in 2023, the amount of interest that certain businesses can deduct be limited to 40% of their earnings in the first year of the measure, and 30% thereafter. Relief will be provided for small businesses and for other situations that do not represent significant tax base erosion risks. The government expects to release draft legislation this summer and will seek stakeholder input on the new rules.
- *Digital Services Tax:* The Budget proposes to implement a Digital Services Tax at a rate of 3% on revenue from digital services that rely on data and content contributions from Canadian users. The tax would apply to large businesses with gross revenue of 750 million euros or more. It would apply as of January 1, 2022, until an acceptable multilateral approach with other countries comes into effect.
- *Lowering the cost of credit card transaction fees:* The government proposes to lower the average overall cost of interchange fees for merchants, ensuring that small businesses benefit from pricing similar to large businesses, and protect existing rewards points of consumers. Following consultations with stakeholders, detailed next steps will be outlined in the 2021 Fall Economic Statement.

Measures Affecting Charities

The following measures in the Budget could impact charitable giving:

Review of Disbursement Quota

Every year, charities are required to spend a minimum amount on their charitable programs or on gifts to qualified donees. This is known as the "disbursement quota" and it ensures that charitable donations are being invested into communities. Currently the disbursement quota for charitable foundations is 3.5% of the value of investable assets averaged over a two-year period. The Budget notes that while most charities meet or exceed their disbursement quotas, a gap exists of at least $1 billion in charitable expenditures.

The Budget proposes launching public consultations with charities over the coming months on potentially increasing the disbursement quota and updating the tools at the CRA's disposal, beginning in 2022. The Budget estimates this could potentially increase support for the charitable sector and those that rely on its services by between $1 billion and $2 billion annually.

Administrative Measures

The Budget also proposes measures to combat anti-money laundering and terrorist financing in the charities sector by seeking to address legislative gaps and streamline the revocation process to prevent abuse of charitable status (e.g., where a charity provides false statements for the purposes of maintaining their registration).

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Other Notable Measures

Integrity Measures

As in previous budgets, this Budget continues the government's efforts to make legislative adjustments to help ensure that the tax system is functioning as intended and introduces certain proposals to maintain the fairness and integrity of the tax system by:

- providing $230 million over 5 years, starting in 2021, for the CRA to improve its ability to collect outstanding taxes. The Budget anticipates that this proposal will lead to the collection of an additional $5 billion in outstanding taxes over 5 years. In addition, it proposes amendments that confirm the authority of CRA officials to require taxpayers to provide reasonable assistance for any purposes related to the administration of a statute;
- providing additional support to the CRA to increase GST/HST audits of large businesses where risk assessment models have found the greatest risk of non-compliance, modernizing the CRA's risk assessment process to prevent unwarranted and fraudulent GST/HST refund and rebate claims at the outset, and enhancing capacity to identify tax evasion involving trusts;
- combating abusive tax debt avoidance schemes by amending the Income Tax Act to address planning where a small number of high-net-worth taxpayers are engaging in complex transactions intended to avoid the collection of their tax debts by transferring their assets to non-arm's length parties leaving them without assets necessary to pay tax debts;
- implementing a publicly accessible corporate beneficial ownership registry on individuals who own and control corporations to catch those who attempt to launder money, evade taxes, or commit other complex financial crimes;
- beginning a consultation period to enhance Canada's mandatory disclosure rules to identify changes to the Income Tax Act's reportable transactions rules, and introducing a new requirement to report notifiable transactions, as well as a new requirement for specified corporations to report uncertain tax treatments, and rules providing for the extension of the applicable reassessment period and the introduction of penalties; and
- releasing a consultation paper on improving Canada's transfer pricing rules and taking next steps to strengthen and modernize Canada's general anti-avoidance rule, as originally announced in the 2020 Fall Economic Statement.

Electronic Filing and Certification of Tax and Information Returns

To improve the administration of, and compliance with, the tax system, the Budget proposes various amendments to the tax legislation to improve the CRA's ability to operate digitally. This includes the ability of the CRA to send certain notices of assessment electronically without the taxpayer having to authorize the CRA to do so, and allowing issuers of T4A and T5 information returns to provide them electronically without having to also issue a paper copy and without the taxpayer having to authorize the issuer to do so.

Employee Ownership Trusts

Employee ownership trusts can encourage employee ownership of a business, and facilitate the transition of privately owned businesses to employees. Both the United States and the United Kingdom permit employee ownership though these types of arrangements.

The Budget announces that the government will engage with stakeholders to examine what barriers exist to the creation of employee ownership trusts in Canada, and how workers and owners of private businesses in Canada could benefit from the use of employee ownership trusts.

Enhanced Employment Insurance (EI)

The Budget proposes $3.9 billion over 3 years, starting in 2021-22, for a suite of legislative changes to make EI more accessible and simpler for Canadians over the coming year while the job market begins to improve. The Budget also announced forthcoming consultations on future, long-term reforms to EI. To support this effort, the government proposes to conduct targeted consultations with Canadians, employers, and other stakeholders from across the country. Consultations will examine systemic gaps exposed by COVID-19, such as the need for income support for self-employed and gig workers; how best to support Canadians through different life events such as adoption; and how to provide more consistent and reliable benefits to workers in seasonal industries. Any permanent changes to further improve access to EI will be made following these consultations and once the recovery is fully underway.

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Previously–Announced Measures

The Budget confirms the government's intention to proceed with many other previously announced tax and related measures that have not yet been formally enacted into law, including the following notable measures affecting individuals and Canadian private companies:

- The anti-avoidance rules consultation and the income tax measures announced on November 30, 2020 in the Fall Economic Statement in respect of registered disability savings plans and employee stock options.
- The legislative proposals released on July 30, 2019 to implement Budget 2019 income tax measures, including permitting additional types of annuities under registered plans; and
- The income tax measures announced in Budget 2018 to implement enhanced reporting requirements for certain trusts to provide additional information on an annual basis.

The **2021 Federal Budget Review** was developed by our in-house tax experts in the BMO Wealth Planning and Advisory Services Group at BMO Private Wealth; **John Waters**, Vice-President, Director of Tax Consulting Services and **Dante Rossi**, Director, Tax Planning. For more insights, visit **bmo.com/wealthexchange**

If you have any questions regarding these budget proposals, please consult with your tax advisor for further details.

This document is a summary of the Federal Budget and does not represent BMO Financial Group's view on the tax policies expressed in the Federal Budget.

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