Wealth Management



A SPECIAL REPORT FROM RBC WEALTH MANAGEMENT SERVICES



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2022 Federal Budget April 7, 2022

A summary of the key measures that may have a direct impact on you

On April 7, 2022, Deputy Prime Minister and Minister of Finance Chrystia Freeland released the federal budget, the first since the 2021 Federal Election. While this is another Liberal minority budget, it was tabled just weeks after the Liberal Party and New Democratic Party announced a Supply and Confidence Agreement to support the current government until June 2025.

While this budget shifts away from pandemic measures, other current events and realities are at the forefront. These include inflation, housing affordability, the transition to a green economy, and supporting Ukraine in the face of an invasion that has upset the rules of international order we have relied on since World War II.

With a focused theme of "make life more affordable," the budget contains only a few new or increased taxes, targeted at financial institutions and life insurance companies, and does not change federal personal or corporate tax rates. However, medium-sized business owners are promised increased access to small business tax rates on their first $500,000 of taxable income.

A great deal of emphasis in the budget is on new spending aimed at housing affordability, a national dental plan and defence spending. Long-rumoured changes including an increase to the inclusion rate on capital gains and changes to the principal residence exemption were once again not on the agenda. Instead, there was a sprinkling of new measures and credits across the board.

The following is a summary of the most significant tax and financial planning measures announced in the budget.

Housing measures

Tax-Free First Home Savings Account (FHSA)

The budget proposes to create the FHSA, a new registered account to help individuals save for their first home. Contributions to an FHSA will be deductible and income earned in an FHSA will not be subject to tax. Qualifying withdrawals from an FHSA made to purchase a first home will be non-taxable.

Some features of the FHSA were provided in the budget, which are summarized below. However, the government indicated more information will be provided in the near future.

Eligibility

- You must be a Canadian resident and at least 18 years of age to open an FHSA
- You must not have lived in a home that you owned either at any time in the year the account is opened or during the preceding four calendar years
- You will be limited to making non-taxable withdrawals in respect of a single property in your lifetime. Once you have made a non-taxable withdrawal to purchase a home, you will be required to close your FHSA within a year from the first withdrawal and will not be eligible to open another FHSA

Contributions

- You can make contributions of up to $8,000 per year to an FHSA starting in 2023
- There is a lifetime contribution limit of $40,000
- If you contribute less than $8,000 in a given year, the excess will not be carried forward
- If you open more than one FHSA the total amount contributed to all the FHSAs cannot exceed the annual and lifetime contribution limits

Withdrawals and transfers

- Qualifying withdrawals from the FHSA made to purchase a first home will be non-taxable
- Non-qualifying withdrawals for other purposes will be taxable
- You will not be permitted to make both an FHSA withdrawal and a withdrawal under the Home Buyers' Plan (HBP) in respect of the same qualifying home purchase
- You may transfer funds from an FHSA to a registered retirement savings plan (RRSP) or to a registered retirement income fund (RRIF). Transfers to your RRSP or RRIF would be on a tax-deferred rollover basis; however, these amounts when withdrawn from your RRSP or RRIF will be taxable in the usual manner
- Transfers to your RRSP and RRIF will not reduce, or be limited by, your available RRSP room
- Withdrawals and transfers will not replenish FHSA contribution limits
- If you have not used the funds in your FHSA for a qualifying first home purchase within 15 years of first opening an FHSA, your FHSA must be closed
- Any unused savings may be transferred into an RRSP or RRIF, or would otherwise have to be withdrawn on a taxable basis
- You will be allowed to transfer funds from an RRSP to an FHSA on a tax-deferred basis, subject to the $40,000 lifetime and $8,000 annual contribution limits. These transfers will not restore your RRSP contribution room

Illustration

You and your spouse each contribute $8,000 per year (the annual maximum) in your own FHSA starting in 2023. Both of you can deduct the contribution from your taxable income each year. The tax savings on your federal tax return each year will be based on your marginal tax rate. For example, if each of you make between $50,000 and $100,000, the FHSAs allows each of you to receive an annual federal tax refund of $1,640 (i.e. $8,000 x 20.5%). At the end of 2027, when you are ready to buy your first home, your combined FHSA amounts to $90,000, which includes $10,000 of tax-free investment income earned in the plan. You can withdraw this amount tax-free for a down-payment on your first home.

The government will work with financial institutions with the goal to have the infrastructure in place for individuals to be able to open an FHSA and start contributing at some point in 2023.

Doubling the First-Time Home Buyers' Tax Credit (HBTC)

The HBTC is intended to provide support to Canadians buying their first home. The budget proposes to double the HBTC amount to $10,000, which would provide a 15% non-refundable tax credit of $1,500. You can continue to split the credit with your spouse or common-law partner as long as the combined total does not exceed $1,500.

You are a first-time home buyer if neither you nor your spouse or common-law partner owned and lived in

another home in the calendar year of the home purchase or in any of the four preceding calendar years. This credit is also available for certain acquisitions of a home by or for the benefit of a disabled individual, even if the first-time home buyer condition is not met. A qualifying home is one that you or your spouse or common-law partner intend to occupy as your principal residence no later than one year after its purchase.

This measure will apply to homes purchased on or after January 1, 2022.

Doubling the Home Accessibility Tax Credit (HATC)

The HATC is a non-refundable tax credit that helps support independent living for seniors who are 65 years of age or over at the end of a tax year and those who are eligible to claim the Disability Tax Credit (DTC) at any time in a tax year. The HATC is available for eligible home renovation or alteration expenses in respect of an eligible dwelling.

The budget proposes to double the annual expense limit of the HATC to $20,000 for the 2022 and subsequent taxation years. The credit is 15% of the lesser of eligible expenses and $20,000, resulting in a tax credit of up to $3,000, for accessibility renovations or alterations.

Multigenerational Home Renovation Tax Credit (MHRTC)

To support families who are living together in multigenerational homes, the budget proposes to introduce the MHRTC, which would provide a refundable credit of up to $7,500 for constructing a secondary suite for a senior or an adult with a disability living with a relative. The credit would allow families to claim 15% of up to $50,000 in eligible renovation and construction costs incurred in order to construct a secondary suite.

This measure will apply for the 2023 and subsequent taxation years.

Support for those in housing need

The government recognizes that many Canadians are struggling with housing costs and are in need of additional assistance. The budget proposes to provide a one-time $500 payment to those facing housing affordability challenges. The specifics and delivery method will be announced at a later date.

Residential property flipping rule

Property flipping involves purchasing real estate with the intention of reselling the property in a short period of time to realize a profit. Profits from flipping properties are fully taxable as business income, meaning they are not eligible for the 50% capital gains inclusion rate or the Principal Residence Exemption (PRE).

To ensure profits from flipping residential real estate are always subject to full taxation, the budget proposes to introduce a new deeming rule. Specifically, profits arising from dispositions of residential property (including a rental property) that was owned for less than 12 months will be deemed to be business income.

The new deeming rule would not apply for individuals who sell their home due to certain life events such as death, household addition, separation, personal safety, disability or illness, employment change, insolvency or involuntary disposition. Exemptions will be set in forthcoming rules and there will be a consultation period for the draft legislative proposals.

Where the new deeming rule applies, the PRE would not be available. Where the new deeming rule does not apply because of a life event listed above or because the property was owned for 12 months or more, it would remain a question of fact whether profits from the disposition are taxed as business income.

The measure will apply in respect of residential properties sold on or after January 1, 2023.

Ban on foreign investment in Canadian housing

To ensure housing is affordable to Canadians, the government proposes restrictions that will prohibit foreign commercial enterprises and people who are not Canadian citizens or permanent residents from acquiring non-recreational, residential property in Canada for a period of two years.

Exemptions to the ban will be provided to those who have been authorized to come to Canada under emergency travel while fleeing international crisis and international students who are on the path to permanent residency in certain circumstances.

The government will continue to monitor the impact that foreign investment is having on Canadian housing costs and may introduce additional measures to strengthen the proposed ban. Non-Canadians who own homes that are being underused or left vacant will be subject to the Underused Housing Tax that was announced in the 2021 budget.

Personal measures and tax changes

Dental care for Canadians

The government proposes to provide funding to Health Canada to provide dental care for Canadians. This will start with under 12-year-olds in 2022, and then expand to under 18-year-olds, seniors and persons living with a disability in 2023, with full implementation by 2025. The

program would be restricted to families with an income of less than $90,000 annually and no co-pays for those with income under $70,000 annually.

Medical Expense Tax Credit (METC) for surrogacy and other expenses

The METC is a 15% non-refundable tax credit for eligible medical expenses in respect of products and services received by a patient. Currently, the patient must be the individual, the individual's spouse or common-law partner or certain dependants.

The budget proposes to provide a broader definition of patient in cases where an individual would rely on a surrogate or a donor in order to become a parent. In these cases, a patient could be the individual; their spouse; a surrogate mother; or a donor of sperm, ova or embryos. In addition, the budget proposes to allow reimbursements by an individual of medical expenses incurred by a surrogate or donor and fees paid to fertility clinics and donor banks in order to obtain donor sperm or ova to be eligible for the METC.

Only expenses incurred in Canada and that are in accordance with the *Assisted Human Reproduction Act* and associated regulations would be eligible. This measure will apply to expenses incurred in the 2022 and subsequent taxation years.

Labour Mobility Deduction for Tradespeople (LMDT)

Temporary relocations to obtain employment may not currently qualify as deductible moving or travel expenses, particularly if they do not involve a change in an individual's ordinary residence and the employer does not provide relocation assistance.

To recognize certain travel and relocation expenses of workers in the construction industry, the budget proposes to introduce the LMDT, which would allow eligible workers to deduct up to $4,000 in eligible expenses per year.

This measure will apply to the 2022 and subsequent taxation years.

Business tax changes

Small business deduction

Canadian-controlled private corporations (CCPCs) are taxed federally at the small business rate of 9% on the first $500,000 of active business income (the business limit). Currently the business limit is reduced on a straight line basis when:

a. the combined taxable capital employed in Canada of the CCPC and its associated corporations is over $10 million and is fully eliminated when this amount is $15 million; or

b. the combined adjusted aggregate investment income of the CCPC and its associated corporations is over $50,000 and is fully eliminated when this amount is $150,000.

The business limit applicable to the small business rate is $500,000 minus the above-mentioned business limit reductions.

The budget proposes to extend the taxable capital range to increase the amount of combined taxable capital employed in Canada of the CCPC and its associated corporations before a grind-down to the business limit occurs. The new range would be $10 million and fully eliminated at $50 million.

These changes will apply to taxation years that begin on or after April 7, 2022.

Substantive CCPCs

The Canadian income tax system aims to achieve neutrality by ensuring that income earned directly by a Canadian-resident individual is taxed at roughly the same rate as income earned through a corporation. This concept is known as integration.

The government is aware that tax planning, which includes non-CCPC planning, is currently used to avoid paying the additional refundable corporate income tax that would otherwise be paid on investment income earned in these corporations. This may be done in a number of ways, such as by moving a corporation into a foreign low-tax jurisdiction, by using foreign shell companies, or by moving passive portfolios to an offshore corporation.

The budget proposes targeted amendments to the Income Tax Act (ITA) to ensure that, for taxation years that end on or after April 7, 2022, investment income earned and distributed by private corporations that are, in substance, CCPCs (substantive CCPCs) is subject to the same taxation as investment income earned and distributed by CCPCs.

Substantive CCPCs would be private corporations resident in Canada (other than CCPCs) that are ultimately controlled (in law or in fact) by Canadian-resident individuals.

The budget also proposes targeted amendments to the ITA to eliminate the tax-deferral advantage available to CCPCs and their shareholders earning investment income through controlled foreign affiliates.

These measures will generally apply to taxation years that begin on or after April 7, 2022.

Genuine intergenerational transfers

There is a tax rule that prevents taxpayers from converting dividends into lower-taxed capital gains using certain self-dealing transactions—a practice referred to as "surplus stripping." In 2021, legislation was passed to introduce an exception to this rule in order to help facilitate intergenerational business transfers.

The budget notes the exception may unintentionally permit surplus stripping, without requiring that a genuine intergenerational business transfer takes place. As such, the government is announcing a consultation process for Canadians to share their views on how the existing rules can be modified to protect the integrity of the tax system, while still facilitating genuine intergenerational business transfers.

Employee ownership trusts

Employee ownership trusts can be used to facilitate the transition of privately owned businesses to employees. To encourage the use of employee ownership trusts, the budget proposes to create a dedicated type of trust under the ITA to support employee ownership.

Implementing a publicly accessible beneficial ownership registry

The government intends to increase transparency around ownership of assets, including businesses and expensive property. They intend to accelerate their commitment by two years to amend the Canada Business Corporations Act to implement a public and searchable beneficial ownership registry for federally incorporated businesses, which will now be accessible before the end of 2023.

Canada Recovery Dividend (CRD) and additional tax on banks and life insurers

The budget proposes to introduce the CRD in the form of a one-time 15% tax on bank and life insurer groups. A group would include a bank or life insurer and any other financial institution that is related (for certain purposes) to the bank or life insurer.

The CRD would be determined based on a corporation's taxable income for taxation years ending in 2021. The CRD liability would be imposed for the 2022 taxation year and would be payable in equal amounts over five years.

The budget also proposes to introduce an additional tax of 1.5% of the taxable income for members of bank and life insurer groups. The proposed additional tax will apply to taxation years that end after April 7, 2022. For a taxation year that includes April 7, 2022, the additional tax will be prorated based on the number of days in the taxation year after April 7, 2022.

Exchange of tax information on digital economy platform sellers

The digital economy includes the sharing and gig economies and online sellers of goods. In Canada, taxpayers who earn business income including those carrying on business through online platforms have to report the income to the Canada Revenue Agency (CRA).

To address concerns of underreported income, the Organisation for Economic Co-operation and Development (OECD) has developed model rules for reporting by digital platform operators with respect to platform sellers.

The budget proposes to implement the model rules in Canada. This measure will apply to calendar years beginning after 2023.

Environmental business tax changes

Phasing out flow-through shares for oil, gas and coal activities

The budget proposes to eliminate the flow-through share regime for fossil fuel sector activities. This will be done by no longer allowing expenditures related to oil, gas and coal exploration and development to be renounced to flow-through share investors for flow-through share agreements entered into after March 31, 2023.

Critical Mineral Exploration Tax Credit (CMETC)

Currently, individuals who invest in mining flow-through shares are entitled to a 15% Mineral Exploration Tax Credit (METC) on specified mineral exploration expenses that are renounced to them. The budget proposes a new 30% CMETC for renounced exploration expenses of specified minerals used in the production of batteries, permanent magnets, semi-conductors and other clean technologies. The rules for the CMETC will generally follow the existing METC rules. Eligible expenditures would not benefit from both the CMETC and METC. The CMETC will apply to expenditures renounced under eligible flow-through share agreements entered into after April 7, 2022, and on or before March 31, 2027.

Credit for carbon capture, utilization and storage (CCUS)

CCUS is a suite of technologies that capture carbon dioxide (CO_2) emissions from fuel combustion, industrial processes or directly from the air, to either store the CO_2 (typically deep underground) or use the CO_2 in industry.

The budget proposes a refundable investment tax credit (ITC) for businesses that incur eligible CCUS expenses, starting in 2022. The ITC would be available to CCUS projects to the extent that they permanently store captured CO_2 through an eligible use. Eligible CO_2 uses include dedicated geological storage and storage of CO_2 in concrete, but does not include enhanced oil recovery.

Clean technology tax incentives – air-source heat pumps

The budget proposes to allow the accelerated tax deductions for business investments in clean energy equipment to include air-source heat pumps. This measure will be effective for the air-source heat pumps acquired and become available for use on or after April 7, 2022.

In addition, the budget proposes to include the manufacturing of air-source heat pumps as an eligible zero-emission technology manufacturing or processing activity. This means a 50% reduction of the general corporate and small business income tax rates would apply to related manufacturing and processing income. The reduced tax rates will apply to taxation years that begin after 2021, subject to a phase-out starting in taxation years that begin in 2029, and would be fully phased out for taxation years that begin after 2031.

Changes for charities

Annual disbursement quota (DQ) for registered charities

Registered charities are generally required to expend a minimum amount each year, referred to as the DQ. The DQ is currently equal to 3.5% of the registered charity's property not used directly in charitable activities or administration. The budget proposes to make a number of changes to increase expenditures by larger charities, and to improve the enforcement and operation of the DQ rules.

The budget proposes to increase the DQ rate from 3.5% to 5% for the portion of property not used in charitable activities or administration that exceeds $1 million.

In addition, the budget proposes to clarify that expenditures for administration and management are not considered qualifying expenditures for the purpose of satisfying a charity's DQ. The budget also proposes changes to the relief provisions relating to the DQ.

These measures will apply to charities in respect of their fiscal periods beginning on or after January 1, 2023.

Charitable partnerships

Under the ITA, registered charities are limited to devoting their resources to charitable activities they carry on themselves or providing gifts to qualified donees. Where charities conduct activities through an intermediary organization (other than a qualified donee), they must maintain sufficient control and direction over the activity such that it can be considered their own.

The budget proposes a number of changes to improve the operation of these rules, allowing charities to make qualified disbursements to organizations that are not qualified donees, provided that they meet certain accountability requirements.

In addition, in order to be considered a qualifying disbursement, charities will be required to meet certain mandatory accountability requirements defined in the ITA that are designed to ensure their resources will be used for charitable purposes.

These changes will apply as of royal assent of the enacting legislation.

International tax measures

Canada has joined other members of the OECD on a two-pillar plan for international tax reform agreed to on October 8, 2021.

Pillar One is intended to reallocate a portion of taxing rights over the profits of the largest and most profitable multinational enterprises (MNEs) to market countries (i.e. where their users and customers are located). As a back-up plan, if this tax framework does not come into force by 2024, the government can impose a previously proposed Digital Services Tax (DST).

Pillar Two is intended to ensure the profits of large MNEs are subject to an effective tax rate of at least 15%, regardless of where they are earned.

Previously announced tax measures

The budget confirms the government's intention to proceed with previously announced legislative proposals including, but not limited to:

- Luxury tax
- Digital services tax
- Enhanced trust reporting rules
- Allocation to redeemers methodology for mutual fund trusts

Prior to implementing any strategies, individuals should consult with a qualified tax advisor, legal professional or other applicable professional.

While it has been the long-standing practice of the CRA to allow taxpayers to file their tax returns based on proposed legislation, a taxpayer remains potentially liable for taxes under current law in the event that a budget proposal is not ultimately passed. Therefore, if proposed legislation does not become law, it is possible that the CRA may assess or re-assess your tax return based on existing legislation. It is recommended that you consult a professional tax advisor to assist you in assessing the costs and benefits of proceeding with specific budget proposals as they relate to you.



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