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Federal Budget 2021: A Summary of Key Measures Affecting Businesses

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On April 19, 2021, the Government of Canada released its first budget since the onset of the COVID-19 pandemic ("Budget 2021"). Overall, this pre-election budget is focused on spending and provides some tax relief to Canadian taxpayers. From a revenue perspective, Budget 2021 generally emphasizes enhancing existing rules and enforcing compliance over introducing new taxing measures. One exception arises in the expansion of sales taxes on electronic commerce. We summarize below some of Budget 2021's key tax measures for businesses.

A. Corporate Tax Measures

1. *COVID-19 Relief Programs*

Canada Emergency Wage Subsidy ("CEWS"), Canada Emergency Rent Subsidy ("CERS") and Lockdown Support

Budget 2021 proposes to extend these programs until September 2021. The subsidy rates will decline over the July to September 2021 period.

For CEWS, starting on July 4, 2021, only employers with a reduction in revenues of more than 10% would be eligible for the subsidy. The subsidy rate is graduated based on the employers' revenue decline. For example, if the employer's revenue decreases at a rate between 10 and 50%, the subsidy rate is calculated as: (the revenue decline – 10%) x 0.875 for the period between July 4 to July 31, 2021. This rate is further reduced over the next two periods.

Budget 2021 proposes to require a publicly listed corporation to repay wage subsidy amounts received for a period after June 5, 2021 if the compensation it pays to its "specified executives" during the 2021 calendar year exceeds the compensation it paid to its specified executives during the 2019 calendar year. "Specified executives" would include the named executive officers whose compensation is required to be disclosed under the Canadian securities laws. The amount of wage subsidy required to be repaid is equal to the lesser of:

- the wage subsidy received for periods that begin after June 5, 2021; and
- the amount of compensation paid to specified executives in 2021 that exceeds the amount of compensation paid to specified executives in 2019.

The repayment is calculated on a group level.

The CERS will also be phased out starting on July 4, 2021. Similarly, only businesses with a decline of more than 10% in revenues would be eligible for CERS, and the Lockdown Support. The Lockdown Support will also be extended to September 25, 2021.

Canada Recovery Hiring Program

Budget 2021 proposes a temporary measure that provides eligible employers with a subsidy of up to 50% on the incremental remuneration paid to an eligible employee between June 6, 2021 and November 20, 2021. The employer may claim this subsidy or the CEWS for a particular period, but not both.

Eligible employers include Canadian-controlled private corporations, individuals, non-profit organizations, registered charities and certain partnerships. An eligible employee for this program must be employed in Canada by the eligible employer throughout a qualifying period. This program is not available for furloughed employees. This subsidy is calculated based on a subsidy rate of 50% (declining to 20%) on the difference between an employer's total eligible remuneration paid to eligible employees for the qualifying period and its total eligible remuneration paid to eligible employees for the baseline period (this period is defined as between March 14 to April 10, 2021). The eligible remuneration for each eligible employee would be subject to a maximum of $1,129 per week. Similarly, to qualify for this new subsidy, the employer must have a decline in revenue of more than 10% for the period between July 4 to November 20, 2021.

2. *Anti-Avoidance and Enforcement Measures*

Avoidance of Tax Debts

The *Income Tax Act* (Canada) contains a rule which provides that where a taxpayer transfers property to a non-arm's length person for insufficient consideration, the transferee is liable for the tax payable by the transferor for the current year or any previous year. Budget 2021 proposes to enhance this rule in response to complex tax plans designed to avoid its technical application. Budget 2021 would also impose a penalty for planners and promoters of certain arrangements which contravene the tax debt avoidance rules. These rules would apply in respect of property transfers occurring on or after April 19, 2021.

Mandatory Disclosure Rules

Budget 2021 announced that the government is consulting on numerous proposals to introduce new requirements to report certain transactions to the Canada Revenue Agency.

The existing rules require disclosure of a "reportable transaction" by June 30 of the year following the calendar year in which the transaction occurred. The proposed amendments would broaden the scope of transactions which fall under the purview of a "reportable transaction", and accelerate the mandatory disclosure of such a transaction to 45 days from its occurrence. Other proposals to expand the mandatory disclosure regime introduced by Budget 2021 would require disclosure:

- of certain transactions designated by the Canada Revenue Agency and the Ministry of Finance (Canada) having a particular fact pattern or outcome; and
- by certain corporations having assets in excess of $50 million of uncertain tax treatments for financial statement purposes.

An additional rule would delay the commencement of the normal reassessment period of a taxpayer who has failed to comply with its reporting requirements.

General Anti-Avoidance Rule

Previously, the Government of Canada had announced it would begin consultations to enhance Canada's anti-avoidance rules and, in particular the general anti-avoidance rule in section 245 of the *Income Tax Act* (Canada) ("GAAR"). Budget 2021 restated the Government of Canada's commitment, stating that it would "take next steps" to strengthen and modernize the GAAR.

Beneficial Ownership Transparency

Budget 2021 commits to spending $2.1 million for the implementation of a publicly accessible corporate beneficial ownership registry by 2025 to prevent tax evasion, money laundering and other financial crimes. This registry will allow tax and enforcement authorities to have access to up-to-date information on the shareholders of corporations.

Audit Power

Various taxing statutes will be amended to provide the Canada Revenue Agency with the authority to require persons to answer all proper questions orally or in writing, including in any form specified by a Canada Revenue Agency representative.

B. International Tax Measures

1. *Interest Deductibility Limits*

Budget 2021 proposes to introduce a new rule that would limit the amount of net interest expense that a corporation may deduct in computing its taxable income to no more than a fixed ratio of "tax EBITDA" (the corporation's taxable income before taking into account interest expense, interest income and income tax and deductions for depreciation and amortization). Detailed rules will be enacted to define what is included in "tax EBITDA" and what constitutes interest. This new rule will apply to trusts, partnerships and Canadian branches of non-resident taxpayers.

Interest that is not deductible under this proposed rule may be carried forward for up to 20 years or back for up to 3 years. The denied interest may be carried back to taxation years before the Transition Year (as defined below), provided that the taxpayer would have had the capacity to absorb the denied interest had the proposed rule have been in effect for those years. Whether a taxpayer had the capacity to absorb the denied interest is measured by reducing the overall net interest expense for all those years that exceeded the fixed ratio. The fixed ratio would be phased in: 40% for taxation years beginning on or after January 1, 2023 but before January 1, 2024 ("Transition Year"), and 30% for taxation years beginning on or after January 1, 2024. There are special rules regarding the carryback of denied interest.

Canadian-controlled private corporations (and their associated corporations) with taxable capital in Canada of less than $15 million and groups of corporations and trusts whose aggregate net interest expense among their Canadian members is less than $250,000 will not be subject to the proposed interest deductibility limits. Budget 2021 further states that it is expected that standalone Canadian corporations and Canadian corporations that are members of a group none of whose members is a non-resident would, in most cases, not have their interest expense deductions limited under the proposed rule.

Draft legislation for the proposed rule is expected to be released for comment in the summer.

2. *Hybrid Mismatch Arrangements*

The proposed rule is meant to address arrangements whereby multinational enterprises derive tax benefits from the use of hybrid mismatch arrangements. One example of such an arrangement occurs where a country allows the payor a deduction in respect of a cross-border payment, but the receipt is not included in the ordinary income of the recipient in the other country. Another example would be a tax deduction in two or more countries in respect of a single economic expense.

Budget 2021 proposes to enact a new rule to disallow a deduction for payments made by Canadian residents under a hybrid mismatch arrangement. Similarly, a payment made under such an arrangement by an entity not resident in Canada that is deductible for foreign tax purposes, would not be deductible against the income of a Canadian resident. Any amount of the payment received by a Canadian resident would also be included in income.

Draft legislation will be introduced in two packages. The first package will be released in 2021 for comment and those rules would apply as of July 1, 2022. The second package will be released after 2021 for comment and those rules would apply no earlier than 2023.

3. *Transfer Pricing Review*

Budget 2021 contends that shortcomings in the current transfer pricing rules are evident in the Federal Court of Appeal decision in *Her Majesty the Queen v. Comeco Corporation*, in which the Court rejected the Canada Revenue Agency's attempt to use transfer pricing rules to pierce the corporate veil and disregard the taxpayers' true legal relationship. A review of the current transfer pricing rules will be undertaken and a consultation paper will be released.

C. Sales Tax Measures

1. *Taxation of Electronic Commerce*

In the Fall Economic Statement 2020, the Government of Canada proposed changes targeting the application of the Goods and Services Tax / Harmonized Sales Tax (GST/HST) to e-commerce transactions. Budget 2021 proposes additional clarifying rules and introduces draft legislation which reflect stakeholder comments.

Currently, a supplier who is not resident in Canada and does not carry on business in Canada is generally not required to register for GST/HST, or to collect and remit GST/HST on supplies made to Canadian residents. The new rules will significantly expand the geographic scope of the GST/HST by imposing registration and collection obligations on non-resident businesses making sales to Canadian consumers of $30,000 over a 12-month period of digital products or services (other than supplies that are GST/HST-free under existing rules) to Canadian consumers. The new registration, collection and remittance obligations will also apply to digital platforms having control over key elements of transactions between non-resident suppliers and Canadian consumers. Similar rules will apply to non-resident suppliers of short-term accommodations in Canada, and to digital platform operators who facilitate such supplies.

A non-resident supplier or digital platform operator that does not carry on business in Canada may be eligible to participate under a simplified GST/HST registration and remittance regime. However, compliance with the normal registration and remittance rules will be required in respect of goods shipped to Canadian consumers from a fulfilment warehouse or other place in Canada.

The new rules only apply in respect of supplies made to Canadian consumers; no obligations are imposed in respect of supplies to Canadian businesses (who can claim input tax credits to recoup GST/HST that they pay).

The new measures would come into force on July 1, 2021. Budget 2021 states that the Canada Revenue Agency will work closely with affected businesses, and will take a practical approach to compliance where a business demonstrates that it is precluded from fully meeting its obligations due to operational difficulties.

2. *Digital Services Tax*

Following its announcement in the Fall Economic Statement 2021, the Government of Canada provides additional details in Budget 2021 on the new tax on corporations providing digital services. Revenues from certain digital services reliant on the engagement, data and content contributions of Canadian users will be subject to a tax at the rate of 3%. This digital services tax is proposed to apply starting 1 January 2022, until an acceptable multilateral option takes effect (e.g., a multilateral solution under the auspices of the OECD).

3. *Supplementary GST/HST Measures*

Budget 2021 proposes the following additional GST/HST-related measures:

- Under the existing rules, the information that a business is required to retain to claim an input tax credit increases when the amount paid in respect of a supply exceeds thresholds of $30 or $150.These thresholds will be increased to $100 and $500, respectively.
- The input tax credit information rules will be expanded to permit a business to claim an input tax credit using information provided by a billing agent.

D. Other Measures

1. *Luxury Tax*

Budget 2021 introduces a new tax on the purchase of new vehicles and aircraft with a cost of more than $100,000 (before applicable sales tax) and boats with a cost of more than $250,000 (before applicable sales tax). This tax, applicable on or after January 1, 2022, will be equal to the lesser of (a) 10% of the total cost or (b) 20% of the cost in excess of the amounts indicated.

2. *Tax on unproductive/ vacant use of Canadian housing by foreign non-resident owners*

Budget 2021 proposes an annual 1% tax on the value of vacant or underused residential properties owned by non-resident, non-Canadian persons, starting on January 1, 2022. There will be a requirement to file an annual declaration, beginning on January 1, 2023.

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