2023 Fall Economic Statement – Tax measures

November 22, 2023

On Nov. 21, 2023, the Honorable Chrystia Freeland introduced the federal government's (the government's) 2023 Fall Economic Statement (the Statement).

The Statement outlines the government's views on the state of the economy and its strategies for addressing housing affordability, supporting workers and building a cleaner economy. In an unusual step, the government announced that it surveyed 12 private sector economists in the process of preparing its economic forecast.

In this article, we summarize the significant tax measures announced in the Statement.

Business Income Tax Measures

Dividend Received Deduction by Financial Institutions - Exception

As we previously reported, the 2023 Federal Budget proposed prohibiting financial institutions from claiming a deduction on dividends received from Canadian-resident corporations on shares that are "mark-to-market" property. The Statement proposes to introduce an exception to this prohibition in situations where the financial institution receives dividends on "taxable preferred shares" as defined in the *Income Tax Act* (Canada) (The Tax Act).

Digital Services Tax (DST)

The Statement affirms the government's commitment to move ahead with the Canadian DST while awaiting consensus from the international community with respect to a multilateral treaty to implement Pillar One, and that forthcoming legislation will allow the government to determine the entry-into-force date of the DST, signalling a possible deferral. In prior announcements the government had stated that that DST legislation would be enacted by Jan. 1, 2024 with retroactive effect to Jan. 1, 2022.

Concessional Loans

Earlier this year, the Supreme Court of Canada refused to hear the taxpayer's appeal in a case involving the tax treatment of "government assistance". In that case (*CAE Inc. v. Canada*, 2022 FCA 178), the entire principal amount of certain low-interest government

loans received by the taxpayer was treated as “government assistance” (not merely the economic value of the below-market interest rate), despite being unconditionally repayable.

As we observed at that time here, this case was extremely surprising, as the Canada Revenue Agency had previously issued a public statement to the effect that it did not apply the provisions in question to low-interest loans that were unconditionally repayable, and if left unchecked this case had the potential to severely reduce the attractiveness and impact of the five new “clean economy” investment tax credits announced by the government over the past 18 months.

The Statement includes the welcome announcement that the Tax Act will be amended to provide that *bona fide* low-or-no-interest loans (concessional loans) with “reasonable repayment terms” from public authorities will generally not be considered “government assistance”. This amendment will come into force on Nov. 21, 2023. Borrowers from government or quasi-government lenders (such as Canada Infrastructure Bank) will be greatly relieved by this development, for which the government should be commended.

Pension Fund Investment

The Statement announces the government’s intention to work collaboratively with Canadian pension funds to create an environment that encourages investments in Canada by pension funds and by other responsible investment pools.

The Statement also announces that the government will explore removing the “30 per cent rule”, which restricts Canadian pension funds from holding more than 30 per cent of the voting shares of most corporations, from investments in Canada.

The government also proposes to require large federally-regulated pension plans to disclose the distribution of their investments, both by jurisdiction and asset-type per jurisdiction, to the Office of the Superintendent of Financial Institutions (OSFI).

Clean Hydrogen Investment Tax Credit (CH-ITC)

The Statement outlines additional requirements for claiming the CH-ITC for clean ammonia production, specifically:

- The taxpayer claiming the CH-ITC for ammonia production must use their own hydrogen from projects that are already eligible for the CH-ITC;
- Ammonia production needs must be met by existing clean hydrogen projects;
- Transportation feasibility requirements.

The Statement provides further details on dual-use equipment for the conversion of hydrogen and ammonia, specifically that the CH-ITC would be allocated based on relative use for each process. Additionally, Carbon Intensity (CI) calculations would consider the ratio or allocation of electricity for such dual-use equipment.

The Statement proposes that the use of renewable natural gas (RNG) would be eligible for the purpose of calculating a project's CI under the Fuel Life Cycle Assessment (LCA) Model maintained by Environment and Climate Change Canada. Use of RNG would be

subject to a variety of conditions including demonstrating that the RNG be purchased in connection with a hydrogen project.

The Statement provides additional details on the LCA model and considerations for project CI assessments used to establish applicable tax credit rates (15 per cent to 40 per cent CH-ITC credit depending on CI tier). The Statement includes details on CI tier considerations such as:

- Verification and compliance timelines for assessing CI tiers;
- Third-party independent verification procedures and reporting to Natural Resources Canada;
- Recovery and interest on CH-ITC where projects fail to meet CI tiers.

Clean Technology Investment Tax Credit (CTI-ITC) and Clean Electricity Investment Tax Credit (CEI-ITC) - Biomass Equipment

The Statement announces the expansion of CTI-ITC and CEI-ITC eligibility for equipment and systems using waste biomass:

- Expanded eligibility for the 30 per cent refundable CTI-ITC – available for taxpayers investing in eligible systems and equipment used for electricity generation, stationary electricity storage, and low-carbon heating systems that use “specified waste materials” to generate electricity or heat or both. Available for investments in eligible property that is acquired and becomes available for use on or after Nov. 21, 2023.
- Expanded eligibility for the 15 per cent refundable CEI-ITC – available for both taxable and non-taxable entities (*i.e.* Crown corporations and publicly owned utilities, corporations owned by First Nations communities, and pension funds) investing in “eligible property” or as part of an eligible integrated system. Available as of the date of Budget 2024.

Accelerated capital cost allowance (CCA) for “specified waste materials” under CCA Classes 43.1 and 43.2 is to include wood waste, plant residue, municipal waste, sludge from an eligible sewage treatment facility, spent pulping liquor, food and animal waste, manure, pulp and paper by-product and separated organics.

The Statement follows through on the government’s commitment to engage with the biofuels industry and promote growth in Canada.

Biomass technology will be required to meet certain heat rate thresholds (11,000 British thermal units/ kWh) and compliance obligations with environmental laws, bylaws and regulations to be considered an eligible property.

The CTI-ITC and CEI-ITC are subject to prevailing union wage and apprenticeship requirements.

Canadian Journalism Labour Tax Credit (CJLTC)

The Statement proposes to (i) increase the cap on labour expenditures per eligible newsroom employee to $85,000 (from $55,000) and (ii) temporarily increase the CJLTC

rate from 25 per cent to 35 per cent for a period of four years. These changes would apply to qualifying labour expenditures incurred on or after Jan. 1, 2023. The credit rate would return to 25 per cent for expenditures incurred on or after Jan. 1, 2027. Transitional rules are also expected to apply.

International Tax Measures

International Shipping

Income from international shipping activities is generally not subject to Canadian corporate income tax. Further, Pillar Two of the two-pillar multilaterally agreed solution for international tax reform (which Canada has proposed to adopt) generally excludes international shipping income from the imposition of top-up tax. A key requirement of the Pillar Two exclusion is that the "strategic or commercial management" of a multinational group's international shipping operations must be located in the jurisdiction where the group books its income.

As shipping companies managed from Canada that have structured their operations to align with Canada's domestic international shipping exemption generally book their international shipping income in the foreign jurisdiction where they are incorporated (that is, where they are deemed resident), they may not qualify for the exclusion from Pillar Two (which would require such companies to book their income where their management is located).

To ensure consistency with international tax norms, the Statement proposes to make the exemption for international shipping income in the Tax Act generally available to Canadian resident companies. This would allow shipping companies with management in Canada to continue their operations in line with Pillar Two and the Tax Act.

This measure would apply to taxation years that begin on or after Dec. 31, 2023.

Sales and Excise Measures

Enhanced GST Rental Rebate

As we previously reported, the government recently implemented an enhanced 100 per cent GST "Rental Rebate" for certain new residential developments projects, which currently limits the eligibility of "cooperative housing corporations" from receiving such rebate. It is now proposed that the enhanced GST Rental Rebate apply to cooperative housing corporations that offer "long-term rental accommodation" on new rental housing, provided that the balance of pre-existing and applicable conditions are satisfied.

Proposed New Joint Venture Election Rules

The Statement announces proposed new GST/HST joint venture election rules. Draft legislative proposals with respect to these proposed measures will be released for public consultation and the government is seeking feedback and comments on these proposed rules by March 15, 2024.

Under the current rules, to simplify tax accounting, a joint venture participant that is a registrant (referred to as the operator) can make an election with another participant (the co-venturer) if the activities under their joint venture agreement are eligible activities set out in subsection 273(1) of the *Excise Tax Act* (Canada) (ETA) or prescribed activities under the *Joint Venture (GST/HST) Regulations*.

The new election rules are proposed to include the following amendments:

- Replacing the condition that the joint venture activities must be eligible activities as set out under subsection 273(1) the ETA or under the *Joint Venture (GST/HST) Regulations* with an all or substantially all commercial activities condition (within the meaning of the GST/HST legislation);
- Requiring all electing joint venture participants to be registered for GST/HST purposes; and
- Replacing existing deeming measures with revised deeming measures that are more specifically focused on tax accounting.

Psychotherapists' and Counselling Therapists' Services

“Psychological services” are currently exempt from GST/HST where provided by psychologists licensed under the applicable association in the province which they practice. To expend upon and clarify the scope of mental health services that are exempt from GST/HST, the Statement proposes that “psychotherapists” and “counselling therapists” be added to the list of “practitioners” contemplated under the ETA. This will require that such individuals be licensed in their respective professions before the services relating thereto are exempt from GST/HST.

Underused Housing Tax (UHT)

The Statement proposes to make various changes to the UHT to help facilitate compliance, while ensuring the tax continues to apply as intended. The government invites Canadians and stakeholders to provide feedback on these proposals by Jan. 3, 2024.

Of note, the Statement proposes to eliminate the filing requirement for an owner of a residential property who is a “Specified Canadian Corporation” (generally a Canadian corporation having less than 10 per cent of its votes and equity value owned by foreign individuals or corporations), who holds the residential property on behalf a “Specified Canadian Partnership” (generally a partnership who partners are exclusively Canadian) or as a trustee of a “Specified Canadian Trust” (generally a trust whose beneficiaries are exclusively Canadians). Currently, these owners are required to file UHT returns despite being exempt from the UHT. The proposed changes would expand the definition of “excluded owner” to include Specified Canadian Corporation, partners of Specified Canadian Partnership and trustees of Specified Canadian Trust. As excluded owners, these owners would no longer have UHT reporting obligations.

The Statement also proposes to expand the definition of “Excluded Owner”, “Specified Canadian Corporation”, “Specified Canadian Partnership” and “Specified Canadian Trust” to provide UHT filing and tax relief for a broader range of Canadian ownership structure. However, the Statement did not provide details with respect to the proposed changes.

These changes would apply in respect of 2023 and subsequent calendar years.

Other proposed changes include:

- Reducing the minimum penalty for failure to file a UHT return from $5,000 to $1,000 for individuals and from $10,000 to $2,000 for corporations, per failure, applicable in respect of 2022 and subsequent calendar years;
- Providing exemption for residential properties held as a place of residence or lodging for employees, anywhere in Canada other than in a population center within a census metropolitan area or census agglomeration having 30,000 or more residents, applicable in respect of 2023 and subsequent calendar years;
- Providing exemption for unitized ("condominiumized") apartment buildings by removing it from the definition of "residential property" for UHT purposes;
- Ensuring that a spousal unit may only claim the "vacation property" exemption for one residential property for a calendar year, effective in respect of 2024 and subsequent calendar years; and
- Extending the filing deadline for 2022 UHT returns to April 2024.

Other Announcements

The Statement contained several other key tax announcements. We anticipate further details on these measures in the coming days:

- **Short-term Rentals**: As part of the Housing Action Plan, effective Jan. 1, 2024, the government proposes to deny income tax deductions for expenses incurred on short term rentals, including interest expenses, in provinces and municipalities that have prohibited short term rentals and in circumstances where the operators are not compliant with applicable provincial or municipal licensing, permitting or registration requirements. The government will also provide municipalities with $50 million over three years to support enforcement actions.
- **Enhanced Capital Gains Exemption for Sales to Employee Ownership Trusts**: The 2023 Federal Budget announced rules for Employee Ownership Trusts to acquire Canadian businesses starting in 2024. To further encourage business owners to consider selling their businesses to Employee Ownership Trusts, the Statement proposes to exempt from tax the first $10 million in capital gains realized on the sale of a business to an Employee Ownership Trust where certain conditions are met. This incentive would initially apply to sales in 2024, 2025 and 2026.

Previously Announced Measures

The government reiterated its commitment to a large number of previously announced tax and related measures dating back to 2019 and affirmed is commitment to enact technical amendments to improve the certainty and integrity of the tax system.

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