



# 2023

## Federal budget overview

*Prepared by the Sun Life Insurance Solutions Tax Team*

Here is a summary of the federal budget speech delivered by the Minister of Finance, The Honourable Chrystia Freeland on March 28, 2023.

To help you understand how the 2023-2024 federal budget affects individuals and businesses financially, our Insurance Solutions Tax Team has provided this analysis.

Here are the highlights.

*Note: There were no changes in personal tax rates or in the capital gains inclusion rate in this budget.*

### 1. Measures concerning individuals

#### **Grocery rebate**

The Goods and Services Tax Credit (GSTC) helps to offset the impact of the GST on low- and modest-income individuals and families.

Budget 2023 proposes to introduce an increase to the maximum GSTC amount for January 2023 that would be known as the Grocery Rebate. The Grocery Rebate would be paid as soon as possible, through the GSTC system.

The maximum amount under the Grocery Rebate would be:

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

There would be no change to the income thresholds at which then, the single supplement would phase in and the GSTC entitlement would phase out.

## **Registered Education Savings Plans (RESPs)**

### *Increasing Educational Assistance Payment withdrawal limits*

When an RESP beneficiary is enrolled in an eligible post-secondary program, government grants and investment income can be withdrawn from the plan as Educational Assistance Payments (EAPs) in order to assist with post-secondary education-related expenses. EAPs are taxable income for the RESP beneficiary.

The *Income Tax Act* requires that RESPs places limits on the amount of EAPs that can be withdrawn. For beneficiaries enrolled full-time (i.e., in a program of at least three consecutive weeks' duration requiring at least 10 hours per week of courses or work in the program), the limit is \$5,000 in respect of the first 13 consecutive weeks of enrollment in a 12-month period. For beneficiaries enrolled part-time (i.e., in a program of at least three consecutive weeks' duration requiring at least 12 hours per month of courses in the program), the limit is \$2,500 per 13-week period.

Budget 2023 proposes to amend the *Income Tax Act* such that the terms of an RESP may permit EAP withdrawals of up to \$8,000 in respect of 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.

These changes would come into force on Budget Day. RESP promoters may need to amend the terms of existing plans in order to apply the new EAP withdrawal limits. Individuals who withdrew EAPs prior to Budget Day may be able to withdraw an additional EAP amount, subject to the new limits and the terms of the plan. The *Income Tax Act* allows for EAPs to be withdrawn up to six months after a beneficiary ceases to be enrolled in an eligible program.

### *Allowing divorced or separated parents to open joint RESPs*

At present, only spouses or common-law partners can jointly enter into an agreement with an RESP promoter to open an RESP. Parents who opened a joint RESP prior to their divorce or separation can maintain this plan afterwards, but are unable to open a new joint RESP with a different promoter.

Budget 2023 proposes to enable divorced or separated parents to open joint RESPs for one or more of their children, or to move an existing joint RESP to another promoter.

This change would come into force on Budget Day.

## **Registered Disability Savings Plans (RDSPs)**

Registered Disability Savings Plans are designed to support the long-term financial security of a beneficiary who is eligible for the disability tax credit. Where the contractual competence of an individual who is 18 years of age or older is in doubt, the RDSP plan holder must be that

individual's guardian or legal representative as recognized under provincial or territorial law. However, establishing a legal representative can be a lengthy and expensive process that can have significant repercussions for individuals. Some provinces and territories have introduced measures that provide sufficient flexibility to address this concern.

### ***Qualifying family members***

A temporary measure, which is legislated to expire on December 31, 2023, allows a qualifying family member, who is a parent, spouse or common-law partner, to open an RDSP and be the plan holder for an adult whose capacity to enter into an RDSP contract is in doubt, and who does not have a legal representative.

Budget 2023 proposes to extend the qualifying family member measure by three years, to December 31, 2026. A qualifying family member who becomes a plan holder before the end of 2026 could remain the plan holder after 2026.

To increase access to RDSPs, Budget 2023 also proposes to broaden the definition of 'qualifying family member' to include a brother or sister of the beneficiary who is 18 years of age or older. This will enable a sibling to establish an RDSP for an adult with mental disabilities whose ability to enter into an RDSP contract is in doubt and who does not have a legal representative.

This proposed expansion of the existing qualifying family member definition would apply as of royal assent of the enabling legislation and be in effect until December 31, 2026. A sibling who becomes a qualifying family member and plan holder before the end of 2026 could remain the plan holder after 2026.

### **Deduction for tradespeople's tool expenses**

Under the deduction for tradespeople's tool expenses, a tradesperson can claim a deduction of up to \$500 of the amount by which the total cost of eligible new tools acquired in a taxation year as a condition of employment exceeds the amount of the Canada Employment Credit (\$1,368 in 2023). The total cost of eligible new tools cannot exceed the total of the employment income earned as a tradesperson and any apprenticeship grants received to acquire the tools, which are required to be included in income.

Budget 2023 proposes to double the maximum employment deduction for tradespeople's tools from \$500 to \$1,000, effective for 2023 and subsequent taxation years.

## 2. Measures concerning businesses

### **Strengthening the intergenerational business transfer framework**

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 that is earned through a corporation. This objective is commonly referred to as integration.

Because capital gains are generally subject to a lower tax rate than dividends, individuals may seek to obtain significant tax benefits by entering into a series of transactions aimed at converting corporate distributions of after-tax business income from their corporations (ordinarily taxed as dividends) into lower-taxed capital gains. This practice undermines integration, resulting in individuals who earn the same amount of income having significantly different tax liabilities.

Section 84.1 of the *Income Tax Act* is designed to address this type of tax planning by re-characterizing the capital gain as a dividend. A private member's bill from the 43rd Parliament (Bill C-208), introduced an exception to section 84.1, effective June 29, 2021, for certain share transfers from parents to corporations owned by their children or grandchildren.

#### ***Bill C-208 follow-up***

Although the stated purpose of Bill C-208 was to facilitate intergenerational business transfers in circumstances where section 84.1 inappropriately applied, the rules introduced by Bill C-208 contain insufficient safeguards and are available where no transfer of a business to the next generation has taken place.

More specifically, the amendments introduced by Bill C-208 do not require that:

- the parent cease to control the underlying business of the corporation whose shares are transferred,
- the child have any involvement in the business,
- the interest in the purchaser corporation held by the child continue to have value, or
- the child retain an interest in the business after the transfer.

#### ***Proposed amendments***

Budget 2023 proposes to amend the rules introduced by Bill C-208 to ensure that they apply only where a genuine intergenerational business transfer takes place. A genuine intergenerational share transfer would be a transfer of shares of a corporation (the Transferred Corporation) by a natural person (the Transferor) to another corporation (the Purchaser Corporation) where a number of conditions are satisfied.

The following existing conditions would be maintained:

- each share of the Transferred Corporation must 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; and

- the Purchaser Corporation must be controlled by one or more persons each of whom is an adult child of the Transferor (the meaning of “child” for these purposes would include grandchildren, step-children, children-in-law, nieces and nephews, and grandnieces and grandnephews).

To ensure that only genuine intergenerational share transfers are excluded from the application of section 84.1, additional conditions are proposed to be added.

To provide flexibility, it is proposed that taxpayers who wish to undertake a genuine intergenerational share transfer may choose to rely on one of two transfer options:

1. an immediate intergenerational business transfer (three-year test) based on arm’s length sale terms For example, parents immediately and permanently transfer both legal and factual\* control of business, including an immediate transfer of a majority of the voting shares, and a transfer of the balance of voting shares within 36 months.  
\*Factual control means economic and other influence that allows for effective control of a corporation (for example, economic dependence on a person who also acts as the controlling mind) or
2. a gradual intergenerational business transfer (five-to-ten-year test) based on traditional estate freeze characteristics. An estate freeze typically involves a parent crystallizing the value of their economic interest in a corporation to allow future growth to accrue to their children while the parent’s fixed economic interest is then gradually diminished by the corporation repurchasing the parent’s interest. For example, parents immediately and permanently transfer only legal\*\* control (not factual control), including an immediate transfer of a majority of the voting shares (no transfer of factual control), and a transfer of the balance of voting shares within 36 months.  
\*\*Legal control generally means the right to elect a majority of the directors of a corporation.

The immediate transfer rule would provide finality earlier in the process, though with more stringent conditions. In recognition of the fact that not all business transfers are immediate, the gradual transfer rule would provide additional flexibility for those who choose that approach.

Both the immediate and gradual business transfer options would reflect the hallmarks of a genuine intergenerational business transfer.

The rules introduced by Bill C-208 that apply to subsequent share transfers by the Purchaser Corporation and the lifetime capital gains exemption are proposed to be replaced by relieving rules that would apply upon a subsequent arm’s length share transfer or upon the death or disability of a child.

There would be no limit on the value of shares transferred in reliance upon this rule. The Transferor and child (or children) would be required to jointly elect for the transfer to qualify as either an immediate or gradual intergenerational share transfer. The child (or children) would be jointly and severally liable for any additional taxes payable by the Transferor, because of section 84.1 applying, in respect of a transfer that does not meet the above conditions. The joint election and joint and several liability recognize that the actions of the child could potentially cause the parent to fail the conditions and to be reassessed under section 84.1.

In order to provide the Canada Revenue Agency with the ability to monitor compliance with these conditions and to assess taxpayers that do not so comply, the limitation period for reassessing the Transferor's liability for tax that may arise on the transfer is proposed to be extended by three years for an immediate business transfer and by 10 years for a gradual business transfer.

Budget 2023 also proposes to provide a 10-year capital gains reserve for genuine intergenerational share transfers that satisfy the above proposed conditions.

These measures would apply to transactions that occur on or after January 1, 2024.

## **Retirement Compensation Arrangements**

Under the *Income Tax Act*, a retirement compensation arrangement (RCA) is a type of employer-sponsored arrangement that generally allows an employer to provide supplemental pension benefits to employees.

Employers can choose to pre-fund supplemental retirement benefits through contributions to a trust established under an RCA (RCA trust). Under Part XI.3 of the *Income Tax Act*, a refundable tax is imposed at a rate of 50 per cent on contributions to an RCA trust, as well as on income and gains earned or realized by the trust. The tax is generally refunded as the retirement benefits are paid from the RCA trust to the employee.

Employers who do not pre-fund supplemental retirement benefits through contributions to an RCA trust, and instead settle retirement benefit obligations as they become due, can obtain a letter of credit (or a surety bond) issued by a financial institution in order to provide security to their employees. To secure or renew the letter of credit, the employer pays an annual fee or premium charged by the issuer. These fees or premiums are subject to the 50 per cent refundable tax. For example, if the annual fee for a letter of credit is \$100,000, the employer must contribute \$200,000 to the RCA trust, as \$100,000 will be paid to the financial institution to cover the fee and the other \$100,000 will be remitted to the Canada Revenue Agency for the refundable tax.

When retirement benefits become due from an unfunded plan, the employer pays the benefits out of corporate revenues. Consequently, there are no benefit payments from an RCA trust to trigger a 50 per cent refund, and employers are required to fund escalating refundable tax balances with no practical mechanism for recovery.

Budget 2023 proposes to amend the *Income Tax Act* so that fees or premiums paid for the purposes of securing or renewing a letter of credit (or a surety bond) for an RCA that is supplemental to a registered pension plan will not be subject to the refundable tax.

This change would apply to fees or premiums paid on or after Budget Day.

Budget 2023 also proposes to allow employers to request a refund of previously remitted refundable taxes in respect of fees or premiums paid for letters of credit (or surety bonds) by RCA trusts, based on the retirement benefits that are paid out of the employer's corporate revenues to employees that had RCA benefits secured by letters of credit (or surety bonds). Employers would be eligible for a refund of 50 per cent of the retirement benefits paid, up to the amount of refundable tax previously paid.

This change would apply to retirement benefits paid after 2023.

These changes would not affect RCAs that currently use life insurance to fund future benefits.

### **Investment tax credit for clean technology manufacturing**

Budget 2023 proposes to introduce a refundable investment tax credit for clean technology manufacturing and processing, and critical mineral extraction and processing, equal to 30 per cent of the capital cost of eligible property associated with eligible activities.

Investments by corporations in certain depreciable property that is used all or substantially all for eligible activities would qualify for the credit. Eligible property would generally include machinery and equipment, including certain industrial vehicles, used in manufacturing, processing, or critical mineral extraction, as well as related control systems.

Tax integrity rules would apply to recover a portion of the tax credit if eligible property is subject to a change in use or sold within a certain period of time.

#### *Interaction with other federal support*

Businesses would be able to claim only one of the Investment Tax Credit for Clean Technology Manufacturing, the Investment Tax Credit for Clean Technology, the Investment Tax Credit for Clean Electricity, or the Investment Tax Credit for Clean Hydrogen, if a particular property is eligible for more than one of these tax credits.

The Investment Tax Credit for Clean Technology Manufacturing would apply to property that is acquired and becomes available for use on or after January 1, 2024. The Investment Tax Credit for Clean Technology Manufacturing would be gradually phased out starting with property that becomes available for use in 2032 and would no longer be in effect for property that becomes available for use after 2034.

## 3. Other measures

### **Alternative Minimum Tax for high-income individuals**

The Alternative Minimum Tax (AMT) is a parallel tax calculation that allows fewer deductions, exemptions, and tax credits than under the ordinary income tax rules, and that currently applies a flat 15 per cent tax rate with a standard \$40,000 exemption amount instead of the usual progressive rate structure.

The taxpayer pays the AMT or regular tax, whichever is highest. Additional tax paid as a result of the AMT can generally be carried forward for seven years and can be credited against regular tax to the extent regular tax exceeds AMT in those years.

To better target the AMT to high-income individuals, Budget 2023 proposes several changes to its calculation that are described in detail below. Additional details will be released later this year.

### ***Broadening the AMT base***

A number of changes are proposed to broaden the AMT base by further limiting tax preferences (i.e., exemptions, deductions, and credits).

### ***Capital gains and stock options***

The government proposes to increase the AMT capital gains inclusion rate from 80 per cent to 100 per cent. Capital loss carry forwards and allowable business investment losses would apply at a 50 per cent rate. It is also proposed that 100 per cent of the benefit associated with employee stock options would be included in the AMT base.

### ***Lifetime capital gains exemption***

Under current rules, 30 per cent of capital gains eligible for the lifetime capital gains exemption are included in the AMT base. The government proposes to maintain this treatment.

### ***Donations of publicly listed securities***

The government proposes to include 30 per cent of capital gains on donations of publicly listed securities in the AMT base, mirroring the AMT treatment of capital gains eligible for the lifetime capital gains exemption. The 30 per cent inclusion would also apply 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.

### ***Deductions and expenses***

Under the new rules, the AMT base would be broadened by disallowing 50 per cent of the following deductions:

- employment expenses, other than those 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;
- deduction for workers' compensation payments;
- deduction for social assistance payments;
- deduction for Guaranteed Income Supplement and Allowance payments;
- Canadian armed forces personnel and police deduction;
- interest and carrying charges incurred to earn income from property;
- deduction for limited partnership losses of other years;
- non-capital loss carryovers; and
- Northern residents deductions.



Expenses associated with film property, rental property, resource property, and tax shelters that are limited under the existing AMT rules would continue to be limited in the same manner.

### ***Non-refundable credits***

Currently, most non-refundable tax credits can be credited against the AMT. The government proposes that only 50 per cent of non-refundable tax credits would be allowed to reduce the AMT, subject to 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.

The proposed AMT would continue to use the cash (i.e., not grossed-up) value of dividends and fully disallow the Dividend Tax Credit.

Some non-refundable credits that are currently disallowed would continue to be disallowed in full: the Political Contribution Tax Credit, the Labour Sponsored Venture Capital Corporations Credit, and the non-refundable portion of investment tax credits.

### ***Raising the AMT exemption***

The exemption amount is a deduction available to all individuals (excluding trusts, other than graduated rate estates) that is intended to protect lower and middle-income individuals from the AMT.

The government proposes to increase the exemption from \$40,000 to the start of the fourth federal tax bracket. Based on expected indexation for the 2024 taxation year, this would be approximately \$173,000. The exemption amount would be indexed annually to inflation.

### ***Increasing the AMT rate***

The government proposes to increase the AMT rate from 15 per cent to 20.5 per cent, corresponding to the rates applicable to the first and second federal income tax brackets, respectively.

### ***Carry forward period***

The length of the carry forward would be maintained at seven years.

### ***Coming into force***

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

## General Anti-Avoidance Rule

The general anti-avoidance rule (GAAR) in the *Income Tax Act* is intended to prevent abusive tax avoidance transactions while not interfering with legitimate commercial and family transactions. If abusive tax avoidance is established, the GAAR applies to deny the tax benefit created by the abusive transaction.

A consultation on various approaches to modernizing and strengthening the GAAR has recently been conducted. A consultation paper released last August identified a number of issues with the GAAR and set out potential ways to address them.

To respond to the issues raised in the paper and further to the 2022 GAAR consultation, Budget 2023 proposes to amend the GAAR by: introducing a preamble; changing the avoidance transaction standard; introducing an economic substance rule; introducing a penalty; and extending the reassessment period in certain circumstances.

- **Preamble.** A preamble would be added to the GAAR, in order to help address interpretive issues and ensure that the GAAR applies as intended.
- **Avoidance transaction.** The threshold for the avoidance transaction test in the GAAR would be reduced from a “primary purpose” test to a “one of the main purposes” test. This is consistent with the standard used in many modern anti-avoidance rules and strikes a reasonable balance, as it would apply to transactions with a significant tax avoidance purpose but not to transactions where tax was simply a consideration.
- **Economic substance.** A rule would be added to the GAAR at the “misuse or abuse” stage of the GAAR analysis so that it better meets its initial objective of requiring economic substance in addition to literal compliance with the words of the *Income Tax Act*. Currently, Supreme Court of Canada jurisprudence has established a more limited role for economic substance.
- **Penalty.** A penalty would be introduced for transactions subject to the GAAR, equal to 25 per cent of the amount of the tax benefit. Where the tax benefit involves a tax attribute that has not yet been used to reduce tax, the amount of the tax benefit would be considered to be nil. The penalty could be avoided if the transaction is disclosed to the Canada Revenue Agency, either as part of the proposed mandatory disclosure rules or voluntarily. This would build upon the mandatory disclosure rules and ensure that the Canada Revenue Agency has early access to the information it needs to respond quickly to tax risks through informed risk assessments, audits and changes to legislation. As such, a consequential amendment would be made to the proposed reportable transaction rules to permit voluntary reporting.
- **Reassessment period.** A three-year extension to the normal reassessment period would be provided for GAAR assessments, unless the transaction had been disclosed to the Canada Revenue Agency. This extension reflects the complexity of many GAAR transactions, along with the difficulties in detecting them.

## Dividend Received Deduction on shares held by Financial Institutions

The Income Tax Act permits corporations to claim a deduction in respect of dividends received on shares of other corporations, to limit the imposition of multiple levels of corporate taxation on tax paid earnings. Budget 2023 proposes to deny the dividend received deduction in respect of dividends received by financial institutions on shares that are mark-to-market property.

According to the information in the budget, the strategies offered through life insurance should not be impacted by the new rules proposed for the general anti-avoidance rule. Advisors who recommend sophisticated tax planning strategies to clients should review the proposed changes to the GAAR. The proposed changes to the GAAR are meant to make it easier for the CRA to challenge such strategies in the future.

### *Consultation*

The government is interested in stakeholders' views and are invited to send written representations to the Department of Finance Canada, Tax Policy Branch at GAAR-RGAE@fin.gc.ca by May 31, 2023. Following a period of consultation, the government intends to publish revised legislative proposals and announce the application date of the amendments.

## For more information

To find out more about the 2023-2024 Federal Budget, visit [budget.canada.ca](https://budget.canada.ca).

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