2022

Federal budget

Insights from our
Tax & Estate Planning professionals

RICHARDSON
Wealth

On April 7, 2022, Deputy Prime Minister and Finance Minister Chrystia Freeland released the Liberal Government's federal budget ("Budget 2022"). This is her second federal budget, as well as the first federal budget since the Liberal Government and the New Democratic Party reached a temporary "confidence and supply agreement" back in March 2022.

As the title *A Plan to Grow Our Economy and Make Life More Affordable* suggests, Budget 2022 is focused on measures intended to assist Canadians with affordability (particularly when it comes to housing, child care, and health care), with some measures on climate action and investing in innovation and productivity.

Insight:

Some good news — Budget 2022 does **not** propose changes to the following items:

- **Personal income tax rates and brackets**;
- The **capital gains inclusion rate of 50%**; and
- **Corporate income tax rates** (except for certain banks and insurance companies).

The following is a summary of the Budget 2022 proposals that we believe are of interest to Richardson Wealth clients, as well as our insights on them.

Housing Affordability Measures

Tax-Free First Home Savings Account (FHSA)

Budget 2022 proposes the creation of the FHSA, a registered account intended to help individuals save for their first home. If enacted, individuals will be able to start contributing to FHSAs **starting in 2023**.

In order to open an FHSA, the following conditions must be satisfied:

- The individual must be a **resident of Canada** and **at least 18 years of age**; and
- The individual must not have lived in a home that they owned either at any time in the year the FHSA is opened, or during the preceding four calendar years.

An eligible individual can only use the FHSA in respect of a single property in their lifetime. An eligible individual is permitted to contribute up to an **annual limit of $8,000**, with a **lifetime limit of $40,000**.

Insight:

The unused portion of the annual limit does not carry over to future years. For example, if you contribute $6,000 to your FHSA in 2023, you cannot carry over the $2,000 room not used and contribute $10,000 in 2024. Your contributions in 2024 would remain limited to $8,000. You would still have a lifetime limit of $40,000.

The benefits of the FHSA are that:

- Contributions are **tax-deductible**; and
- Amounts withdrawn to fund the purchase of a qualifying first home, **including the investment income generated within the account**, are **not taxable**.

Insight:

The FHSA effectively combines the benefits of a Registered Retirement Savings Plan (RRSP) on contributions and a Tax-Free Savings Account (TFSA) on withdrawals.

Once a FHSA is opened, an individual is required to use the funds in the account for a qualifying first home purchase within 15 years; otherwise, the account will have to be closed. Once a non-taxable withdrawal is made from an individual's FHSA to purchase a qualifying first home, they are required to close the account within a year from the first withdrawal and are no longer eligible to open another FHSA. Furthermore, withdrawals or transfers from a FHSA do not replenish contribution limits.

In the event there are unused funds remaining at the time a FHSA is required to be closed, an individual could potentially:

- **Withdraw the funds on a taxable basis**; or
- **Transfer the funds to an RRSP** or **Registered Retirement Income Fund (RRIF) on a tax-deferred basis**, without impacting their existing RRSP contribution room. Tax would become payable once funds are withdrawn from the RRSP or RRIF.

For added flexibility, an individual can also transfer funds from their RRSP to their FHSA on a tax-free basis, subject to the same annual $8,000 and lifetime $40,000 limits. These transfers will not replenish an individual's RRSP contribution room.

Insight:

The existing **Home Buyers' Plan (HBP)** will continue to be available to you; however, you cannot make both an FHSA withdrawal and an HBP withdrawal for the same home purchase.

As background, the HBP allows individuals to withdraw up to $35,000 from their RRSP to purchase or build a home without having to pay tax on the withdrawal. HBP withdrawals are required to be repaid to an RRSP over a period not exceeding 15 years.

Boosting Existing Housing Tax Credits

Budget 2022 proposes the following with respect to existing federal housing tax credits:

- An increase to the **First-Time Home Buyers' Tax Credit** amount from $5,000 to **$10,000** for purchases of qualifying first homes made on or after **January 1, 2022**. This equates to a non-refundable federal credit of **$1,500**.
- An increase to the expense limit of the **Home Accessibility Tax Credit** from $10,000 to **$20,000** for eligible home renovation or alteration expenses incurred in the **2022 and subsequent taxation years**. This equates to a non-refundable federal credit of up to **$3,000**.

Insight:

If you participate in the FHSA to save for the purchase of your first home, you could benefit from a tax-free withdrawal on a down-payment (under the FHSA) as well as an additional $1,500 in tax relief (under the enhanced First-Time Home Buyers' Tax Credit).

Multigenerational Home Renovation Tax Credit

Budget 2022 proposes a new **Multigenerational Home Renovation Tax Credit** for qualifying renovation expenses incurred to create a secondary dwelling unit for an eligible person to live with a qualified relation. An eligible person could be an individual **at least 65 years of age and disabled persons at least 18 years of age (who are eligible for the Disability Tax Credit)**.

If enacted, the credit would apply for the **2023 and subsequent taxation years**, in respect of work performed and paid for and/or goods acquired on or **after January 1, 2023**.

The expense limit for this credit is **$50,000**, which equates to a federal credit value of **up to $7,500. The credit is refundable.**

Qualifying renovation expenses include the cost of labour and professional services, building materials, fixtures, equipment rentals and permits. Items such as furniture, appliances, and construction equipment and tools would not qualify, nor would recurring or routine repair and maintenance costs and financing costs. All expenses must be supported by receipts.

Residential Property Flipping Rule

Profits realized on the disposition of residential property are generally taxable as capital gains eligible for the 50% capital gains inclusion rate; however, where individuals are engaged in "property flipping" (i.e., purchasing and selling properties in a short period of time for profits), such gains are fully taxable as business income.

The determination of whether an individual is engaged in residential property flipping is subjective in nature. As a result, Budget 2022 proposes to introduce a new rule that deems any profits arising from dispositions of residential property (whether personal-use or rental-use) to be **fully taxed as business income**. This deeming rule automatically applies if the residential property was **owned for less than 12 months**.

If enacted, the new rules would apply to residential properties disposed **on or after January 1, 2023**.

The government intends to provide exceptions to the deeming rule for those who dispose of their residential property due to certain life events, which could include: death, birth of a child, breakdown of a marriage or common-law partnership, disability or illness, and employment changes.

Insight:

If the profit on the disposition of a principal residence is deemed to be taxed as business income under the Residential Property Flipping Rule, the **principal residence exemption cannot be claimed** as it is only available against profits on principal residences that are taxed as capital gains.

Note that holding properties for more than 12 months does not necessarily mean profits will always be taxed as capital gains. A similar anti-flipping concept already exists according to the positions of tax authorities and the courts, but it applies on a case-by-case basis looking at facts and circumstances. Now this deeming rule automatically applies if the residential property was owned for less than 12 months.

Potential Ban on Foreign Investment in Canadian Housing

The government has raised concerns of Canadians being priced out of the housing market due to foreign money coming into the country to acquire residential property. Therefore, Budget 2022 announces the government's intention to propose restrictions that would prohibit those who are not Canadian citizens or permanent residents and foreign commercial enterprises from acquiring Canadian non-recreational, residential property for a **period of two years**.

Refugees, international students on the path to permanent residency, and individuals in Canada on work permits are expected to be exempt from this potential ban.

No proposed rules or effective dates have been announced. Details on this potential ban are expected to be released by the government in the future.

Insight:

It appears that this ban would only apply to new acquisitions of residential properties by foreigners. Foreigners who already own properties in Canada may, however, be exposed to the annual 1% "**Underused Housing Tax**" that was announced in Budget 2021, once it is enacted.

Other Housing Affordability Measures

Other items contained in Budget 2022 intended to facilitate housing affordability include:

- An extension of the **First-Time Home Buyer Incentive** (a shared-equity mortgage with the government) to March 31, 2025.
- A proposal to provide a **one-time payment of $500** to those facing housing affordability challenges in 2022-23. Additional details on this payment will be announced by the government in the future.

Potential New Minimum Tax for High Earners

While Budget 2022 does not propose any changes to personal income tax rates and brackets, it announces the government's intention to examine a **new minimum tax regime targeting certain high earners** who pay relatively little in personal income tax as a share of their income. The government's research shows that in 2019, 28% of filers with gross income over $400,000 paid an average federal personal income tax rate of 15% or less.

The government will release more details on this measure in their 2022 fall economic and fiscal update.

Insight:

Canada's federal income tax laws already contain an "**Alternative Minimum Tax**" (AMT) regime intended to target high earners who are able to use deductions and credits to significantly reduce their tax liabilities. For example, you may find yourself having to pay AMT in years where you claim your lifetime capital gains exemption (of up to $913,630 in 2022) on dispositions of shares of qualified small business corporations.

It is unknown at this time how a new minimum tax regime will integrate with the existing AMT.

Flow-Through Investment Measures

In line with the government's commitment towards the green transition and climate action, Budget 2022 proposes the following measures that will impact individuals who participate in flow-through share investments:

- **The elimination of the flow-through share regime for oil, gas, and coal activities** by disallowing oil, gas, and coal exploration or development expenditures to be renounced to a flow-through share investor. If enacted, this change would apply to expenditures renounced under flow-through share agreements entered into **after March 31, 2023**.
- **The introduction of a new 30% Critical Mineral Exploration Tax Credit** for specified minerals used in the production of batteries and permanent magnets used in clean technology and zero-emission vehicles. If enacted, this new credit would apply to expenditures renounced under eligible flow-through share agreements entered into **after April 7, 2022 and on or before March 31, 2027**.

Taxes on Banks and Life Insurers

Budget 2022 proposes the following measures that will impact Canada's largest banks and insurance companies who, in the government's opinion, made significant profits during the COVID-19 pandemic and need to contribute more in order to support the country's recovery:

- **The introduction of the Canada Recovery Dividend (CRD)**. The CRD is a **one-time 15% tax on bank and life insurer groups on taxable income over $1 billion for taxation years ending in 2021**. If enacted, the CRD would be **imposed for the 2022 taxation year** and would be **payable in equal amounts over five years**.
- **An increase in the corporate income tax rate by 1.5%** on taxable income for members of bank and life insurer groups that exceed **$100 million**. If enacted, the tax rate increase would apply to taxation years that end after **April 7, 2022**.

Insight:

It is possible that the cost to banks and life insurer groups of these two proposals will be passed down to customers and investors in the form of higher fees and lower dividends.

Expanded RRSP and RRIF Reporting

Currently, financial institutions are required to annually report to the Canada Revenue Agency payments out of, and contributions to, each RRSP and RRIF they administer. Budget 2022 proposes to require financial institutions to also annually report to the Canada Revenue Agency **the total fair market value (at the end of the calendar year) of property held in each RRSP and RRIF they administer**.

If enacted, the reporting would apply to the **2023 and subsequent taxation years**.

Insight:

Financial institutions are already required to annually report to the Canada Revenue Agency the fair market value of property held in each TFSA they administer. It appears the extension of this reporting obligation to RRSPs and RRIFs is intended to assist the Canada Revenue Agency with its review of whether investments held by RRSPs and RRIFs are qualified investments..

Charitable Tax Measures

A registered charity is required to meet a minimum "**disbursement quota**" (DQ) each year. The DQ is currently 3.5% of a registered charity's property not used directly in charitable activities or administration.

To boost investments into communities by registered charities, Budget 2022 proposes to increase the "**disbursement quota**" (DQ) of registered charities from 3.5% to **5%** for the portion of investment assets not used in charitable activities or administration that **exceeds $1 million**. Investment assets under $1 million would still be subject to the DQ of 3.5%.

If enacted, the change will apply to registered charities in respect of their fiscal periods beginning on or **after January 1, 2023**.

Insight:

You may be impacted by this measure if you have set up your own **private foundation**. You may also be impacted by this measure if you have set up a **Donor Advised Fund** through an existing registered charity, since the charity (as a whole) is subject to the DQ.

Health Care Measures

Some of the notable items contained in Budget 2022 intended to strengthen the country's health care include:

- A proposal to provide Health Canada with funding to provide dental care to Canadians with family incomes of **under $90,000 annually**, starting with **under 12-year-olds in 2022** and expanding to **under 18-year-olds, seniors, and disabled persons in 2023**, with **full implementation by 2025**. Furthermore, Canadians with family incomes of **under $70,000 annually will not have co-pays**.
- The announcement of the government's intention to continue working towards a **universal national pharmacare program**. The government aims to have legislation tabled **by the end of 2023**.
- A proposal to allow medical expenses **incurred within Canada** in the **2022 and subsequent taxation years** related to **surrogacy or sperm, ova, or embryo donations** to be eligible expenses under the **Medical Expense Tax Credit**.

Insight:

In the 2022 taxation year, the non-refundable Medical Expense Tax Credit is available for eligible medical expenses in excess of the lesser of **$2,479 or 3% of your net income**.

Child Care

The government had announced in Budget 2021 its intention to work closely with provincial and territorial partners to build a **national system** that will provide families access to **high-quality and affordable early learning and child care**. The government aimed to reduce average regulated early learning and child care fees by **50% as early as the end of 2022**, with the ultimate goal to reduce these fees down to an **average of $10 per day by 2025-26**.

In Budget 2022, the government announced that it had reached agreements with all 13 provinces and territories and is on track to achieve its target of reducing child care fees by an average of 50% by the end of 2022. This is expected to result in a marked improvement in labour market participation by women with children.

Private Company Tax Measures

Small Business Deduction Limit

The **small business deduction limit** provides a **Canadian-controlled private corporation (CCPC)** with a lower federal income tax rate of **9% on up to $500,000 of active business income**. However, existing rules reduce the small business deduction limit on a straight-line basis when either:

- The combined "**taxable capital employed in Canada**"[1] of the CCPC and its associated corporations is **between $10 million and $15 million**; or
- The combined "**adjusted aggregate investment income**" of the CCPC and its associated corporations is **between $50,000 and $150,000**.

Budget 2022 proposes to expand the range over which the small business deduction limit is reduced based on the combined taxable capital employed in Canada of the CCPC and its associated corporations to between **$10 million and $50 million**.

If enacted, this measure will apply for taxation years that begin **on or after April 7, 2022**.

1 A CCPC's "taxable capital employed in Canada" generally refers to its shareholders' equity and debt, with certain adjustments.

Insight:

Even though Budget 2022 expands the range for taxable capital employed in Canada, it does not expand the range for adjusted aggregate investment income. Therefore, CCPCs that generate more than $50,000 of passive investment income such as portfolio dividends, interest, and capital gains will still have their small business deduction limit reduced.

The existing rules reduce the small business deduction limit by **$5 for every $1 of adjusted aggregate investment income over $50,000**, with a full elimination of the limit once such income exceeds **$150,000**.

Substantive CCPC Rules

Canada's income tax system is intended to operate on the concept of "**integration**," where income earned by a Canadian individual is taxed at approximately the same rate as income that is first earned in a CCPC and then distributed out to an individual shareholder.

To achieve integration, investment income earned in a CCPC is subject to an additional refundable tax, which is then fully or partially refunded to the CCPC once it pays out taxable dividends to its shareholders. On the other hand, corporations that are not CCPCs ("**non-CCPC**") are not subject to the refundable tax regime and thus investment income is taxed at regular rates.

Insight:

A CCPC currently pays federal income tax of 38.67% on ordinary investment income (a portion of which is refundable), while a non-CCPC only pays federal income tax of **15%** on the same income. This equates to **a rate differential of 23.67%** on investment income.

In order to take advantage of the lower rate on investment income earned by a non-CCPC, some taxpayers had engaged in sophisticated planning to change their CCPC's tax status to a non-CCPC. This could create significant tax deferral on future capital gains. One way this was done was by continuing the corporation under the laws of a foreign jurisdiction, while still maintaining its Canadian income tax residency by maintaining central management and control in Canada.

In response, Budget 2022 proposes amendments to the Income Tax Act intended to eliminate non-CCPC planning by taxing investment income of a **"substantive CCPC" at the same rates and applying the same refundable tax regime as a CCPC**. A substantive CCPC would be a private corporation resident in Canada that is ultimately controlled (in law or in fact) by Canadian residents.

If enacted, the amendments would apply to taxation years that end **on or after April 7, 2022.**

See the next page for an Update on Bill C-208 Intergenerational Business Transfers.

Update on Bill C-208 Intergenerational Business Transfers

On June 29, 2021, **Bill C-208**, a private Member's bill, was enacted into law. Bill C-208 made amendments to the Income Tax Act with the intention of neutralizing the income tax impact to a taxpayer of transferring an incorporated business, whether to a related party or to an arm's length party.

The Department of Finance, however, expressed concerns that Bill C-208 may inappropriately facilitate tax-motivated business transfers within families, where there is no intention of having the business carried on by the next generation. The Department of Finance had intended to put forth additional amendments to Bill C-208 that could have applied as early as November 1, 2021; however, no amendments were tabled.

Budget 2022 provides an update on the status of Bill C-208 and **announces a consultation process** available to Canadians to share views on how the existing rules could be modified to protect the integrity of the tax system while continuing to facilitate genuine intergenerational business transfers. **The government will accept comments until June 17, 2022**.

Insight:

This suggests that you may still be able to initiate intergenerational business transfers under the less stringent criteria of current Bill C-208, until the government tables amended legislation.

If you wish to learn more about Bill C-208, ask your **Richardson Wealth Advisor** for a copy of our education article on this topic.

Status of Notable Proposals from Prior Federal Budgets

In addition to introducing the key measures outlined above, Budget 2022 confirms the government's intent to proceed with various measures that were announced prior to April 7, 2022. Notable measures that have not yet been enacted include but are not limited to:

- **Enhanced annual reporting requirements by trustees** of most trusts to disclose certain identifying information pertaining to all settlors, trustees, beneficiaries, and other persons that can exert control over such trusts. If enacted, these requirements will apply to trusts with taxation years **ending on or after December 31, 2022**.
- **Select Luxury Items Tax** on new cars and aircraft costing **more than $100,000** and on new boats costing **more than $250,000**. The tax would be calculated at the **lesser of 20% of the value above the aforementioned thresholds and 10% of the full value**. If enacted, the tax would be effective as of **September 1, 2022**.
- **Annual Underused Housing Tax of 1%** on the value of non-resident, non-Canadian-owned residential real estate that is considered to be vacant or underused. If enacted, the tax would be effective as of **January 1, 2022**.
- **Immediate expensing of investments in eligible property** acquired by CCPCs and unincorporated businesses carried on by Canadian-resident individuals. If enacted, the expensing would apply for investments **made on or after January 1, 2022 that become available for use before 2025**, limited to $1.5 million per taxation year.
- **Inclusion of postdoctoral fellowship income as "earned income"** for purposes of the RRSP contribution limit, starting from the **2011 taxation year**.

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