Grant Thornton

Economic and Fiscal Update 2021

December 14, 2021

Chrystia Freeland, Deputy Prime Minister and Finance Minister, presented the Economic and Fiscal Update 2021—typically known as the Fall Economic Statement (FES)—virtually on December 14, 2021 due to some of her staffers testing positive for COVID-19. Although many in the tax community have been eagerly awaiting several significant measures—including further changes to the intergenerational transfer rules, rules around increased taxation of financial institutions, and immediate expensing of certain capital expenditures for CCPCs—no additional details or draft legislation for these measures were included.

Fiscal update

The FES painted a general picture of our economy, with key indicators suggesting that Canada is at the same place it was prior to the pandemic—and better in some cases. Unemployment rates are down and GDP is up, but the threat of higher inflation and ongoing uncertainty around the pandemic due to the new variant continues to loom.

The following table outlines certain key economic indicators from the FES:

Projected amounts	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026	2026-2027
Deficit	($327.7B)	($144.5B)	($58.4B)	($43.9B)	($29.1B)	($22.7B)	($13.1B)
Debt as % of GDP	47.5	48.0	47.3	46.9	46.2	45.3	44.0

Tax measures

Digital Services Tax

The FES made brief mention of the Digital Services Tax (DST), including the 3% rate and that it would be imposed on January 1, 2024, retroactive to revenues earned as of January 1, 2022.

However, after the release of the FES, the government also released the proposed *Digital Services Tax Act*, which provides greater detail of the potentially forthcoming tax. It's important to note that the DST will only come into force if the OECD's multilateral treaty under Pillar 1 of the Base Erosion and Profit Shifting (BEPS) initiative does not come into force by January 1, 2024. The OECD/G20 Inclusive Framework on BEPS expects that these rules can be put into effect by 2023.

Key characteristics of the DST

- 3% tax rate on revenues from certain digital services involving engagement, data and content contribution of Canadians as well as the licensing and sale of user data.
- Applicable to large domestic and foreign businesses that meet both of the following revenue thresholds:
  - Total Revenue threshold: Consolidated revenue from all sources of €750,000,000 or greater in a fiscal year, and
  - In-scope Revenue threshold: Consolidated revenue from in-scope Canadian revenues of greater than C$20,000,000 in the calendar year.
- DST applies to in-scope revenue in excess of a C$20,000,000 threshold, shared amongst all members of the consolidated group, with certain pro-rata adjustments required when there are changes to the group.
- In-scope revenue is as follows:
  - Online marketplace services revenue: commissions and revenues from providing an online marketplace, as well as premium-service fee revenue. Fees for storage and shipping and financial service providers would be excluded.
  - Online advertising services revenue: fees earned for targeted online advertising, with an anti-cascading rule to prevent taxing the same revenue when paid from one entity in online advertising to another.
  - Social media services revenue: revenue from social media platforms including premium services and facilitating user interaction or user-generated content. Platforms whose sole purpose is to private communication services such as video/voice calls, emails and instant messaging are excluded.
  - User data revenue: revenue from the sale or licensing of user data.

Sourcing and location

- DST applies only to in-scope revenue sourced to Canada. The sourcing of revenue to Canada can be based on the user's location or, if revenue cannot be traced to specific users, on a formulaic approach. Sourcing varies, depending on the type of in-scope revenue.
  - Online marketplace services revenue is based on one of three methods:
    1. If earned from a supply of a service delivered in physical form (e.g., transportation or accommodations) and the service is performed in Canada, sourced entirely to Canada.
    2. If earned from facilitating transaction between users, sourcing depends on location of users. If both in Canada, revenue is sourced entirely to Canada. If only one is in Canada, 50% is sourced to Canada.
    3. If online marketplace revenue cannot be traced to a specific transaction, a formulaic approach applies, based on the percentage of marketplace participants located in Canada.
  - Online advertising services revenue is based on one of two methods:
    1. If revenue can be traced to the display of an advertisement to a specific user located in Canada, it's traced entirely to Canada.
    2. If revenue cannot be traced to specific users, a formulaic approach applies, based on the percentage of users that the advertisement was displayed to located in Canada.
  - Social media services revenue: a formulaic approach applies, based on the percentage of users located in Canada.
  - User data revenue is based on one of two methods:
    1. If revenue can be traced to user data of a single user located in Canada, it's sourced entirely to Canada.
    2. If revenue is from a data set of multiple users, revenue is sourced based on the percentage of those users located in Canada.

- The location of a user is determined based on the user data that the taxpayer has available. This can include the billing or shipping address or phone number that was most recently provided; or GPS or IP address data, where applicable.
- Since some in-scope revenue sources can be based on the location of a user, the user's ordinary location is applicable. For example, a user who is in Canada only on vacation would not be considered to be located in Canada for most cases of in-scope revenue. However, if a targeted advertisement is made or user data is sold based on real-time location, the user's location at the time the advertisement was sold or data is collected would be relevant.

Filing, Payment and Administrative requirements

- Taxpayers that meet two (slightly different) thresholds are required to register for the DST by January 31 of the year following when the thresholds are met:
  - Consolidated revenue from all sources of €750,000,000 or greater in a fiscal year, and
  - Consolidated revenue from in-scope Canadian revenues of greater than C$10,000,000 (not $20 million, as above) in the calendar year
- A DST return will be required to be filed for taxpayers that meet the threshold. The due date for the return and the tax owing will be June 30 of the calendar year following the calendar year for which the return is required to be filed. Note: the deadline is *not* six months after year-end, which is the filing deadline for corporate tax returns in Canada.
- Any one entity in a consolidated group can be designated to fulfill the above-noted filing and payment obligations of the group; however, all members are jointly and severally liable for the tax.
- The DST would potentially be deductible in computing taxable income if incurred for the purpose of earning income, as per general Canadian tax principles. However, no credit is available against income taxes.

Small Businesses Air Quality Improvement Tax Credit

The Small Businesses Air Quality Improvement Tax Credit—arguably the most significant new tax measure in the FES—is meant to encourage small businesses to improve air quality at their place of business.

Its key characteristics are:

- Eligible entities: sole proprietors and Canadian-controlled private corporations (CCPC) with taxable capital less than $15 million in the previous year. Members of partnerships can claim the credit, provided they are either an individual or a qualifying CCPC.
- 25% refundable tax credit on qualifying expenditures (QE)
- Maximum QE of $10,000 per location and $50,000 across all qualifying locations.
- QE must be incurred between September 1, 2021 and December 31, 2022.
  - QEs incurred before January 1, 2022 are claimed in the first tax year ending after January 1, 2022.
  - QEs incurred after January 1, 2022 are claimed in the tax year the expense is incurred.
- QEs include purchases and upgrades of HVAC and HEPA (air filter) systems that meet certain minimum air filtration rate requirements (minimum efficiency reporting value, or MERV, of 8).
  - Certain exclusions apply: agreements entered into before September 1, 2021, repairs and maintenance, financing costs, payments to non-arm's length parties or for employee wages and for amounts that would be returned to the eligible entity.
  - Any government assistance received that reduces the amount of the expense would reduce the amount of the QE.

Refundable tax credit on fuel charges

Under the carbon pollution pricing system (i.e., carbon tax), the federal government returns the proceeds to the provincial governments for provinces that have adopted the federal system. In those provinces where the federal requirements are not met, i.e., Ontario, Alberta, Manitoba and Saskatchewan, known as the "back-stop jurisdictions", the proceeds from the carbon tax are, for the most part, returned to individuals. In Budget 2021, the government announced it would also return the proceeds from the carbon tax directly to farmers. In the FES, the government has proposed to provide this support via a refundable tax credit and has provided the following additional details.

It's expected that the following farming businesses would be eligible to receive this refundable tax credit:

- Corporations, individuals, partnerships and trusts that are actively engaged in farming,
- Incur a total farming expenses of $25,000 or more, and
- All or a portion of the expenses are attributable to backstop jurisdictions (i.e., Ontario, Manitoba, Saskatchewan and Alberta)

The credit amount is calculated by multiplying the eligible farming expenses with the payment rate specified by the Minister of Finance. The payment rate per $1,000 in eligible farming expenses for 2021 is $1.47 (2022 - $1.73).

Eligible farming expenses are amounts deducted in calculating income from farming for tax purposes, excluding certain inventory adjustments and transactions with non-arm's length parties. When a corporation's taxation year is not in congruence with a calendar year, eligible farming expenses are prorated to each calendar year. Furthermore, for multi-jurisdiction businesses, eligible farming expenses are apportioned to the provinces in the same way as taxable income is allocated (i.e., based on permanent establishment rules).

Changes to Eligible Educator School Supply Tax Credit

In 2016, the Eligible Educator School Supply Tax Credit was introduced as a 15% refundable tax credit to educators who purchased certain qualifying supplies for use in their classroom or regulated childcare facility. The proposed changes in the FES increase the rate of the refundable tax credit, expand the list of qualifying expenditures and allow for the use of the supplies in any location.

The rate of the refundable tax credit will be increased to 25%, which will apply as of the 2021 taxation year.

Furthermore, certain electronic devices would also qualify for the tax credit, including:

- calculators (including graphing calculators)
- external data storage devices
- web cams, microphones and headphones
- wireless pointer devices
- electronic educational toys
- digital timers
- speakers
- video streaming devices
- multimedia projectors
- printers
- laptop, desktop and tablet computers, if none of these items are made available to the eligible educator by their employer for use outside of the classroom

Changes to Underused Housing Tax

The Underused Housing Tax was introduced in Budget 2021, although few details were provided at the time other than it was taxed at 1% of the property value and that it would apply as of January 1, 2022 to vacant or underused residential property owned by non-resident, non-Canadians.

After a consultation process, additional changes are being proposed to this upcoming tax as follows:

- the owner's interest in a residential property is exempt if the property is the primary residence of the owner, their spouse or common-law partner, or their child is occupying that residence because they are completing their studies in Canada
- vacation/recreational properties are exempt provided:
  - the property is not in a census metropolitan area or census agglomeration with more than 30,000 residents, and,
  - it is personally used by the owner or their spouse or common-law partner for at least 4 weeks in the calendar year.
- An Underused Housing Tax return for 2022 will be required to be filed by April 30, 2023, along with the payment of any tax owing due by that same date.

COVID-19 measures

Although the FES did not introduce any new programs, the government had recently announced new programs that would provide wage and rent subsidies for businesses in the tourism and hospitality industries and for those that continue to experience a significant decline in revenues, as well as a reduced income support for individuals. The legislation for these new measures and other extensions is still undergoing the Parliamentary process as of the date of this article. The following table provides a summary of the government's most significant COVID-19-related support programs that are still, or soon-to-be, available:

Program/measure	Duration proposed	Details
Canada Recovery Hiring Program	Extended to May 7, 2022 (with possibility to extend to July 2, 2022)	Available for eligible employers that increase wages and suffer a minimum decline in revenue. Also proposed is an increase to the subsidy rate from 20% to 50% for the October 24-November 20, 2021 claim period.
Tourism and Hospitality Recovery Program	October 24, 2021 – May 7, 2022 (with possibility to extend to July 2, 2022)	Wage and rent subsidies available for eligible employers in the tourism or hospitality industries with a minimum revenue decline of 40% in the period and in the prior year.
Hardest-hit Business Recovery Program	October 24, 2021 – May 7, 2022 (with possibility to extend to July 2, 2022)	Wage and rent subsidies available for eligible employers in any industry with a minimum revenue decline of 50% in the period and in the prior year.
Public health lockdown support	October 24, 2021 – May 7, 2022 (with possibility to extend to July 2, 2022)	Wage and rent subsidies available to eligible employers with a current-month revenue decline of at least 40% and have at least 25% of their revenue in the prior reference period from activities restricted due to lockdown. No prior year revenue decline is required.
CEBA	Program no longer open for application. Repayment deadline of December 31, 2022	Freeland mentioned extending the repayment deadline for small businesses, but no specifics were provided.
Canada Worker Lockdown Benefit	October 24, 2021 to May 7, 2022 (with possibility to extend to July 2, 2022)	$300/week for workers unable to work due to a lockdown.
Canada Recovery Caregiving Benefit and Canada Recovery Sickness Benefit	Extended to May 7, 2022 (with possibility to extend to July 2, 2022)	$500/week available under either program. CRCB max duration increased from 42 weeks to 44 weeks. CRSB max duration increased from 4 weeks to 6 weeks.
Home Office Expense deduction	2022 taxation year	Simplified flat rate method available again (introduced in 2021) and max increased to $500.

Additional tax-related announcements

Luxury Tax: A tax equal to the lesser of 10% of the value of a luxury car, boat or aircraft and 20% over the threshold ($100,000 for cars and aircraft, $250,000 for boats). Nothing new in the FES, other than a note that draft legislation will be released in early 2022.

Carbon Capture Utilization and Storage: an investment tax credit (ITC) for CCUS projects was announced in Budget 2021 for blue hydrogen projects and direct air capture projects, as well as the potential for tax support for green hydrogen producers. Again, nothing new in the FES except that the final design of the ITC will be announced in Budget 2022.

Northern Residents Deduction: The government reiterated its intention to increase access to the Northern Residents Deduction. This was mentioned in Budget 2021.