Important Tax Changes Coming into Effect in Canada

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The new year has brought with it some important tax changes for businesses and residential property owners in Canada.

(1) Making the Small Business Deduction More Accessible

The small business deduction ("**SBD**") reduces the corporate income tax rate for Canadian-controlled private corporations ("**CCPCs**") to 9%, instead of the general federal corporate tax rate of 15%, on the first $500,000 CAD of its active business income.

A qualifying CCPC receives the full SBD tax credit so long as its aggregate taxable capital employed in Canada in the prior fiscal year does not exceed $10 million CAD. If it does exceed this lower limit, the SBD tax credit is reduced on a straight-line basis until an upper limit of $15 million CAD of aggregate taxable capital. Once their aggregate taxable capital exceeds $15 million, the taxpayer cannot access the SBD. For example, if a CCPC has $12 million CAD as its aggregate taxable capital in the prior fiscal year, the CCPC would be limited to using the reduced rate of 9% on the first $300,000 CAD of its active business income, with the remainder being taxed at the usual 15% rate.

As a result of the new tax changes, the upper limit on taxable capital has increased from $15 million CAD to $50 million CAD. This will allow more medium-sized CCPCs to take advantage of the SBD for taxation years from April 7, 2022, onwards.

(2) New "Excessive Interest and Financing Expenses Limitations" Rules

The Canadian government has revised proposed legislation regarding excessive interest and financing expenses limitations ("**EIFEL**") of a taxpayer. EIFEL aims to limit tax planning strategies used by multinational enterprises to shift profits to low or no-tax locations or erode tax bases by deducting excessive interest and financing costs principally in the context of multinational enterprises and cross-border investments.

The proposed legislation limits the amount of net interest and financing expenses that may be deducted from a taxpayer's income. With the proposed legislation, taxpayers may deduct a fixed ratio of permissible expenses from the taxpayer's adjusted taxable income ("**ATI**"). For the taxation years beginning on or after October 1, 2023, and before January 1, 2024, the fixed ratio will be 40% of permissible expenses. After that period, it will be 30% of permissible expenses. Any taxpayer attempting to shorten a taxation year in the three taxation years preceding October 1, 2023, will be subject to an anti-avoidance rule and result in a fixed ratio of 30%.

Canadian members of a group of corporations and/or trusts may be able to jointly elect to use a group ratio that exceeds the fixed ratio. However, the group ratio rules are complex, and it is advised that you consult with your financial accounting and tax professionals to ensure compliance and eligibility.

The EIFEL rules will not apply to the following "excluded entities" for a particular taxation year:

1. A CCPC corporation that, together with any associated corporations, has taxable capital employed in Canada of less than $50 million CAD;

2. A taxpayer, or an eligible group entity, whose net of interest and financing revenues for the taxation year is $1 million CAD or less;
3. A Canadian-resident taxpayer that is a stand-alone entity or a member of a group where:
    1. all or substantially all of the business, undertakings and activities are carried on in Canada throughout the taxation year;
    2. the greater of the book cost of the group's foreign affiliate shares it holds and the FMV of the assets of all foreign affiliates held by the group does not exceed $5 million CAD;
    3. the particular taxpayer or eligible group entity does not have a non-resident entity who owns shares of the capital stock of the corporation:
        1. that give the holders 25% or more of the votes that could be cast at an annual meeting of the shareholders; and
        2. that have a FMV of 25% or more of the FMV of all the issued and outstanding shares of the corporation; and
    4. such entity is a trust or partnership that can satisfy certain criteria, such groups ought to contact their financial accounting and tax professionals for further details.

(3) Changes to the Reporting Requirements for Trusts

The tax changes also expand the categories of trusts that are required to file a *T3 Trust Income Tax and Information Return* ("**T3**"). All express trusts resident in Canada, including bare trusts, are now required to file a T3 Return for the taxation years ending on or after December 31, 2023, even if there are no taxes payable. Trusts must also disclose information in their T3 regarding the name, address, date of birth, jurisdiction of residence, and taxpayer identification number of each of the following:

1. The trustees;
2. The beneficiaries;
3. The settlors; and
4. Persons who have the ability, through the trust or related agreement, to exert influence over trustee decisions regarding the appointment of income or capital of the trust.

Failing to file a T3 or comply with the new reporting requirements will carry a penalty equal to the greater of $2,500 and 5% of the highest FMV, at any time in the taxation year, of all of the trust's property. There are a number of trusts that will be exempted from these reporting requirements, and it would be prudent to consult with your tax and legal professionals to see if your trust qualifies for an exemption.

(4) Home Renovation Tax Credit for Multigenerational Families

As interest rates and rental fees continue to rise, more families are opting to live in multi-generational homes. Taxpayers who created a secondary dwelling unit for a related family member who is a senior or an adult with a disability, will be eligible to receive a one time 15% tax credit for up to $50,000 in renovation expenses that are incurred within the

taxation year in which the renovation period ends.

The secondary dwelling must be owned by the taxpayer and be where both the family member and the taxpayer intend to ordinarily reside. The dwelling portion can not be greater than one-half hectare and the renovations must be permanent and integral in nature.

(5) Residential Property Flipping May Now Be Considered as Business Income

In the past, some individuals flipping residential real estate reported their income as capital gains and, in some cases, claimed the principal residence exemption. The new residential property flipping rule targets this. Any profits made from the disposition of residential real estate, including rental property, which have been owned for less than 12 months, are deemed to be business income.

However, there are exemptions, and the rule will not apply to dispositions of property related to the following:

1. Death of the taxpayer or a related person;
2. A related person joining the taxpayer's household or the taxpayer joining a related person's household;
3. Separation of a marital partnership or common-law partnership that causes the taxpayer to have lived separately and apart for a period of at least 90 days;
4. Threat to personal safety of the taxpayer or a related person;
5. The taxpayer or a related person suffering from a serious disability or illness;
6. Employment change with the new residence being at lest 40 km closer to the new work location;
7. Insolvency; and
8. Involuntary disposition (e.g. expropriation, destruction, condemnation due to a natural or man-made disaster).

Note that even if a disposition fell under one of the eight exemptions, it would still remain a question of fact and the disposition may still be taxed as business income. This will be an important issue for any real estate agent, home buyer, or real estate investor to consider when evaluating the purchase or sale of a property.

Please note that this bulletin is intended for informational purposes only and does not constitute legal advice. We encourage you to contact your Miller Canfield attorney or one of the authors of this alert if you have questions about how these changes may affect you.