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Canadian federal government proposes tax amendments

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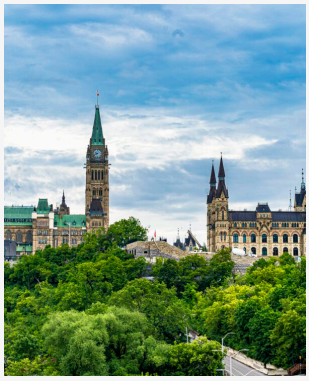

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On August 15, 2025, the Canadian federal government released several packages of draft legislation to implement various tax measures, update certain previously released draft legislation and make certain technical changes (August 2025 proposals). The August 2025 proposals include measures first announced in the 2024 federal budget (Budget 2024) and the 2024 Fall Economic Statement, as well as updated versions of draft legislation released in Budget 2024, on August 12, 2024 (August 2024 proposals) and earlier. The news release that accompanied the August 2025 proposals invites Canadians to make submissions with respect to the measures by September 12, 2025.

The August 2025 proposals cover a wide variety of measures, many of which are addressed in this Update.

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CRA information requests

Budget 2024 proposed a number of legislative amendments in respect of the audit powers of the Canada Revenue Agency (CRA). Minor changes were subsequently proposed by the Department of Finance in the August 2024 proposals. These proposals followed in close succession to the expansion of the CRA's general audit power under section 231.1 of the *Income Tax Act* (Canada) (ITA), enacted in 2022.

The August 2025 proposals make further revisions to these draft amendments and are accompanied by revised explanatory notes.

Penalties

The August 2025 proposals retain the possibility of a penalty of 10% of the aggregate tax payable (compliance order penalty) if the CRA is successful in obtaining a compliance order. However, the August 2025 proposals enable the Minister to impose a lesser (or no) penalty, as follows:

- Proposed subsection 231.7(6) now provides that the quantum of any compliance order penalty is "*up to*" 10% of the aggregate amount of tax payable, explicitly providing for the imposition of no penalty or a penalty in some amount less than 10%.
  - The expectation that the quantum of any compliance order penalty should be "fair" and "proportionate" in the circumstances is made clear by the proposed introduction of subsection 231.7(10), which provides that, if a taxpayer objects to the assessment of a compliance order penalty under subsection 231.7(9), the Minister *shall* vacate or vary the assessment if the Minister determines that the penalty is disproportionate or unfair in the circumstances (*and* provide any other relief deemed appropriate).
- In addition to the tax payable threshold for the compliance order penalty (where the amount of taxes payable is less than $50,000 for each year to which the compliance order relates), the compliance order penalty will now also not apply if one of the reasons for not complying was the taxpayer's reasonable belief that the information, documents or answers sought were protected from disclosure by solicitor-client privilege.
  - This penalty exception (for taxpayers who reasonably believe that a requirement seeks solicitor-client-privileged information or documents) is also proposed to be made available for taxpayers otherwise subject to the penalty associated with a notice of non-compliance (found in subsection 231.9(12), by way of proposed subsection 231.9(13)).

Costs of compliance

Budget 2024 and the August 2024 proposals explicitly provided that the CRA's information gathering powers had to be complied with "without cost to His Majesty in right of Canada" with respect to

- a requirement that a taxpayer or any other person provide and deliver any information or document requested under paragraph 231.1(1)(f)
- a requirement that any person provide documentation or information under subsection 231.2(1)
- a requirement that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or document under subsection 231.6(2)

In each case, the August 2025 proposals have removed the explicit reference to the obligation to comply being without cost to His Majesty in right of Canada. Although the August 2025 proposals do not provide a mechanism for recovering costs of compliance from His Majesty in right of Canada, these changes suggest that there can be circumstances where recovery of costs of complying with a requirement may be appropriate.

Global Minimum Tax Act

The August 2025 proposals include various amendments to the *Global Minimum Tax Act* (GMTA).

The GMTA, which received royal assent on June 20, 2024, gives effect to the OECD/G20 Pillar Two regime in Canada. As enacted, only the income inclusion rule (IIR) and the qualified domestic minimum top-up tax (QDMTT) are in force.

The legislative provisions enacted in the GMTA generally follow the OECD/G20's global anti-base erosion (GloBE) model rules and three sets of administrative guidance and accompanying commentary issued before 2024, but did not include the third tax measure set out in the GloBE model rules — the undertaxed profits rule (UTPR) — or subsequent administrative guidance. Both the IIR and QDMTT apply to taxation years beginning on or after December 31, 2023.

Amendments to the GMTA that were included in the August 2024 proposals proposed to implement the UTPR, the transitional UTPR safe harbour and certain elements of the OECD/G20's fourth set of administrative guidance (fourth AG). Those proposals have not yet been enacted. It is unclear whether Canada still intends to proceed with the UTPR in the face of U.S. opposition to that measure and potential retaliatory action that the United States may take against countries that adopt the UTPR.

The GMTA is expected to continue to be updated to reflect additional administrative guidance released by the OECD/G20. The August 2025 proposals introduce several technical updates that are intended to align with certain elements from the OECD/G20 administrative guidance (including the third set of administrative guidance released on December 18, 2023, the fourth AG and the fifth set of administrative guidance released on January 25, 2025), as well as related explanatory notes. There are also changes to ensure consistency between the English and French versions of the Act. These proposed amendments are also set to apply retroactively to taxation years beginning on or after December 31, 2023.

The August 2025 proposals include the following:

1. Definitions and scope

- Introduction of a new definition of "private investment entity", together with de-consolidation rules in subsection 9(2.1). The new de-consolidation rules are intended to "address potentially negative compliance and tax outcomes under the [GMTA]" where a private investment entity controls a publicly listed Canadian corporation but prepares only unconsolidated financial statements under accounting standards for private enterprises (ASPE).
- Updates to the definitions of "recapture exception accrual", "substitute loss carry-forward recapture amount", "substitute loss carry-forward tax credit" and "unclaimed accrual" to reflect recent OECD/G20 administrative guidance.

2. Entity location

- Clarification of rules for determining the location of entities, including those continued to jurisdictions without a corporate income tax. The explanatory notes state the changes are intended to ensure that "for example, an entity that is created in a jurisdiction where it is

tax resident based on its place of management, but that is then continued into another jurisdiction without a domestic corporate income tax, is considered to be located in that second jurisdiction."

3. Calculation of GLoBE income or loss

- Adjustments to the adjusted GloBE carrying value of an asset following certain impairments or reversals for purposes of computing the adjusted covered tax of a constituent entity to align with recent OECD/G20 administrative guidance.

4. Allocation

- Changes to rules for allocating covered taxes among tax transparent entities and hybrid and flow-through entities to align with OECD/G20 administrative guidance.
- Introduction of the "specified jurisdictional effective tax rate" concept for allocating taxes under blended controlled foreign company (CFC) regimes. This proposed change implements the "GloBE Jurisdictional ETR" concept from the commentary to Article 4.3.2(c) of the GloBE model rules.
- Introduction of a five-year election to exclude a deferred tax expense in certain jurisdictions. This election allows an MNE group to simplify compliance by opting out of the complex deferred tax "push-down" allocation process, effectively treating all such deferred tax expenses in the parent jurisdiction as nil for GloBE purposes.

5. Deferred tax assets under the transitional rules

- Rules for the treatment of deferred tax assets and liabilities for purposes of transitioning to Pillar Two, including exclusions for certain deferred tax assets arising from post-December 1, 2021, transactions, governmental arrangements and new tax regimes.

6. Safe harbour and filing provisions

- Amendments to the definition of "designated filing entity" to allow entities in jurisdictions with a qualified domestic minimum top-up tax safe harbour to file on behalf of the MNE group.

In addition to the amendments to the GMTA, the August 2025 proposals include changes to the ITA to coordinate with the GMTA, notably providing foreign tax credit and foreign accrual tax recognition of certain domestic minimum top-up taxes.

Many of the changes to the GMTA are proposed to apply on a retroactive basis to the introduction of the GMTA. This approach appears to be inconsistent with the approach taken by certain other jurisdictions. Although the GloBE rules are intended to have consistent outcomes between different countries, the OECD Inclusive Framework does not appear to have addressed the differences in domestic laws that could prevent certain jurisdictions from effectively introducing new taxes on a retroactive basis.

Anti-deferral rule for CCPCs and substantive CCPCs with CFAs

In the 2022 federal budget (Budget 2022), the Canadian federal government proposed a measure purportedly targeted at Canadian-controlled private corporations (CCPCs) (and substantive CCPCs), as well as their shareholders, that earn "highly-mobile" investment income through controlled foreign affiliates (CFAs). Draft legislation for the proposed

measure was released on August 9, 2022.

This measure was intended to address a perceived tax-deferral advantage available to CCPCs and their shareholders earning investment income through CFAs by effectively reducing the deduction in respect of foreign tax paid by the CFA, mainly through an amendment to the definition of "relevant tax factor" in subsection 95(1) of the ITA. Under the proposed change, if a CFA is subject to foreign tax at a rate lower than 52.63%, the corresponding foreign accrual property income (FAPI) inclusion would not be fully offset. Related amendments were proposed to address the integration of FAPI once repatriated to and distributed by CCPCs (and substantive CCPCs) to individual shareholders. Amidst criticism that the measure was overly broad given its stated purpose — to address "highly-mobile" investment income — Finance introduced a rather narrow "foreign accrual business income" (FABI) carveout in the August 2024 proposals.

The August 2025 proposals contain the third iteration of this proposed measure, which retains the FABI carveout but significantly expands the scope of that concept. The resulting proposed legislation now better aligns with what the federal government had stated was its intended goal when it first announced the measure in Budget 2022.

The measures are generally proposed to take effect retroactive to taxation years beginning on or after April 7, 2022, in some cases or August 9, 2022, in other cases (the dates of the 2022 federal budget and the date the first version of the draft legislation was released), though some are proposed to apply prospectively unless an election is filed.

Revised FABI carveout

Generally, the proposed definition of FABI in the August 2024 proposals only included certain types of services and real estate business income where the income was linked to a sufficient level of activities performed by certain persons and employees outside of Canada. The carveout only applied on an elective basis.

The FABI carveout means that if a CCPC (or substantive CCPC) elects for the FABI carveout to apply and the CFA pays foreign tax of at least 25% in respect of the FABI, then the deduction under subsection 91(4) should fully offset the FABI portion of the FAPI included in income under subsection 91(1).

The August 2025 proposals' version of FABI, on the other hand, effectively carves out most types of FAPI services and business income, such that a CCPC (or substantive CCPC) may elect to be subject only to the lower "relevant tax factor" rules on income that

- would not be included in the computation of the CFA's aggregate investment income (as defined in subsection 129(4), which includes certain income from property and net taxable capital gains) if both
  - the CFA were, at all times, a CCPC
  - all amounts that were included in the computation of the CFA's FAPI for the taxation year were from a source in Canada; and
- is not derived from an amount paid or payable, directly or indirectly, by certain specified persons or partnerships, that is deductible in computing the aggregate investment income or reducing the tax otherwise payable under section 123.3 for a taxation year of the payer or the relevant member, or in computing FAPI (other than FABI)

The revised FABI carveout provides welcome relief for many CCPCs (and substantive CCPCs)

with CFAs engaged in FAPI-earning businesses with material commercial ties to foreign jurisdictions or commercial or regulatory reasons to be carried on through a foreign corporation.

Cryptoasset reporting framework

The August 2025 proposals implement the OECD's Crypto-Asset Reporting Framework (CARF) within the ITA, reflecting a significant step to enhance tax transparency in relation to cryptoasset transactions. This new legislative regime targets cryptoasset service providers — entities resident in or conducting business in Canada that facilitate exchange transactions involving cryptoassets, including exchanges, brokers, dealers and operators of cryptoasset ATMs.

Under the proposed rules, these service providers will face new annual reporting obligations to the CRA. Key reportable information includes the annual aggregate value of cryptoasset exchanges with fiat currency, exchanges between cryptoassets and payments made in cryptoassets for goods or services worth US$50,000 or more. The framework requires detailed identification and transaction data on both Canadian-resident and non-resident customers. Once the CRA receives information on non-resident customers having reportable cryptoasset transactions, it must share the information with the jurisdictions of residence of the non-resident customers. (The same is also intended to be true the other way around where the foreign jurisdiction has also implemented CARF: if a Canadian resident has cryptoasset transactions that get reported to the tax authority of the foreign jurisdiction, that information will be exchanged with the CRA.)

Excluded from CARF's reporting requirements are central bank digital currencies and certain specified electronic money products, which will instead fall under the evolving Common Reporting Standard (CRS) rules in the ITA. The August 2025 proposals also contain changes to those rules, aiming in particular to improve coordination with CARF, so as to avoid duplicative reporting under the two regimes.

These measures are targeted to take effect for reporting years beginning in 2026. Canadian cryptoasset exchanges and other entities subject to the Canadian CARF rules would be required to collect required information on their customers in 2026, with the first international information exchanges under CARF and the amended CRS expected in 2027.

Tracking interests

Canada's FAPI regime contains certain anti-avoidance rules that apply to "tracking interests" in non-resident corporations (including non-resident trusts deemed by subsection 94.2 of the ITA to be non-resident corporations). An example of a tracking interest is a share of a class of a corporation that participates economically in only part of the assets, income or activities of the corporation. Under the current version of these rules, non-Canadian investment funds organized as "umbrella funds" — i.e., a corporation or trust housing multiple separate portfolios or funds, each of which is tracked by a different class of equity interests — may potentially be subject to adverse or in some cases uncertain tax consequences under these rules. The August 2025 proposals contain proposed changes to the FAPI tracking interest rules, including but not limited to changes relevant to umbrella funds. The following amendments would apply to taxation years of trusts and foreign affiliates beginning after February 26, 2018.

Trust tracking interests

The August 2025 proposals seek to clarify the treatment of tracking interests in non-resident trusts for FAPI purposes. Section 94.2 deems a non-resident trust to be a controlled foreign affiliate of a taxpayer where the taxpayer or another CFA of the taxpayer holds 10% or more (by value) of the beneficial interests of any class in the trust. A new relieving measure will provide that this deemed CFA status in respect of the entire trust will not apply where the 10% limit is exceeded on a class of tracking interests in the trust. In other words, the fact that the 10% threshold for CFA status in section 94.2 is met by a holder of a tracking class of an umbrella trust will not suffice to deem the entire trust to be a CFA.

Instead, new subsection 94.2(5) provides that, for umbrella trusts, FAPI attribution to Canadian taxpayers is based solely on the income, gains and losses of the specific sub-fund (which is now deemed to be the CFA) in which the taxpayer holds tracking interests, rather than the trust as a whole. The rules ensure that the tracking arrangement provisions in subsection 95(11) apply appropriately, and that double taxation is avoided through specific adjustments.

Tracking interests generally

The August 2025 proposals also propose to update the tracking arrangement rules in subsection 95(11) to prevent avoidance of CFA status — and the associated accrual taxation of FAPI — through the use of tracking shares or arrangements. The amendment clarifies that these rules do not apply to a foreign affiliate that is already a CFA, ensuring that FAPI cannot be excluded from income by relying on tracking interests.

In addition, new subsection 95(13) implements a Department of Finance comfort letter dated March 25, 2019, by providing that the tracking interest rules will not apply to deem CFA status where the creation, issuance or holding of a tracking interest was not intended to avoid, prevent or defer a FAPI inclusion. This exception focuses on the specific purpose for structuring the interest as a tracking interest, rather than the general investment purpose. It should cover most instances where Canadian residents hold more than 50% of a single tracking class of shares of a non-resident (actual or deemed) corporation.

EIFEL

The excessive interest and financing expenses limitation (EIFEL) rules generally apply to restrict the deductibility of certain net interest and financing expenses where the amount of such expenses exceeds 30% of tax EBITDA (as computed under the rules). The definition of "exempt interest and financing expenses" (EIFE) is relevant for purposes of providing an exemption for certain types of interest and financing expenses (IFE) from the EIFEL rules. Currently, only specified IFE incurred in respect of the financing of certain Canadian public-private partnership (P3) projects are exempt under the EIFE definition.

The August 2024 proposals proposed to add two types of IFE to the EIFE definition: regulated energy utility businesses (REUB) and purpose-built residential rentals.

The August 2025 proposals reintroduce these August 2024 proposals with a few notable changes:

- The August 2024 proposals proposed that to qualify for the REUB exemption, all or substantially all of the borrower's property must be used for the purpose of earning income from the REUB of the borrower. The August 2025 proposals add a new exception in determining whether this condition is satisfied: property acquired using borrowed money,

the interest from which is excluded interest, is excluded in determining whether this condition is satisfied. The stated intention for this revision is to prevent this condition from negatively impacting related group loss consolidation planning.

- A deeming rule is proposed to be added as subsection 18.2(21) to provide that, for greater certainty, if the borrower is a partnership that carries on a business or activity (such as a Canadian REUB), a taxpayer that is a member of that partnership is not considered to be also carrying on that business solely because it is a member of that partnership. This rule appears to operate to prevent a partner of a partnership from relying on the partnership's business activities to qualify for the REUB exemption.
- A further deeming rule is proposed to be added as subsection 18.21(9) to exclude the income from a REUB carried on by a taxpayer (or a partnership of which it is a partner) in the computation of the consolidated group's group adjusted net book income where an election has been made to apply the REUB exemption.

The government has not otherwise revised the scope of the exemptions for REUBs and purpose-built residential rentals, as set out in the August 2024 proposals. These measures introduced by the August 2025 proposals are proposed to take retroactive effect to taxation years that begin on or after October 1, 2023.

Qualified investments and securities lending arrangements

Section 207.04 of the ITA requires the controlling individual of a first home savings account, registered disability savings plan, registered education savings plan, registered retirement income fund, registered retirement savings plan or tax-free savings account (registered plans) that governs a trust to pay a special tax if the trust acquires property that is, *inter alia*, a "non-qualified investment" for the trust. Proposed subsection 207.04(7) would, for purposes of this section and certain other qualified investment rules applicable to registered plans, deem rights acquired under particular "securities lending arrangements," as defined in section 260, not to be "non-qualified investments".

Proposed subsection 207.04(7) would apply as of January 1, 2023, to "securities lending arrangements" over certain listed securities where the trust is the lender of the securities and the borrower is a registered securities dealer resident in Canada. The trust must have a right under the arrangement to require the borrower to transfer or return an identical security during the term of the loan, and the borrower must post liquid collateral (cash or government debt) in favour of the trust. Further, the controlling individual of the registered plan that governs the trust must be provided written disclosure of the arrangement and consent to the arrangement prior to the time it is entered into (presumably on a global basis rather than on a security-by-security basis). These conditions are generally consistent with rules introduced by the Canadian Investment Regulatory Organization (CIRO) governing securities dealers who borrow fully paid securities from retail clients (CIRO rules).

However, unlike the CIRO rules, paragraph (d) of proposed subsection 207.04(7) would also require the security lent or transferred under the arrangement (or property substituted for it) not to be received by a person who does not deal at arm's length with the controlling individual of the registered plan that governs the trust. Given that a retail client under a fully paid lending agreement is facing its dealer as principal, and unaware of subsequent lending activity, monitoring this requirement would be highly impractical, if not impossible. This impossibility extends to the registered securities dealer, who cannot track a share through a chain of lending or exchange transactions to which neither the dealer nor the client is a party. Ideally, proposed paragraph (d) would be removed in its entirety. A compromise

solution would be that paragraph (d) applies only where a controlling individual knew or ought to have known that the security would be received by a non-arm's length person.

While a clarifying amendment regarding the ability of registered plans to engage in fully paid lending is welcome, the need for a deeming rule in respect of rights acquired under a "securities lending arrangement" is questionable. The scheme of the rules governing "securities lending arrangements" in section 260 treats the lender as the owner of the security for tax purposes. Disaggregating various contractual rights under a "securities lending arrangement" and treating them as property of the lender separate from the lent security is inconsistent with this scheme. It also opens the door to potential disaggregation of rights under other contractual arrangements. For example, the rights of a holder under a bond could be disaggregated into the right to receive interest, the right to receive principal, the right to vote under certain circumstances and other ancillary rights. Will deeming rules now be required to ensure these rights are not "non-qualified investments"?

Rather than the proposed rule in subsection 207.04(7), which would apply to deem disaggregated rights under certain "securities lending arrangement" not to be "non-qualified investments", it would be preferable to introduce a "for greater certainty" rule stating that where a trust governed by a registered plan transfers or lends property that is a "qualified investment" under a "securities lending arrangement", such property shall be deemed to continue to be a "qualifying investment" of the trust inclusive of any rights or entitlements of the trust under the "securities lending arrangement". Such a rule would be consistent with the legislative scheme of section 260 and existing administrative and judicial statements made in analogous circumstances.

Excise Tax Act measures

The August 2025 proposals include a proposal to make the rules relating to notional input tax credits (NITCs) under subsection 181(5) of the *Excise Tax Act* more restrictive. Specifically, under the current rule, a person who pays an amount to a supplier for accepting a reimbursable coupon is generally entitled to an NITC provided the payment is made in the course of commercial activities. The recent *President's Choice Bank* decision of the Federal Court of Appeal interpreted subsection 181(5) broadly to mean that if the payment is made in the course of any commercial activities, you could get at least a partial ITC.

The August 2025 proposals propose that most registrants will only be entitled to such NITCs if the payment is made in the course of activities, *all or substantially all* of which are commercial activities, and that financial institutions will only be entitled to such NITCs if the payments is made in the course of activities, *all* of which are commercial activities. The news release that accompanied the August 2025 proposals noted that this proposal was "in response to a recent Federal Court of Appeal decision", presumably referring to the *President's Choice Bank* decision.

This measure is proposed to be effective August 16, 2025, and in respect of any input tax credits for payments made not already claimed in a return filed on or prior to August 15, 2025.

Other measures

The August 2025 proposals include several other previously announced measures and certain technical amendments, including the following:

- changes to the trust reporting rules previously proposed in the August 2024 proposals,

including

  - extending the relief to public companies in the oil and gas and mining sectors that use nominee or bare trust arrangements to hold "Canadian resource properties" to only require "all or substantially all" of the property held to be Canadian resource property
  - extending the exemption where a general partner holds property for the use or benefit of a partnership to property held by all partners, including limited partners
- various technical amendments to the ITA, including revised proposals to amend subsections 85.1(4) and 87(8.3) that correct certain issues created by prior proposals in 2022 to amend these provisions
- sales of businesses to employee ownership trusts and worker co-ops
- eligible small business corporation shares
- draft legislation to implement changes to the scientific research and experimental development program announced in the 2024 Fall Economic Statement
- non-profit organizations' reporting requirements

If you have any questions or require additional analysis on the August 2025 proposals or other measures discussed above, please contact any member of our National Tax Department.