2022 Federal Budget

April 7, 2022

Jamie Golombek
Managing Director, Tax and Estate Planning, CIBC Private Wealth

The 2022 federal budget (the “Budget”) included a number of tax measures that will affect Canadian taxpayers. Rather than summarize every tax measure included in the Budget document, this report, which was prepared from within the Budget lock-up in Ottawa, will focus on some of the tax measures that are of most interest to individuals, business owners and charities.

Individuals

A more effective alternative minimum tax?

The top federal tax rate of 33 per cent kicks in at income over $221,708 for 2022. While the Budget introduced no rate changes to the five federal tax brackets, the government expressed concern that despite it having bumped up the top federal bracket to 33% (from 29%) in 2016, “some high-income Canadians still pay relatively little in personal income tax (PIT) as a share of their income.” For example, according to the Budget materials[1], 28 per cent of filers with gross income above $400,000 pay an average federal tax rate of 15 per cent or less by using a variety of tax deductions and tax credits.

While Canada does have an Alternative Minimum Tax (AMT), which has been around since 1986, it hasn't been substantially updated since its introduction. As a result, the government announced its intention to explore a new minimum tax regime, expected to be unveiled in the 2022 fall economic and fiscal update.

Increased reporting requirements for RRSPs and RRIFs

Under the current rules, financial institutions are required to report to the Canada Revenue Agency, annually, any RRSP or RRIF withdrawals and contributions for each RRSP or RRIF plan they administer. Contrast that to the TFSA regime in which financial institutions file a comprehensive annual information return for each TFSA, which includes the fair market value of each account at the end of the calendar year.

The Budget proposed to require financial institutions, beginning in 2023, to start reporting the total fair market value as of the end of each calendar year of RRSP and RRIF accounts as well, which is meant to assist the CRA in its “risk-assessment activities regarding qualified investments held by RRSPs and RRIFs.”

Home owners

The Budget contained a variety of new tax measures for home owners, some of which are summarized below.

Tax-Free First Home Savings Account (“FHSA”)

The Budget introduced more details on the upcoming launch of the Tax-Free First Home Savings Account (FHSA), a new registered account to help individuals save for their first home. Contributions to an FHSA would be tax deductible and income earned in an FHSA would not be taxable while in the plan, nor taxable when qualifying withdrawals are taken to buy a first home.

---

1 Materials from the 2022 Federal Budget are available online at budget.gc.ca/2022/home-accueil-en.html.

To open an FHSA, you must be at least 18 years of age and a resident of Canada. In addition, you can't have lived in a home that you owned either in the year you open the account or during the prior four calendar years. Individuals can only participate once in their lifetime to purchase a single property. Once a non-taxable withdrawal is made towards a qualifying purchase of a home, the FHSA must be closed within one year from the first withdrawal.

There's a lifetime contribution limit of $40,000, and an annual contribution limit of $8,000 beginning in 2023. Unlike RRSP or TFSA contributions, unused annual contribution room cannot be carried forward, meaning an individual contributing less than $8,000 in a given year would still face an annual limit of $8,000 in subsequent years.

And, while you can have multiple FHSAs, the total amount you can contribute to all of your FHSAs can't exceed the annual and lifetime FHSA contribution limits.

To provide greater flexibility, you'll be able to transfer funds from an FHSA to an RRSP (or RRIF) on a tax-deferred basis. Transfers to an RRSP or RRIF won't be taxable at the time of transfer, but amounts will be taxed when withdrawn from the RRSP or RRIF in the usual manner. Transfers will not affect your RRSP contribution room in any way.

If you haven't used the funds in your FHSA for a qualifying first home purchase within 15 years of first opening the FHSA, it must be closed and any unused savings can either be transferred into an RRSP or RRIF, or can simply be withdrawn on a taxable basis.

You'll also be allowed to transfer funds from an existing RRSP to an FHSA on a tax-free basis, subject to the $40,000 lifetime and $8,000 annual contribution limits. These transfers will not restore your RRSP contribution room with respect to the amount transferred.

Note that the Home Buyers' Plan (HBP), which allows individuals to withdraw up to $35,000 from an RRSP to purchase or build a home without having to pay tax on the withdrawal, isn't going away. Amounts withdrawn under the HBP must be repaid to an RRSP over a period not exceeding 15 years, starting the second year following the year of the withdrawal. And while no changes are being made to the HBP rules, you won't be permitted to make both an FHSA withdrawal and an HBP withdrawal for the same home purchase.

It's hoped that Canadians will be able to open an FHSA and start contributing at some point in 2023.

Anti-flipping rule

The government continues to be concerned with individuals who purchase residential real estate with the intention of "flipping" it by selling it in a short period of time to realize a profit. Under our tax law, where properties are "flipped" in this manner, the profit is fully taxable as business income. In other words, they're not eligible for the 50-per-cent capital gains inclusion rate nor the Principal Residence Exemption (PRE).

In recent years, the CRA has been cracking down on perceived abuse of the exemption, most recently with a letter campaign, in which the CRA sent letters to individuals "who may have applied the principal residence exemption in error."

The Budget, therefore, proposed to introduce a new deeming rule to ensure that profits from flipping residential real estate are always subject to full taxation. Specifically, profits arising from the disposition of residential real estate, including a rental property, that was owned for less than 12 months would be deemed to be business income. The PRE will not be available.

The new deeming rule won't apply, however, if the sale or the disposition is related to a life event, including: death, a household addition, separation, personal safety, disability or illness, employment change, insolvency or an involuntary disposition such as an expropriation.

The measure will apply to any sales of residential properties starting on January 1, 2023.

Home Buyers' Amount Tax Credit

The Home Buyers' Amount provides a 15 per cent non-refundable federal credit for first-time home buyers. To qualify, you or your spouse or partner must not have lived in another home owned by you (or your spouse or partner) in the year or in any of the four preceding calendar years. The credit is calculated as 15% of the base amount of $5,000, yielding a maximum tax credit of $750.

The Budget proposed to double the base amount to $10,000. At 15 per cent, this would provide a tax credit of $1,500 to help pay the extra costs of buying a home, including closing costs, legal fees, transfer taxes and inspections. Spouses or partners can continue to split the tax credit, but the total claimed cannot exceed $1,500.

This measure would apply to purchase of a home made on or after January 1, 2022.

Home Accessibility Tax Credit

The Home Accessibility Tax Credit is an existing 15% non-refundable credit that provides recognition of eligible home renovation or alteration expenses made for an individual who is at least 65 or is entitled to the Disability Tax Credit.

The Budget proposed to double the amount eligible for the credit to $20,000 (from $10,000) effective for the 2022 tax year. This increase will provide more support for significant renovations such as building a bedroom or a bathroom on the main level of the house for an individual with mobility challenges accessing other floors of a home.

Multigenerational Home Renovation Credit

The Budget proposed a new Multigenerational Home Renovation Tax Credit which would provide a 15% refundable credit for eligible expenses (up to $50,000) incurred for a qualifying renovation that creates a secondary dwelling unit to permit an eligible person (a senior or a person with a disability) to live with a relative. Qualifying relatives include parents, grandparents, (grand)children over age 18, siblings, aunts, uncles, nieces or nephews.

The credit can be claimed either by the eligible person or by the qualifying relative. A secondary unit would be defined as a self-contained dwelling unit with a private entrance, kitchen, bathroom facilities and sleeping area. It could be newly constructed or created from an existing living space that did not already meet the requirements to be a secondary unit.

Eligible expenses include the cost of labour and professional services, building materials, fixtures, equipment rentals and permits. Items such as furniture are not considered to be integral to the dwelling and therefore won't qualify. Interest costs to finance a renovation will also not be eligible. All expenses must be supported by receipts.

Finally, expenses would not be eligible for the Multigenerational Home Renovation Tax Credit if they are claimed under the Medical Expense Tax Credit and/or the existing Home Accessibility Tax Credit.

The credit can be claimed for the tax year that includes the end of the renovation period and will be available in 2023 for work performed and paid for, and/or goods acquired in 2023.

Medical Expense Tax Credit

The Medical Expense Tax Credit (METC) is a 15-per-cent federal non-refundable tax credit that you can claim on eligible medical expenses. For 2022, the METC is available for medical expenses in excess of the lesser of $2,479 and 3% of your net income. The Budget proposes to expand the METC to include a variety of expenses individuals may incur to become parents in the areas of surrogacy, sperm, ova or embryo donations.

Specifically, medical expenses of a surrogate mother, sperm, ova or embryo donor will now be eligible for the METC where they are paid for by prospective parents. For example, expenses paid by a prospective parent to a fertility clinic for an in vitro fertilization procedure for a surrogate mother or for hormone medication for an ova donor would now be eligible for the METC.

While it's illegal in Canada to pay consideration to surrogate mothers or donors, they are entitled to be reimbursed by prospective parents for certain out-of-pocket expenses, including medical expenses. Under current tax rules, these reimbursements aren't eligible to be claimed by the prospective parents. The Budget proposed to allow such reimbursements to now be eligible for the METC.

Budget 2022 also proposed to allow fees paid to fertility clinics and donor banks in order to obtain donor sperm or ova to be eligible for the METC.

These measures are intended to apply for expenses incurred in 2022 and beyond.

Corporations

Small business deduction

Small business corporations currently benefit from a low federal corporate tax rate of 9%, which compares favourably to the general corporate rate of 15%. This rate reduction is achieved through the "small business deduction" (SBD) which applies on up to $500,000 per year of qualifying active business income of a Canadian-controlled private corporation (CCPC).

This business limit is reduced, on a straight-line basis, when the combined taxable capital employed in Canada of the CCPC (and its associated corporations) is between $10 million and $15 million, or when the combined "adjusted aggregate investment income" of the CCPC[2] (and its associated corporations) is between $50,000 and $150,000.

The Budget proposed to extend the range of taxable capital over which the business limit is reduced, with the new range being $10 million to $50 million, effective for taxation years that begin on or after April 7, 2022. This will allow more businesses to benefit from the SBD rate.

Intergenerational Share Transfers

Under the *Income Tax Act*, there's a variety of rules meant to block "surplus stripping," which is the conversion of a corporation's retained earnings, generally paid out as a taxable dividend, into lower-taxed capital gains. In June 2021, a private member's bill (Bill C-208) was passed which introduced an exception to this rule in order to facilitate legitimate intergenerational business transfers.[3]

The government noted, however, that as a result of these changes, the rules may now "unintentionally permit surplus stripping without requiring that a genuine intergenerational business transfer takes place." To this end, the Budget announced a consultation process to explore how the existing rules could be modified "to protect the integrity of the tax system while continuing to facilitate genuine intergenerational business transfers."

The consultation process is open until June 17, 2022.

Non-CCPC planning

The government has become concerned in recent years with taxpayers who have been "manipulating" the CCPC status of their corporations to avoid paying a refundable corporate income tax that these corporations would otherwise pay on investment income. This was often done by continuing a corporation under foreign corporate law in a low-tax jurisdiction, while maintaining Canadian residency by keeping central management and control in Canada. Other similar plans used foreign shell companies, or moved passive investment portfolios to an offshore corporation.

While the CRA is currently attacking some of that planning through individual cases moving through its audit division, and, ultimately, the Tax Court, and has included this structure in the ambit of proposed mandatory reporting rules, the Budget has proposed that, for taxation years that end on or after April 7, 2022, investment income earned and distributed by private corporations that are, "in substance," CCPCs, will be subject to the same taxation as investment income earned and distributed by CCPCs.

---

[2] For more information, see the CIBC report "CCPC tax planning for passive income," which is available online at cibc.com/content/dam/small_business/day_to_day_banking/advice_centre/pdfs/business_reports/ccpc-passive-income-en.pdf

[3] For more information, see the CIBC report "Selling the Family Business?" which is available online at cibc.com/content/dam/personal_banking/advice_centre/tax-savings/intergenerational-transfers-selling-family-business-en.pdf

Charitable organizations

Disbursement quota

Registered charities must spend a minimum amount each year on their own charitable programs or on gifts to other charities. Known as the disbursement quota (DQ), this required spend is based on the fair market value (averaged over a 24-month period) of a charity's "investment assets", such as real estate or investments that are not used for charitable activities or administration. Currently, the DQ for Canadian charities is set at 3.5 per cent.

The Budget has proposed to bump up the DQ to 5% for the portion of investment assets that exceeds $1 million. Administrative and management fees are not considered qualifying expenditures for the purpose of satisfying the charity's DQ.

That being said, if a charity is unable to meet its DQ, it can apply to the CRA and request relief from the DQ requirement. If this relief is granted, the CRA would then have the ability to publicly disclose information relating to such a decision to the public.

This measure would be effective starting in 2023.

Jamie Golombek, CPA, CA, CFP, CLU, TEP is the Managing Director, Tax & Estate Planning with CIBC Private Wealth in Toronto.

jamie.golombek@cibc.com