

## Federal Budget 2023 - Summary of Key Tax Measures

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The 2023 federal budget did not make changes to federal personal or corporate tax rates. Instead, the budget broadened the scope of the “Alternative Minimum Tax” rules while increasing the exemption threshold in order to target high income earning individuals. There is a clear focus on combating abusive tax avoidance strategies both domestically and abroad. The budget also provides amendments to existing rules as well as new rules meant to support and facilitate business succession planning with children and employees. Finally, the budget reconfirms and introduces measures to support the middle class through difficult economic times.

The following summarizes the key personal and corporate income tax matters relevant to individuals and small business owner managers.

### Personal Tax Measures

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#### Alternative minimum tax (AMT)

The AMT is a system of taxation that runs parallel to the regular income tax system and calculates an “alternative” tax based on a separate set of rules and is meant to ensure that individuals pay a minimum level of tax each year. Starting in tax years after 2023, the exemption threshold is increased from \$40,000 to the 4<sup>th</sup> federal tax bracket (approx. \$173,000), the tax rate is increased from 15% to 20.5%, and the capital gains inclusion rate is increased from 80% to 100% (inclusion rate for shares eligible for the lifetime capital gains exemption remains at 30%). Other changes include broadening the AMT base through disallowing certain deductions and the reduction of the application of non-refundable tax credits.

**The takeaway:** While the AMT does not “kick in” until a much higher income threshold, its scope has been broadened and when it does apply, the tax rate will be higher.

#### Intergenerational Transfer Rules

In 2021, new rules were introduced to facilitate the transfer of the shares of the business to the adult children of the original owner. These rules were a welcome change as intergenerational transfers were previously taxed less efficiently than transfers to an unrelated party. However, the rules were drafted in such a way that allowed taxpayers to obtain the tax benefits of the rules without actually transferring ownership of the business. The budget introduces modifications for

transactions that occur on or after January 1, 2024, requiring that the transfer be a genuine intergenerational share transfer (specific conditions must be met) under two transfer options:

1. An immediate intergenerational business transfer (three-year test); or
2. A gradual intergenerational business transfer (five-to-ten year test typical in a wasting freeze type of transaction).

The conditions of a genuine intergenerational share transfer include:

1. Transfer of the control of the business;
2. Transfer of the economic interests in the business;
3. Transfer of the management of the business;
4. The requirement for the child to retain control of the business; and
5. The requirement for the child to work in the business.

Other notable changes:

1. Requirement for a joint election by the transferor and child;
2. The Transferor and child will be jointly and severally liable for additional taxes payable should the intergenerational transfer conditions are not met; and
3. Addition of step-children, children-in-law, nieces, nephews, grandnieces, and grandnephews to the definition of “child” for the purpose of this rule.

**The takeaway:** The amendments in the budget add clarity to the existing rules, allow additional flexibility in structuring a business transfer to an adult child, but tightens the criteria to be met in order to qualify.

## Employee Ownership Trusts

Employee ownership trust (EOT) rules, similar to the intergenerational transfer rules, are a new set of rules aimed at facilitating business succession planning, in this case with employees of the business. These rules will be applied as of January 1, 2024. The EOT facilitates the purchase of a business by its employees (a number of conditions apply).

The conditions for an EOT are:

1. It is a Canadian resident trust with Canadian resident trustee(s);
2. It holds controlling interest in a qualifying business for the benefit of the employees;
3. The definition of a qualifying business includes a business where all or substantially all of the fair market value of the assets are used in active business carried on in Canada;
  - a. Qualifying business must not carry on its business as a partner to a partnership
4. Reasonable distributions are made to the employee beneficiaries;
5. Certain governance restrictions limiting individuals with significant interest in the business as the trustees or directors;
6. The employee beneficiaries of the trust would include individuals employed by the qualifying business or other qualifying businesses such business controls, with certain exceptions; and
7. The shares of a qualifying business are disposed of at no more than fair market value, and to either an EOT or a corporation wholly-owned by the EOT.

A correctly structured transaction involving an EOT allows for:

1. Ten-year capital gains reserve (as opposed to the standard five years),
2. Exception to shareholder loans rules for a period of 15 years, and
3. Exception to 21 year trust disposition rule

Taxation of the EOT:

1. EOT is a taxable trust - undistributed trust income subject to top personal marginal tax rate, income distributed will be taxed at the beneficiary level and dividend distributed will retain character
2. EOT would not be permitted to allocate shares of qualifying business to individual beneficiaries

**The takeaway:** The EOT rules are a welcome change for Canadian business owners looking to transition their business to their employees. The new rules address many of the historical challenges and tax-inefficiencies with transitioning a business ownership to employees.

## Other Personal Tax Measures

1. **File My Return service** – targeting low-income Canadians, the federal government plans to increase the number of Canadians eligible for this auto-file tax return service.
2. **Tax-Free First Home Savings Account to be offered as of April 1, 2023** – available to residents of Canada at least 18 years of age who have not owned a home during the current or any of the preceding four calendar years. Such individuals may make a tax deductible annual contribution of \$8,000 up to a lifetime limit of \$40,000, and income earned in this account is not subject to tax.
3. **RESP** – increased withdrawal limits from \$5,000 to \$8,000 in respect of the first 13 consecutive weeks of enrollment in full-time programs, and from \$2,500 to \$4,000 in respective enrollment in part-time programs. Additional amendment relates to allowing divorced or separated parents to open joint RESP for their children, or to move existing RESP to another promoter.
4. **GST tax credit/ Grocery Rebate** – introduction of the Grocery Rebate equal to twice the amount of GST tax credit that an eligible individual would otherwise receive for January 2023, subject to the specified maximum amounts.

## Corporate Tax Measures

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### General Anti-Avoidance Rule

General anti-avoidance rule (GAAR) modification is under public consultation until May 31, 2023 – the addition of a preamble to GAAR to clarify the application of GAAR to ensure the fairness of the tax system, the addition of economic substance test as part of the “misuse and abuse” analysis, the reduction of the threshold for the avoidance transaction test from “primary purpose” to “one of the main purposes”, the introduction of a 25% penalty on the amount of the tax benefit, as well as a three-year extension on the GAAR assessment to the normal assessment period.

**The takeaway:** While the proposed rules are still under consultation, they reconfirm the government’s desire to modernize the GAAR and tackle perceived abusive tax avoidance planning. While effective tax planning remains a crucial part of any business strategy, these proposals highlight the need to be even more careful and deliberate with tax planning in the future.

### Let’s Connect!

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For a more detailed discussion about how these budget measures may impact you or your business, please don’t hesitate to send me an email at [ychu@jtscpa.ca](mailto:ychu@jtscpa.ca) or a text at 778-987-2102.