2023

Federal budget

Insights from our
Tax & Estate Planning professionals

RICHARDSON Wealth

On March 28, 2023, Deputy Prime Minister and Finance Minister Chrystia Freeland tabled the Liberal Government's federal budget ("**Budget 2023**").

As the title *A Made-In-Canada Plan: Strong Middle Class, Affordable Economy, Healthy Future* suggests, Budget 2023 is focused on measures intended to assist Canadians with affordability, including new targeted inflation relief for those who need it most, stronger public health and dental care, and investments in a clean economy. While the federal government will not meet its originally-planned balanced budget for 2027/2028, it proposes to use a responsible fiscal plan to invest in Canadian projects and to maintain a low deficit.

Insight:

Budget 2023 **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.

However, for business owners and high-income individuals, significant changes **are** proposed to:

- Intergenerational Business Transfers; and
- The Alternative Minimum Tax.

The following is a summary of the Budget 2023 proposals that we believe are of interest to Richardson Wealth clients, as well as our insights on those proposals.

Personal measures

Updates on Intergenerational Business Transfer Rules enacted in Bill C-208

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 an individual of transferring an incorporated business, whether to a related party or to an arm's length party.

Background:

Prior to Bill C-208, individuals were discouraged from transferring their incorporated business to the next generation from an income tax perspective, because of anti-avoidance rules that would deem the transfer to be taxed as dividends rather than as capital gains. The deemed dividend rules are punitive because:

- Dividends are generally taxed at higher rates than capital gains; and
- The individuals would not be able to claim their lifetime capital gains exemption (of up to $971,190 in 2023) since the transfer would be taxed as dividends.

In contrast, the deemed dividend rules would not apply if the sale of the business were to an arm's length party.

The amendments under Bill C-208 facilitated intergenerational business transfers by excluding the application of the deemed dividend rules on transfers of shares of certain types of corporations to related parties, provided other conditions were met.

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

The Department of Finance 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. Budget 2023 proposes to amend the rules enacted under Bill C-208 to ensure that they apply only on a "**genuine intergenerational business transfer**."

If enacted, the measures would apply to transactions that occur **on or after January 1, 2024**.

Insight:

Individuals are still able to initiate intergenerational business transfers under the less stringent criteria of current Bill C-208, provided the transfer is completed by the end of 2023.

Genuine intergenerational business transfer

A "genuine intergenerational business transfer" is a transfer of shares of a corporation ("Transferred Corporation") by a natural person ("Transferor") to another corporation ("Purchaser Corporation"), where the following conditions are satisfied:

- At the time of the transfer, the shares of the Transferred Corporation are shares of a "qualified small business corporation" or a "family farm or fishing corporation"; and
- At the time of the transfer, the Purchaser Corporation is controlled by one or more persons, each of whom is an adult child of the Transferor. A "child" includes grandchildren, step-children, children-in-law, nieces and nephews, and grandnieces and grandnephews.

Transfer options

Assuming the two conditions above are satisfied, additional proposed conditions need to be met in order for the deemed dividend rules to not apply to an intergenerational business transfer. To provide flexibility, individuals can choose one of the following two transfer options:

1. **Immediate Business Transfer (Three-Year Test)**
2. **Gradual Business Transfer (Five-to-Ten Year Test)**

The Transferor and child(ren) would be required to jointly elect one of the two transfer options, and the child(ren) would be jointly and severally liable for any additional taxes payable by the Transferor if the conditions of the elected transfer option are not satisfied and the deemed dividend rules apply.

Both transfer options look at a number of factors when determining eligibility, but the conditions necessary to fulfill a specific factor will differ depending on the transfer option elected. In general, the Immediate Business Transfer option requires the Transferor to transfer legal and factual control of the Transferred Corporation and management of the underlying business to the next generation within 3 years, while the Gradual Business Transfer option provides a longer period of time (5–10 years) for the Transferor to transfer legal and factual control of the Transferred Corporation and management of the underlying business to the next generation.

The following are the proposed factors to qualify as a genuine intergenerational business transfer under both transfer options:

- Transfer of control of the business;
- Transfer of economic interests in the business;
- Transfer of management of the business;
- Child retains control of the business; and
- Child works in the business.

Individuals looking to facilitate an intergenerational business transfer should consult their tax advisors to review these proposals, including the specific conditions required to qualify under the two transfer options.

Insight:

The proposed conditions under the two transfer options seek to address perceived deficiencies in the Bill C-208 amendments. For example, the Bill C-208 amendments did not require that the parent cease to control the underlying business of the corporation whose shares are transferred, and did not require the child to be involved in the business or retain an interest in the business after the transfer.

It appears that the Immediate Business Transfer option is intended to provide individuals with clear results earlier in the business transfer process (albeit with more stringent conditions), while the Gradual Business Transfer option is intended to provide individuals with more flexibility and time to transition their business over to the next generation.

Capital gains reserve

Budget 2023 proposes to extend the maximum capital gains reserve period from 5 years to **10 years** for genuine intergenerational business transfers under the two transfer options.

Insight:

For sales of capital properties where proceeds are received over a number of years, a **capital gains reserve** can be claimed to defer the recognition of the total capital gain realized. Under the default capital gains reserve rules, a taxpayer can only spread out the total capital gain over a maximum of 5 years, with a minimum of 20% of the total capital gain included in income each year. To the extent proceeds received in one year exceed the minimum 20%, a larger proportion of the total capital gain will need to be included in income for that year.

Expansion of Alternative Minimum Tax (AMT) for high-income individuals

While the government did not propose any changes to personal income tax rates and brackets, it proposes numerous changes to the AMT regime to target high-income individuals.

The government's intention to examine an expanded AMT regime was originally announced in Budget 2022, out of concern that certain high-income individuals were paying relatively little in personal income tax as a share of their income.

Background:

Canada's federal income tax laws currently include an AMT regime that calculates personal income tax in a manner that permits fewer deductions, exemptions, and credits than under the ordinary income tax regime. Rather than the progressive rate structure under the ordinary income tax regime, the AMT regime currently applies a flat 15% tax rate on taxable income, with a standard $40,000 exemption amount.

An individual would pay total income tax equal to the greater of the "minimum tax" calculated under the AMT regime, and the tax calculated under the ordinary income tax regime.

For example, you may be subject to the AMT in years where you claim your lifetime capital gains exemption on dispositions of shares of qualified small business corporations.

Under current rules, additional tax paid as a result of the AMT can generally be carried forward for 7 years to be credited against regular tax, to the extent regular tax exceeds minimum tax in those years. The AMT does not apply in the year of the individual's death. The government intends on maintaining the carry forward period.

Note that provinces and territories also impose their own AMT, which is often based on the amount of federal AMT payable.

The proposed changes to the AMT regime would come into force for taxation years that **begin after 2023**. A summary of the key changes are below. The government is expected to provide additional details later this year.

Increasing the AMT rate

The government proposes to increase the AMT rate from 15% to **20.5%**, to correspond to the rates applicable to the first and second federal income tax brackets, respectively.

Raising the AMT exemption amount

The government proposes to increase the AMT exemption amount from $40,000 to the **start of the fourth federal income tax bracket**, and proposes to index the exemption amount annually to inflation. Based on expected inflation, the exemption amount for 2024 would be approximately **$173,000**.

Insight:

The current AMT regime provides a non-indexed exemption amount of $40,000 to all individuals and graduated rate estates. Trusts, which are taxed as individuals, have not qualified for the exemption amount. Budget 2023 does not propose to extend the exemption amount to trusts.

Broadening the base of taxable income subject to AMT

In computing taxable income under the AMT regime, the government proposes the following changes.

Capital gains and losses

Increase the capital gains inclusion rate from 80% to **100%** for the purposes of computing taxable income under the AMT regime. However, the capital gains inclusion rate for capital gains eligible for the lifetime capital gains exemption would stay at **30%**.

Capital loss carryovers and allowable business investment losses would apply at a **50%** inclusion rate.

Example:

In 2024, you sell publicly listed securities and realize a capital gain of $1,000,000. Assume no other transactions occur and no other income is earned for the year.

Under the ordinary income tax regime, you would report a taxable capital gain of $500,000. Under the proposed AMT regime, you would report a taxable capital gain of $1,000,000.

Your minimum tax under the proposed AMT regime would be approximately $169,500, because this is higher than your federal tax under the ordinary income tax regime (approximately $138,600).

Stock options

Include **100%** of the benefit associated with employee stock options for the purposes of computing taxable income under the AMT regime.

Donations of publicly listed securities

Include **30%** of capital gains on donations of publicly listed securities for the purposes of computing taxable income under the AMT regime. This is to match the proposed treatment of capital gains eligible for the lifetime capital gains exemption. The government also proposes to apply the 30% rate to the full benefit associated with employee stock options to the extent that a deduction is available because the underlying securities are publicly listed securities that have been donated.

Insight:

Under the current ordinary income tax regime, capital gains on donations of publicly listed securities can qualify for a 0% capital gains inclusion rate. This proposed change means that individuals who make significant donations of publicly listed securities after 2023 may become exposed to the AMT.

Deductions and expenses

Disallow **50%** of certain deductions and expenses for the purposes of computing taxable income under the AMT regime. Some examples include but are not limited to:

- Employment expenses, other than those incurred to earn commission income;
- Deductions for Canada Pension Plan, Quebec Pension Plan, and Provincial Parental Insurance Plan contributions;
- Moving expenses;
- Child care expenses;
- Disability supports deduction;
- Interest and carrying charges incurred to earn income from property; and
- Non-capital loss carryovers.

Non-refundable credits

Permit only **50%** of non-refundable tax credits to be claimed under the AMT regime, with the following exceptions:

- The Special Foreign Tax Credit would continue to be allowed in full and would be based on the new AMT tax rate of 20.5%.
- The AMT regime would continue to use the actual (not grossed-up) value of Canadian dividends and would continue to fully disallow the Dividend Tax Credit.
- The AMT regime would continue to fully disallow certain non-refundable tax credits, such as the non-refundable portion of Investment Tax Credits.

Affordability measures

Budget 2023 proposes several measures to support middle- and lower-income families as they struggle with higher grocery prices, housing costs, and ongoing inflationary pressure on buying power. As well, it recognizes that the rapid rise in interest rates in Canada and abroad has impacted economic growth and global financial market volatility. Below are several measures that the government proposes to support Canadians and their families.

The Grocery Rebate

A targeted one-time rebate has been proposed to provide an increase in the maximum Goods and Services Tax Credit (GSTC) amount that would be known as the "**Grocery Rebate**." The GSTC is non-taxable, income-tested, and indexed to inflation, and is intended to offset the impact of GST on low- and modest-income Canadians.

Eligible individuals would receive an additional GSTC amount equivalent to twice the amount received for January 2023. The maximum amount of the Grocery Rebate would be:

- $153 per adult;
- $81 per child; and
- $81 for the single supplement.

Insight:

The Grocery Rebate can provide up to the following amounts for eligible Canadians:

- $467 for a couple with 2 children;
- $234 for a single person without children; and
- $225 for a senior.

The Grocery Rebate will be paid **as soon as possible following the passage of legislation.**

Registered Education Savings Plan (RESP) improvements

Changes are proposed for RESPs to ease access to students and to families for the accumulation of savings for post-secondary education for their children.

Budget 2023 proposes that the following changes to be effective on Budget Day (March 28, 2023):

- *Allowing divorced or separated parents to open joint RESPs for one or more of their children*
  At present, only spouses or common-law spouses are permitted to jointly subscribe to an RESP, although an RESP opened prior to divorce or separation can be maintained afterwards. This proposal will increase access to education savings for more families.
- *Increasing the withdrawal limits for Education Assistance Payments (EAPs)*
  When an RESP beneficiary is enrolled in an eligible post-secondary program, government grants and investment income can be withdrawn from the plan as EAPs which are taxable in the beneficiary's hands. Current rules limit the amount of EAPs that can be withdrawn in the first 13 consecutive weeks of enrolment in a 12-month period to $5,000 for beneficiaries in full-time programs and $2,500 for beneficiaries in part-time programs. The proposal would increase these limits to **$8,000 for full-time students** and **$4,000 for part-time students** during the 13-week period.

Insight:

With proposed changes coming into force on Budget Day, individuals who withdrew EAPs prior to Budget Day may be able to withdraw an additional EAP amount, subject to the new limits. Terms of existing plans may need to be amended by RESP promoters in order to apply the new EAP withdrawal limits.

Note that EAPs may be withdrawn up to 6 months after the beneficiary ceases to be enrolled in an eligible program.

Registered Disability Savings Plan (RDSP) changes

RDSPs are designed to support the long-term financial needs of a beneficiary who is eligible for the Disability Tax Credit. Under the current rules, where a beneficiary is age 18 or older and their mental capacity is in doubt, only the beneficiary's guardian or legal representative is able to open an RDSP for their benefit. It can be a long and arduous formal process to appoint a formal guardian or legal representative.

Budget 2023 proposes to extend and ease the ability of a "qualifying family member" (defined currently as a parent, spouse, or common-law partner) to open an RDSP in respect of a beneficiary whose mental capacity is in doubt, with the following changes:

- A 3-year extension to the current temporary measure which allows a "qualifying family member" to open an RDSP for an individual whose contractual capacity is in doubt, and who does not have a legal representative formally in place. This temporary measure would be extended from December 31, 2023 to **December 31, 2026**.
- Broaden the definition of a "qualifying family member" to include a brother or sister of the beneficiary. This temporary measure would also be in effect until **December 31, 2026**.

Insight:

Assuming the proposals are enacted, where a family member recognizes that an individual is eligible for the Disability Tax Credit and could benefit from saving in an RDSP, but the individual's contractual capacity is in doubt and no formal guardian or legal representative is in place to open an RDSP, the parent, spouse, common-law partner, or sibling should consider establishing an RDSP for the beneficiary prior to December 31, 2026.

Note that an individual who becomes a "qualifying family member" and plan holder before the end of 2026 can remain the plan holder after 2026.

New Canadian Dental Care Plan

Budget 2023 proposes to expand the Canadian Dental Care Plan with funding to Health Canada starting in 2023–24 of $13.0 billion over 5 years and $4.4 billion ongoing. This plan will provide dental care to uninsured Canadians with family incomes of under $90,000 annually, with no co-pays for those with family incomes of under $70,000 annually.

The plan would **begin by the end of 2023** with further details on eligible coverage to be released later this year.

Additional funding will also be provided to expand access to dental care through the Oral Health Access Fund, which complements the Canadian Dental Care Plan by addressing oral health gaps among vulnerable populations, including rural and remote communities.

Insight:

This new plan is an extension of the government's Canada Dental Benefit, which was announced in September 2022. Applications opened in December 2022 to provide eligible parents or guardians with direct, tax-free payments of up to $1,300 over 2 years, per child, to cover the cost of dental care for their children under 12 years old.

Housing affordability measures

Budget 2023 continues to provide support for making housing more affordable. The following are some of the key measures:

- **Launch of the Tax-Free First Home Savings Account (FHSA)**. Introduced in Budget 2022, Budget 2023 announces that financial institutions will be able to start offering FHSAs to Canadians as of April 1, 2023, pending development of appropriate platforms at each institution.

Note:

For more details on how the FHSAs will help eligible Canadians to save for their first homes, ask your **Richardson Wealth Advisor** for a copy of our education article on this topic.

- **New guidelines to provide relief for mortgage payments**. Canadians are facing exceptional circumstances in their ability to make mortgage payments, particularly in relation to variable rate mortgages where interest rates have risen exceptionally fast. The new guidelines, in conjunction with the Financial Consumer Agency of Canada, will protect and provide appropriate relief measures including extending amortizations, adjusting payment schedules or authorizing lump-sum payments.
- **Investments in Urban, Rural, and Northern Indigenous Housing Strategy**. Budget 2023 proposes to commit an additional $4 billion, over 7 years, starting in 2024-25 to implement this strategy.

Other proposed affordability measures

- **Reduce "junk fees"** to ensure businesses are transparent with pricing. Junk fees could include higher telecom roaming charges, event and concert fees, excessive baggage fees, and unjustified shipping and freight fees.
- **Lower credit card fees for small businesses** by securing commitments from credit card companies, such as Visa and Mastercard, to lower credit card interchange fees.
- **Implement a "right to repair"** framework by 2024 to reduce the trend for Canadians to buy new appliances instead of repairing existing appliances due to high repair costs and lack of access to replacement parts. This will reduce costs and harmful waste.

- **Establish a standard charging port** (such as the USB-C charging port) for all small handheld devices and laptops by the end of 2024. By exploring this with international stakeholders, the government aims to reduce the need for Canadians to buy a new charger every time they purchase a new device.
- **Provide for auto-filing of tax returns** for an expanded group of low-income Canadians to quickly and easily file their taxes for free.
- **Ease the Retirement Compensation Arrangement (RCA)** expenses for employers who support unfunded RCAs for executives.
- **Enhance student financial assistance** programs starting on August 1, 2023.
- **Strengthen retirement savings for personal support workers**, who are the backbone of long-term care for Canadians, but are often women in low-income situations.
- **Crack down on predatory lenders** by consulting on and changing the Criminal Code to protect vulnerable people (including low-income Canadians, newcomers, and seniors) from lenders who extend very high interest rate loans.

Did you know?

The current "criminal rate of interest" under the Criminal Code is equivalent to 47% APR (annual percentage rate). In Quebec, the maximum interest rate for consumers is currently 35%.

Budget 2023 announces the federal government's intention to lower the criminal rate of interest from the equivalent of 47% APR to 35% APR and to launch consultations on potential further reductions. Further, the government intends to require payday lenders to charge no more than $14 per $100 borrowed.

Business measures

Tax on share buybacks by Canadian publicly listed entities

Budget 2023 proposes an annual tax on the net value of all types of share repurchases by certain entities. If enacted, the tax would apply in respect of repurchases and issues of equity that occur **on or after January 1, 2024**.

Entities subject to the share buyback tax include:

- Canadian publicly listed corporations (excluding mutual fund corporations); and
- Real estate investment trusts, specified investment flow-through (SIFT) trusts, and SIFT partnerships listed on a designated stock exchange.

The tax would be equal to **2%** of the net value of an entity's repurchase of equity (i.e., fair market value of equity repurchased, less the fair market value of equity issued from treasury).

The tax would not apply to an entity in a taxation year if it repurchased less than $1 million of equity during that taxation year, as determined on a gross basis.

Insight:

A share buyback is a transaction in which a corporation redeems its stock from its shareholders. Redemption proceeds are usually in the form of cash.

It appears the intention of this proposed tax is to encourage Canadian publicly listed entities to use their excess cash to reinvest in their businesses, rather than to buy back shares. This proposal is akin to a tax on share buybacks recently introduced in the United States.

Modernizing the General Anti-Avoidance Rule (GAAR)

The GAAR was enacted in 1998 to prevent abusive tax avoidance transactions while not interfering with legitimate commercial and family transactions. If GAAR applies to abusive tax avoidance transactions, the associated tax benefits would be denied.

To modernize the GAAR, Budget 2023 proposes the following amendments to the GAAR to ensure its continued effectiveness:

- Include a preamble to the GAAR to help address interpretive issues and ensure it applies as intended;
- Reduce the threshold for the avoidance transaction test in the GAAR from a "primary purpose" test to a "one of the main purposes" test;
- Require that the determination of the economic substance of transactions be considered at the "misuse

or abuse" stage of the GAAR analysis, and that a lack of economic substance tends to indicate abusive tax avoidance;
- Introduce a penalty for transactions subject to the GAAR, equal to 25% of the tax benefit; and
- Extend the normal reassessment period for GAAR assessments by 3 years unless the transaction was disclosed to the CRA.

Budget 2023 announces a consultation process available to stakeholders to share their views on the GAAR proposals. The consultation period is open until **May 31, 2023**. Following the consultation period, the government intends to publish revised legislative proposals and announce the application date of the amendments.

Employee Ownership Trusts (EOT)

An EOT is a form of employee ownership where a trust holds shares of a corporation for the benefit of the corporation's employees. An EOT may be advantageous to facilitate the purchase of a business by employees without requiring them to pay directly to acquire shares. This can facilitate continuity of an active business and succession planning for the previous business owner.

Budget 2023 proposes new qualifying conditions to facilitate the use of the structure and changes to tax rules to ease the establishment of EOTs. If enacted, the measures would apply as of **January 1, 2024**.

Qualifying conditions

A trust would be considered an EOT if it is a Canadian resident trust that has only the following purposes:

- To hold a controlling interest in the shares of one or more qualifying businesses for the benefit of the employee beneficiaries of the trust; and
- It would make distributions to employee beneficiaries under a distribution formula that would consider the employee's length of service, remuneration, and hours worked.

A qualifying business would need to meet certain conditions, including, among others, that all or substantially all of the fair market value of its assets are attributable to assets used in an active business carried on in Canada.

Facilitating the establishment of EOTs

To facilitate the establishment and use of EOTs, certain tax rules would be modified, including the following:

- *Ten-year capital gains reserve* – Budget 2023 proposes to extend the existing 5-year capital gains reserve to a 10-year reserve for qualifying business transfers to an EOT. A minimum of 10% of the gain would be required to be brought into income each year.
- *Exception to shareholder loan rules* – Budget 2023 proposes to extend the shareholder loan repayment period from 1 to 15 years for amounts loaned to the EOT from the qualifying business to facilitate the transfer.
- *Exception to 21-year rule* – Budget 2023 proposes to exempt EOTs from the existing 21-year deemed disposition rule for trusts.

Growing a clean economy

Budget 2023 proposes several new investment tax credits meant to support clean technology projects, including the following:

- Clean Electricity Investment Tax Credit
- Clean Hydrogen Investment Tax Credit
- Clean Technology Manufacturing Investment Tax Credit
- Clean Technology Investment Tax Credit—Geothermal Energy
- Reduced tax rates for Zero-Emission Technology Manufacturers
- Enhanced Carbon Capture, Utilization, and Storage Investment Tax Credit
- Extension of the Flow-Through Shares and Critical Mineral Exploration Tax Credit to include Lithium from Brines