Advanced Wealth Planning Group

2023 Federal Budget

WELLINGTON-ALTUS

Economic and Tax Highlights from the 2023 Federal Budget

On March 28, 2023, Canada's Deputy Prime Minister and Minister of Finance, the Honourable Chrystia Freeland delivered the 2023 Federal Budget.

Budget 2023 outlined plans to build a stronger, more sustainable and secure Canadian economy against a backdrop of slower global growth, elevated global interest rates, and high inflation.

Together with incremental policy actions implemented following the 2022 Fall Economic Update, Budget 2023 projects deficits of $43.0B for 2022-23, $40.1B for 2023-24, and $35.0B for 2024-25. As a percentage of GDP, the federal deficits are expected to be 42.4% for 2022-23, 43.5% for 2023-24 and 43.2% for 2024-25.

Quick Facts:

- No change to personal or corporate income tax rates.
- No change to the capital gains inclusion rate.
- No change to the principal residence exemption.
- No wealth tax introduced.
- Multiple clean technology incentives introduced.
- Details on the 2% share buyback tax.
- Expansion of Canadian dental benefit.
- One-time grocery rebate.
- Refocusing government spending to a pre-pandemic path.

5 Key Takeaways from Budget 2023 for Wellington-Altus Clients

This document provides details in the 2023 Budget that may be of particular interest:

1. Changes to the Alternative Minimum Tax (AMT)
2. Changes to the General Anti-Avoidance Rule (GAAR)
3. Changes to the Intergenerational Business Transfer Framework – Amendments to Bill C-208
4. Facilitating Business Transfers – Employee Ownership Trusts
5. Personal Tax Measures to Help with the Rising Cost of Living

Alternative Minimum Tax (AMT) for High-Income Individuals

Originally introduced in 1986, the AMT was designed to ensure that the highest-income Canadians could not disproportionately lower their tax bill through advantages in the tax system. Budget 2023 proposes several changes to the existing AMT calculation. Additional details will be released later this year, but the key features proposed for the new AMT regime include:

Broadening the AMT Base

Budget 2023 includes several proposals to broaden the AMT base by further limiting "tax preferences" that may occur in claiming exemptions, deductions, and credits, including:

- Increasing the capital gains inclusion rate to 100% from 80% yet maintaining capital loss carry-forwards and allowable business investment losses at 50%.
- Including 100% of the benefit associated with employee stock options.
- Including 30% of the capital gains on donations of publicly listed securities, mirroring the treatment of capital gains eligible for the lifetime capital gains exemption.
- Disallowing 50% of the following deductions – regular employment expenses, CPP/QPP deductions, moving expenses, childcare expenses, deduction for social assistance/workers' compensation/Guaranteed Income Supplement and Allowance payments, interest and carrying charges incurred to earn income from property, deduction for limited partnership losses of other years, and non-capital loss carryovers.
- Allowing only 50% of non-refundable credits to reduce the AMT, subject to various exceptions.

Raising the AMT Exemption

- The government proposes raising the AMT exemption from $40,000 to the start of the fourth federal tax bracket, which is anticipated to be $173,000 in 2024. The exemption amount would be indexed annually.

Increasing the AMT Rate

- Increasing the AMT rate from 15% to 20.5% corresponding to rates applicable to the first and second federal income tax brackets.

Under these reforms, more than 99% of the AMT anticipated to be collected would be paid by individuals who earn more than $300,000 per year, and about 80% of the AMT paid would be by those who earn more than $1 million per year.

The proposed changes would come into force for taxation years that begin after 2023.

General Anti-Avoidance Rule (GAAR)

The GAAR was introduced in 1988 to help tackle abusive tax avoidance transactions. The government identified that the GAAR rules needed to be modernized and strengthened to ensure it remained effective while not interfering with legitimate commercial and family transactions.

As a result of a consultation paper released last August, Budget 2023 proposes several amendments to the existing GAAR legislation by introducing a preamble, changing the avoidance transaction standard, implementing an economic substance rule, introducing a penalty, and extending the GAAR reassessment period.

Preamble

The proposed preamble addresses common interpretive issues when applying the GAAR, primarily that GAAR will be interpreted as intended.

Avoidance Transaction

Under current legislation, for the GAAR to apply, the "primary purpose" of the transaction must be to obtain a tax benefit. Budget 2023 proposes that the GAAR move from a "primary purpose" test to a "one of the main purposes" test when reviewing potential GAAR transactions. By moving away from a "primary purpose" test, the government is lowering the standard for when GAAR could apply, as the "one of the main purposes" test is considered a less burdensome or lower standard to meet.

Economic Substance

In determining if the transaction misused or abused tax legislation to obtain a tax benefit, an analysis of economic substance has also been proposed in Budget 2023. This reflects the government's belief that a lack of economic substance can often indicate abusive tax avoidance transactions. A potential for pre-tax profit; whether the transaction has resulted in a change of economic position; and whether the transactions is entirely (or almost entirely) tax motivated are identified as indicators that a certain transaction may lack economic substance.

Penalty

If a transaction is subject to the GAAR, the proposals include a penalty equal to 25% of the tax benefit obtained. Where the tax benefit is a tax attribute that has not yet been used to reduce tax, the tax benefit would be considered nil.

Reassessment Period

Citing the complexity of many GAAR transactions, and the difficulties detecting them, the government has proposed extending the normal reassessment period by three years for GAAR assessments, with certain exceptions.

Further Consultation

The government has opened a consultation period for interested stakeholders which will end May 31, 2023. Following the consultation period, revised proposals and application dates will be published.

Changes to the Intergenerational Business Transfer Framework

For years, Canadian business owners complained that rules designed to prevent them from withdrawing corporate surplus at capital gains rates (rather than the higher dividends rates) also prevented them from selling their businesses to the next generation in a tax-efficient manner. This so-called "anti-surplus stripping rule" had the effect of penalizing business owners who sold their corporations to their families, rather than an arm's length party, by limiting their ability to claim their lifetime capital gains exemption and obtain capital gains treatment on the sale of shares to a corporation controlled by a non-arm's length person. Legislation enacted on June 29, 2021, commonly referred to as Bill C-208, sought to correct this issue and significantly broadened the scope of permissible intergenerational business transfers. The Department of Finance indicated at the time that the rules were too permissive and that it intended to narrow the scope of such transfers.

Budget 2023 provides amendments to Bill C-208 to ensure that only "a genuine intergenerational business transfer" will qualify under these rules. The type of business transfer at issue is where an individual (Parent) sells the shares of a corporation (Opco) to a non-arm's length corporation (ChildCo). The proposals maintain the existing conditions that each share of the Opco be a "qualified small business corporation share" or a "share of the capital stock of a family farm or fishing corporation" (both as defined in the *Income Tax Act*), at the time of the transfer (i.e. the lifetime capital gains exemption could apply on the gain from the sale) and that the purchasing ChildCo must be controlled by one or more persons each of whom is an adult child or grandchild of the Parent (referred to as Child).

Proposed Amendments

Notably, Budget 2023, proposes to expand the meaning of Child to include stepchildren, children-in-law, nieces, nephews, grandnieces, and grandnephews of the Parent. This change would allow intergenerational transfers of a business to family members beyond only children and grandchildren as was contemplated in Bill C-208.

The amendments outline five conditions for a "genuine intergenerational business transfer":

1. Transfer of control of the business (both legal and factual)
2. Transfer of economic interests in the business (i.e., equity participation in the growth of the business)
3. Transfer of management of the business within a reasonable time (36 months safe harbour)
4. Acquisition and continued control of the business by the Child; and
5. Active involvement by the Child in the business.

These conditions must be met within certain timelines, depending on the transfer option selected. Budget 2023 proposes that Parent and ChildCo jointly elect between two transfer options:

1. An immediate intergenerational business transfer (three-year test); and
2. A gradual intergenerational business transfer (five-to-10-year test).

The first option, the immediate transfer rule, would have the characteristics of an arm's length business transfer. Control and a majority of participating shares of Opco must be transferred to ChildCo at the time of sale, with the remaining voting and participating shares being transferred within 36 months. The Child must retain legal control of Opco and at least one Child must be actively involved in the business for 36 months following the sale.

The second option, the gradual transfer rule, allows the Parent to retain a fixed economic interest in Opco for a longer period and is more aligned to a traditional estate freeze and redemption plan. Voting control (but not effective control) and a majority of participating shares of Opco would be transferred on sale, with the remaining voting and participating shares being transferred within 36 months. Under this option, the Parent could maintain a fixed economic interest in Opco, to be reduced gradually over 10 years (down to 50% or 30% depending on the type of share). The Child must retain legal control of Opco and at least one Child must be actively involved in the business for 60 months following the sale or until the transfer is completed (if later).

Extended Reserve

Budget 2023 also proposes an extended 10-year capital gains reserve for qualifying genuine intergenerational transfers. This will allow a transferring Parent to better align their tax liability relating to the transfer with the receipt of the proceeds from the transfer.

Joint and several liability

Parent and Child are made jointly and severally liable for any additional tax on these transfers if the conditions for a genuine intergenerational transfer are not met. This joint liability recognizes that both Parent and Child could, by their actions, cause the conditions to not be met.

Limitation Period

Budget 2023 also proposes to extend the limitation period for assessing these types of transfers by three years for an immediate business transfer, and 10 for a gradual business transfer.

These proposed amendments would come into force on January 1, 2024.

Employee Ownership Trusts (EOTs)

Initially introduced in Budget 2021, EOTs provide an additional option for succession planning of Canadian small businesses. Budget 2023 proposes new rules to facilitate the use of EOTs to acquire and hold shares of a business, define qualifying conditions to be an EOT and propose changes to tax rules to facilitate the establishment of EOTs.

Qualifying conditions of an EOT

An EOT is a Canadian resident trust with only two purposes: (1) to hold shares of a qualifying business for the benefit of the employee beneficiaries of the trust, and (2) to make distributions to employee beneficiaries. An EOT would be required to hold a controlling interest in the share of the qualifying business and all or substantially all of an EOT's assets must be shares of a qualifying business. Beneficiaries of the EOT must consist exclusively of qualifying employees who include individuals employed by a qualifying business and any other qualifying businesses it controls, with certain exceptions. In addition, governance, tax treatment and qualifying business transfer considerations for the EOT are addressed.

Facilitating the Establishment of EOTs
To better accommodate the establishment and use of EOTs, Budget 2023 proposes:

- All individuals who dispose of shares in a qualifying business transfer would be eligible to claim an extended 10-year capital gains reserve for qualifying business transfers to an EOT, meaning a minimum of 10% of the gain would be reported each year.
- The introduction of a new exception to extend shareholder loan repayment from the existing one year to 15 years for amounts loaned to the EOT from a qualifying business to purchase shares in a qualifying business transfer. Under normal circumstances, an income benefit is calculated if a shareholder loan exceeds one year from the end of the year in which the loan is made.
- An exemption from EOTs from the 21-year deemed disposition of capital property for Canadian trusts.

The new EOT rules would apply as of January 1, 2024.

Personal Tax Measures to Aid Affordability

Several personal tax measures were announced to help Canadians with the rising cost of living.

Measures for students
Registered Education Savings Plans (RESPs) – Budget 2023 proposes to allow Educational Assistance Payments (EAPs) from RESPs of up to $8,000 (from $5,000) in the first 13 consecutive weeks of enrollment for beneficiaries enrolled in full-time programs, and up to $4,000 per 13-week period for beneficiaries enrolled in part-time programs. As well, Budget 2023 proposes to enable divorced or separated parents to now open joint RESPs for one or more of their children, or to move an existing joint RESP to another promoter.

Both of the proposed changes would come into force on Budget Day.

Budget 2023 proposes to enhance student financial assistance for the 2023/24 school year by increasing Canada Student Grants by 40% ($4,200 for full-time students), raising the interest-free Canada Student Loan limit to $300/week of study, and waiving the requirement for mature students (22 years or older) to undergo credit screening to qualify for federal student grants and loans for the first time. These changes will allow post-secondary students to access up to $14,400 in enhanced Canada Student Financial Assistance for the 2023/24 school year.

Registered Disability Savings Plans (RDSPs)
Budget 2023 proposes to extend the qualifying family member measure an additional three years to December 31, 2026. The qualifying family member measure allows a parent, spouse or common-law partner to open an RDSP and be the plan holder for an adult who lacks capacity to enter into an RDSP contract, and who does not have a legal representative. Budget 2023 also proposes to broaden the definition of a “qualifying family member” to include a brother or sister of the beneficiary who is 18 years of age or older.

The Grocery Rebate
Budget 2023 proposes to introduce a one-time payment through the Goods and Services Tax Credit (GSTC) mechanism to provide targeted inflation relief to approximately 11 million Canadians. The Canada Revenue Agency will arrange for this payment as soon as possible following the passage of legislation.

The maximum amount under the Grocery Rebate would be:

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

Cracking Down on Junk Fees
Budget 2023 announces the government's intention to work with regulatory agencies, provinces and territories to reduce so-called "junk fees" for Canadians, including but not limited to: higher telecom roaming charges, event and concert fees, excessive baggage fees and unjustified shipping and freight fees.

Deduction for Tradespeople's Tool Expenses
Budget 2023 proposes to double the maximum employment deduction for tradespeople's tools from $500 to $1,000, effective in the 2023 tax year.

An Affordable Place to Call Home

The housing proposals contained in Budget 2023 build upon Budget 2022 and the 2022 Fall Economic Update announcements and continue the government's initiatives to make housing more affordable. A recap of these measures include:

- A two-year ban on non-resident, non-Canadians purchasing residential property to help curb speculation and ensure that houses are used as homes for Canadians to live in, rather than as financial assets for foreign investors.
- A one per cent annual underused housing tax on the value of non-resident, non-Canadian owned residential property that is vacant or underused.
- Introducing the Tax-Free First Home Savings Account to allow Canadians to save up to $40,000, tax-free, to help buy their first home. Financial institutions will be able to start offering the Tax-free First Home Savings Account to Canadians as of April 1, 2023.
- Ensuring that profits from flipping properties held for less than 12 months are taxed fully and fairly.
- Doubling the First-Time Home Buyers' Tax Credit to provide up to $1,500 in direct support to home buyers to offset closing costs involved in buying a first home.
- Introducing a refundable Multigenerational Home Renovation Tax Credit providing up to $7,500 in support for construction of a secondary suite for a senior or an adult with a disability, starting in 2023.

- Applying the Goods and Services Tax/Harmonized Sales Tax to all assignment sales of newly constructed or substantially renovated residential housing, to help address speculative trading in the housing market.
- Launching a $4 billion Housing Accelerator Fund to remove barriers and incentivize housing supply growth, with the goal of creating at least 100,000 net new homes across Canada.
- To ensure the dream of home ownership is a possibility for all Canadians, the government will consult on changes required to remove regulatory barriers for homebuyers from diverse communities seeking access to alternative financing products.

Please Note:
Any proposed changes highlighted above are simply proposals until passed into law by the government.