

## Federal budget briefing 2025

Budget 2025 includes modest tax proposals for businesses and individuals, plus long-awaited amendments to the transfer pricing regime.

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The Honourable François-Philippe Champagne, Minister of Finance and National Revenue, tabled the Liberal government's ninth budget on November 4, 2025. Budget 2025 is the first budget released by Prime Minister Carney after he became Canada's prime minister and led the Liberals to re-election this spring. It also marks the first budget to be released in the fall instead of the spring, pursuant to Prime Minister Carney's plan to permanently change the timing of the federal budget's release.

The Liberal party is a minority government that, on its own, is currently just shy of the votes it will need to pass Budget 2025.

Budget 2025 includes proposals to amend Canada's transfer pricing regime, initially signalled in Budget 2021 and similar, though not entirely identical, to proposals in a 2023 consultation paper. Budget 2025 also provides general economic and fiscal information and projections, as well as updates on some previously announced tax measures and the government's intention to proceed with the undntaxed profits rule (UTPR) of the global minimum tax.

Budget 2025 does not provide any updates on the second package of anti-hybrid rules, apart from briefly confirming the government's intention to proceed with such amendments.

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Report from Osler Special Advisor Stephen Poloz, former Governor of the Bank of Canada

## Federal budget 2025: a complete reframing, but similar plotline

A new government, a new prime minister and a whole new world — this federal budget is by all counts the most important in a generation.

The word “generation” is accurate, not hyperbolic. It has been over 30 years since Canada’s fiscal framework hit the wall and investors balked, prompting a deep, soul-searching government restructuring. By the metrics of today, Canada’s current fiscal situation is fine. Many other major countries are in a far worse fiscal situation, not least the United States — although, when we include provincial government debt, the international comparison is far less favourable.

Even so, Canada’s fiscal trajectory looks bad, because we face massive downside economic risk. Among the major economies, Canada is by far the most reliant on international trade for its living standards and, within that frame, far and above the most reliant on the United States as an export sales channel. The entire global trade architecture is being disrupted in seemingly arbitrary and callous fashion by the U.S. administration. The damage is just beginning to show up, as companies freeze investment and hiring, and households turn cautious. When an economy slows, so do government revenues, and government spending picks up automatically through such programs as employment insurance, so fiscal deficits widen. And given the reasons for this slowdown, these conditions are likely to be very long-lasting, even permanent, with dire consequences for our government’s debt trajectory.

A quick recap of federal debt history will help fix ideas. (Note that throughout this piece we use net debt figures, which take into account government assets, including funded public pension plans; other analysts may prefer to use gross debt figures.) In the mid-1990s, Canada faced a fiscal crisis when government debt rose to about 70% of total GDP, and debt service was consuming a very large part of government tax revenues. Comments at the time

from international investors and ratings agencies were politically galvanizing, and the Chrétien and then the Harper governments put Canada's finances on a safer track. The debt-to-GDP ratio in the last Harper budget for 2015 was pegged at 31% and the budget was in surplus. In early 2016, the new Trudeau government planned for persistent small fiscal deficits that would still allow for this debt metric to gradually decline. This fiscal plan was disrupted by COVID-19, however; delivering support for the economy during the pandemic was a major fiscal setback that pushed Canada's indebtedness up to around 45% of GDP. This was actually very good news, considering the worst-case economic scenario contemplated in the spring of 2020 would have taken Canada up to a debt ratio of around 60%. Since the pandemic, however, the government has introduced a number of new programs, the public service has expanded by around 40% and government debt is still sitting at about 42% of GDP. Clearly, Canada is not nearly as prepared to deal with an emergency as it was in 2020.

Given this fiscal starting point, and the gravity of the situation created by the U.S. administration, Canada needs to orchestrate a major economic pivot, and people are looking to this new government to chart a new course. This is not just because Canadians traditionally believe that their government will protect them from harm; it is because many of the underlying problems with the Canadian economy today — problems that have led to a long period of weak business investment and productivity, as well as stagnant income per household — are clearly attributable to government policies and regulations.

Obviously, expectations could not be higher. In what follows, I focus on the broad macro implications of the budget, not the detailed initiatives.

First, the government has done a clean job of dividing its budget into operational versus investment expenditures. I would commend the government for making this change, for the two notions have always been present but there was a vague distinction between them. We think nothing of a company borrowing to make an investment in its business. Normally the investment will more than pay for itself, earning more profits for the company and in the process eventually erasing the debt. Governments also make investments all the time, although not always in a dividend-paying business. Rather, a government "investment" is usually designed to boost economic growth and create jobs. Every new dollar of GDP or every new job created delivers new dollars that are taxed by the government, and future revenues can be stacked up against that new borrowing and arguably "pay it off" in the future. This is in sharp contrast with operational government spending, which funds either direct transfers to persons or pays for public services. Therefore, this repositioning of the government books is a positive change.

The government has defined "investment" as any expenditure that contributes to capital formation in the economy. This is a broad definition, of course, but appropriate in the sense that such expenditures can be expected to catalyze a multiple in GDP (i.e., create more than a dollar of GDP in future for every dollar spent, usually by attracting private sector money to the same channel), which of course then would produce all the usual government tax revenues — corporate taxes, income taxes and sales taxes. Meanwhile, the government plans to balance its operational budget within three years. What this means is that government capital investments rise from around \$30 billion per year presently to around \$60 billion per year starting in fiscal 2026-27. Further, capital investments rise from less than 60% of the fiscal deficit to 100% by 2029-30, because the operational spending deficit falls to zero. This latter adjustment requires a very aggressive adjustment to operational spending and the public service. In particular, the public service will shrink by some 40,000 positions, or 10%, including 1,000 executive positions.

Very importantly, the economic outlook on which the budget is based comes from a survey of private sector economists from this past summer. What this means is that any measure taken in this budget that boosts future economic growth above that baseline forecast will generate higher government revenues and a lower deficit than laid out in the budget.

Suppose, for example, that a \$10-billion investment by the government “catalyzes” \$40 billion in private sector investment, for a total investment of \$50 billion; then, because federal government revenues are about 16% of GDP, new tax revenues will rise by about \$8 billion per year once the investment is up and running. This hypothetical “catalyzation” would create a very fast payback on the \$10-billion government investment, and then would transition to a net fiscal surplus generated by that item. This is, of course, not the case when the government simply transfers \$10 billion to households who spend the proceeds. The implication is that, if the economic outlook does not worsen further, the government deficit trajectory will probably be lower than the one laid out in the budget.

Nevertheless, all this new expenditure means that the government will be taking up a bigger share of the baseline economy. Between the final Harper budget and the last Trudeau budget, government expenditures as a share of the economy rose by three percentage points, from 13% to 16%. This means that over the last 10 years the private sector has had to shrink as a share of the economy by three percentage points, and this is one reason for weak investment and low productivity. In the plan tabled today, despite cutting back on government operational spending, the government’s share of the economy remains at about 16% until beginning to ease after 2028. To be fair, a growing portion of the government expenditure line is aimed at stimulating more private sector demand, investment in particular, so it is hoped that GDP will grow faster than the baseline forecast and lead to a lower share of government in the economy. But only by truly expanding the supply side of the economy — through population growth, infrastructure investment, business investment and productivity growth — can the government turn past crowding out into future crowding in. Positive growth outcomes cannot be assumed, but at least the initiatives are directionally appropriate — a shrinkage of the public service, in particular.

Does the budget respond to the potential damage coming from the anti-trade policies of the U.S. administration? This is a very hypothetical question, for we do not know where those U.S. policies will end up. But acting to boost business investment, increase defence spending and develop the critical minerals business could easily add up to enough to compensate for the damage being wrought by adverse trade policies; adding to that, diversifying international trade, executing some major resource-related projects and favouring Canadian procurement would add even more in the positive direction. We know that removing interprovincial business and labour mobility barriers could easily offset the losses due to U.S. policies, all by themselves. All to say, there is certainly plenty of scope here to set Canada back on a solid growth path, in time, while continuing to work to rectify the disruption to Canada-U.S. trade.

Before concluding, there are a couple of other notable initiatives in the budget, which relate to the consultation I led in 2024 aimed at encouraging our major pension plans to increase investment here in Canada. First, the budget devotes an entire section to “catalysing investment in airports and ports,” which suggests that the government is prepared to consider a wide range of changes that will make such investments more attractive, including the possibility of privatization. This was one of the top recommendations that emerged from the pension fund work last year. Second, \$1 billion has been earmarked for BDC to launch a new Venture and Growth Capital Catalyst initiative, to incentivize pension funds to allocate more funds toward young Canadian growth companies. On top of that, although details remain to be announced, it is reasonable to expect that the work of the Major Projects Office will involve creating financial structures that will attract investments from these same entities.

The bottom line? The budget is financially daring, but its focus on productive investments should be reassuring to investors, both domestic and foreign. If investment really does pick up as a result, the whole package could also be bullish for the Canadian dollar. In short, the budget contains a lot of promise, even if the paradigm shift is less seismic than some were hoping. The hard work begins now.

## Business income tax measures

### Scientific Research and Experimental Development tax credit

Under the Scientific Research and Experimental Development (SR&ED) tax incentive program, qualifying expenditures are fully deductible in the year they are incurred, and are generally eligible for an investment tax credit. Under the existing rules of the *Income Tax Act* (ITA), Canadian-controlled private corporations (CCPCs) are entitled to a fully refundable investment tax credit at an enhanced rate of 35% on up to \$3 million of qualifying SR&ED expenditures annually. The \$3-million expenditure limit is gradually phased out where a CCPC's taxable capital employed in Canada for the previous taxation year is between \$10 million and \$50 million. This limit is shared within an associated group.

The 2024 Fall Economic Statement proposed a number of changes to the SR&ED program, including increasing the expenditure limit from \$3 million to \$4.5 million. Budget 2025 proposes to further increase the expenditure limit for the enhanced tax credit from the previously announced \$4.5 million to \$6 million, and otherwise confirms the government's intention to introduce legislation to implement changes previously announced in the 2024 Fall Economic Statement. This new measure would apply for taxation years that begin on or after December 16, 2024 (the date of the 2024 Fall Economic Statement).

Budget 2025 also announces that the Canada Revenue Agency (CRA) will implement reforms to the administration of the SR&ED program. The government intends for the CRA to

- implement an elective pre-claim approval process to provide businesses with an up-front technical approval of their eligible SR&ED projects
  - For claims submitted through this elective process that require an expenditure review, processing time will be cut in half to 90 days from 180 days.
- increase the use of artificial intelligence in the program's administration to avoid subjecting low-risk claims to unnecessary audit interventions
- streamline the claims review process by eliminating unnecessary steps and reducing burdensome information requirements that can delay the final determination of claims

It is proposed that these changes will be implemented into the SR&ED program operations as of April 1, 2026. Additionally, the CRA intends to engage in targeted consultations to further improve the administration of the SR&ED program, including by reviewing the SR&ED claim form (Form T661).

### Immediate expensing for manufacturing and processing buildings

Currently, a 10% capital cost allowance (CCA) rate applies to eligible buildings in Canada used in the manufacturing or processing of goods for sale or lease (manufacturing or processing buildings). This rate includes the regular 4% CCA rate for buildings (Class 1), plus an additional 6% for manufacturing or processing buildings provided at least 90% of the building's floor space is used to manufacture or process goods for sale or lease.

Budget 2025 proposes to temporarily allow taxpayers to immediately expense the cost of eligible manufacturing or processing buildings, including the cost of eligible additions or alterations made to such buildings. The taxpayer can claim a 100% deduction in computing income for the first taxation year that eligible property is used for manufacturing or processing, provided the minimum 90% floor space requirement is met. Property that has

been used, or acquired for use, for any purpose before it is acquired by the taxpayer would be eligible for such treatment only if both of these conditions are met:

- Neither the taxpayer nor a non-arm's-length person previously owned the property.
- The property has not been transferred to the taxpayer on a tax-deferred "rollover" basis. Recapture rules may apply if a taxpayer claims a deduction and the use of the property subsequently changes.

This measure would be effective for eligible property that is acquired on or after Budget Day and is first used for manufacturing or processing before 2030. The enhanced first-year CCA rate will decrease to 75% for eligible property that is first used for manufacturing or processing in 2030 or 2031, then to 55% for eligible property that is first used for manufacturing or processing in 2032 or 2033.

## Clean technology manufacturing investment tax credit

The clean technology manufacturing investment tax credit is a refundable tax credit equal to 30% of the cost of investments in new machinery and equipment used to manufacture or process clean technologies, and to extract, process or recycle critical minerals essential for clean technology supply chains. Budget 2025 proposes to expand the list of critical minerals eligible for this investment tax credit to include antimony, indium, gallium, germanium and scandium. The expanded credit will apply to property that is acquired and becomes available for use on or after Budget Day.

## Carbon capture, utilization and storage investment tax credit

The carbon capture, utilization and storage (CCUS) tax credit is a refundable tax credit for eligible CCUS capital expenditures. There are three different credit rates depending on the purpose of the eligible equipment:

- 60% for eligible capture equipment used in a direct air capture project
- 50% for all other eligible capture equipment
- 37.5% for eligible transportation, storage and use equipment

The credit is available for expenditures incurred to the end of 2040, with current rates being reduced by half for expenditures incurred from the start of 2031 to the end of 2040. Budget 2025 proposes to extend the current rates for an additional five years, so that the lower rates would now only apply to expenditures incurred from the start of 2036 to the end of 2040.

## Clean electricity investment tax credit

The clean electricity investment tax credit is a refundable credit equal to 15% of the capital cost of eligible investments in equipment related to low-emitting electricity generation, electricity storage and the transmission of electricity between provinces and territories. The capital cost of property that is eligible for the credit may be reduced by government assistance that a taxpayer receives.

Budget 2025 proposes to include the Canada Growth Fund as an eligible entity under the clean electricity investment tax credit (recognizing that the Canada Growth Fund may be an equity investor in projects eligible for the credit) and to introduce an exception so that financing provided by the Canada Growth Fund would not reduce the cost of eligible property for the purpose of computing this tax credit. These measures would apply to

eligible property that is acquired and that becomes available for use on or after Budget Day.

## Critical mineral exploration tax credit

Flow-through shares allow qualifying corporations to renounce or “flow through” qualifying expenses to investors, who can deduct the expenses in calculating their own taxable income at prescribed rates. The critical mineral exploration tax credit (CMETC) provides an additional income tax benefit for individuals who invest in eligible flow-through shares: a tax credit equal to 30% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors.

The following critical minerals are currently eligible for the CMETC: nickel, cobalt, graphite, copper, rare earth elements, vanadium, tellurium, gallium, scandium, titanium, magnesium, zinc, platinum group metals, uranium and lithium (including lithium from brines).

Budget 2025 proposes to expand the eligibility of the CMETC to include the following additional critical minerals: bismuth, cesium, chromium, fluorspar, germanium, indium, manganese, molybdenum, niobium, tantalum, tin and tungsten. This measure would apply to expenditures renounced under eligible flow-through share agreements entered into after Budget Day and on or before March 31, 2027.

## Eligible activities under the Canadian exploration expense

Canadian exploration expenses (CEE) is a category of tax deduction that can be transferred from mining corporations via flow-through shares to equity investors, who can then claim a 100% immediate deduction in computing income on account of the CEE. Individuals (other than trusts) who invest in these flow-through shares may additionally be able to claim the mineral exploration tax credit or the CMETC in respect of certain types of CEE.

Under the current provisions of the ITA, CEE includes expenses incurred by a taxpayer for the purpose of determining the “quality” of a mineral resource in Canada. Budget 2025 proposes to amend the CEE rules to clarify that expenses incurred for the purpose of determining the quality of a mineral resource in Canada do not include expenses related to determining the economic viability or engineering feasibility of the mineral resource. This amendment, which is stated to effectively nullify the potential impact of a recent British Columbia Supreme Court decision — presumably referring to *Seabridge Gold Inc. v. British Columbia*, 2025 BCSC 558 — would apply as of Budget Day.

## Accelerated CCA for LNG equipment and buildings

The accelerated capital cost allowance (CCA) for liquefied natural gas (LNG) equipment and related buildings expired at the end of 2024. Budget 2025 proposes to reinstate accelerated CCA for LNG facilities, but only if they are low-carbon facilities. To be eligible for accelerated CCA, a facility would need to meet new standards of emissions performance. Two levels of CCA would be available:

- LNG facilities that are in the top 25% in terms of emissions performance would be eligible for the same accelerated CCA available in 2024 (30% for liquefaction equipment and 10% for non-residential buildings used in the facilities).
- LNG facilities that are in the top 10% in terms of emissions performance would be eligible for higher accelerated CCA: 50% for liquefaction equipment and 10% for non-residential

buildings used in the facilities.

Details regarding the new emissions performance requirements for these accelerated allowances are to be provided at a later date. These measures would apply to property acquired on or after Budget Day and before 2035.

## Part IV tax deferral through tiered corporate structures

Investment income earned by CCPCs and substantive CCPCs is subject to a refundable tax. Corporations can claim a refund for that tax when they pay taxable dividends on the assumption that individual shareholders will be taxed on that dividend. An existing rule imposes an additional refundable tax under Part IV of the ITA on private corporations and certain non-private corporations that receive a taxable dividend from a “connected corporation” (generally, where the recipient corporation controls the payer corporation or owns more than 10% of the payer corporation by votes and value) where the payer corporation is entitled to a refund of such refundable taxes. In circumstances where the recipient corporation’s balance-due day for paying this additional refundable tax is after the payer corporation’s balance-due day for the taxation year during which it paid the dividend, it is possible to defer, on a net basis, the payment of the refundable tax. This deferral can be extended by continuing to move the dividend through a series of connected corporations with different year ends.

Budget 2025 proposes to limit the ability to defer payment of the refundable tax through the use of such tiered corporate structures with different year ends. This new rule would apply in the case of dividends paid between affiliated corporations as determined under the existing affiliation rules of the ITA. Generally, the refund otherwise owing to the payer corporation upon paying a taxable dividend would be suspended if the recipient corporation’s balance-due day for the taxation year in which the dividend is received is later than that of the payer corporation’s due date. This measure would apply to dividends paid in taxation years that begin on or after Budget Day.

An exception will be available for dividends paid by a payer corporation that is subject to an acquisition of control within 30 days of paying the dividend. This exception may facilitate the payment of certain pre-closing dividends, which are often paid in the context of share sale transactions and which might otherwise be subject to this new rule because of the accelerated balance-due day of the payer corporation resulting from the deemed year end arising as a result of the acquisition of control. A second exception will apply where each recipient corporation in the chain of affiliated corporations subsequently pays a dividend on or before its balance-due day (since no deferral would otherwise have been achieved in such circumstances).

## No mention of innovation flow-through share regime or patent box

Two notable omissions in Budget 2025 are the introduction of a patent box regime and a new flow-through share regime for artificial intelligence, quantum computing, biotech and advanced manufacturing companies modelled on the existing flow-through share regime available to mining exploration companies. These omissions are notable because both of these proposals were mentioned in the Liberals’ April 2025 election platform and the Department of Finance conducted a consultation on the patent box regime in 2024 together with the SR&ED regime. It is not clear from Budget 2025 whether these proposals have been deferred or abandoned.

## International tax measures

### Transfer pricing regime amendments

Budget 2025 contains proposed legislative changes amending section 247 of the ITA to "modernize Canada's transfer pricing rules to better align with the international consensus on the application of the arm's length principle." The Department of Finance's June 2023 consultation paper on Canada's transfer pricing rules previewed this action, which originated from the government's Budget 2021 reaction to the Supreme Court's decision not to grant the government leave to appeal the Federal Court of Appeal's decision in the Cameco case.

The consultation paper suggested that limited detail in the current transfer pricing rules led to undue focus on intra-group contracts instead of what the government described as the "factual substance of transactions", producing profit allocations misaligned with the economic contributions of the parties. Budget 2025 reflects an intent to address the situation. The consultation paper included draft legislation heavily influenced by the OECD's BEPS project and proposed other potential administrative measures. The revised legislation proposed in Budget 2025 follows the general thrust of the 2023 draft legislation, with substantive modifications in the details.

In addition to revising the transfer pricing income adjustment provisions, Budget 2025 proposes amendments to the transfer pricing penalty and documentation rules. Critically, the amendments would shorten the time within which taxpayers must provide transfer pricing documentation to the CRA to 30 days (from three months under the current rules). This change was not foreshadowed in the consultation paper and will place significant compliance pressure on taxpayers.

The amendments to Canada's transfer pricing regime are proposed to be effective for taxation years beginning after Budget Day.

### Collapsing two branches of transfer pricing adjustment provision

The current transfer pricing adjustment rule has two branches. In general, the first (the "pricing" rule) makes adjustments to the terms and conditions of a non-arm's length cross-border transaction if they differ from the terms and conditions that would have been agreed between arm's length parties. The second branch (the "recharacterization" rule) substitutes a different transaction altogether if the non-arm's length cross-border transaction that was entered into would not have been entered into by arm's length parties, even under different terms and conditions, and was entered into primarily to achieve a tax benefit. In a departure from the 2023 proposals, the Budget 2025 amendments would collapse these two branches into a single rule, while seemingly dispensing with certain requirements that must be met for the CRA to apply the existing recharacterization rule.

The proposed transfer pricing adjustment provision would adjust the quantum and nature of amounts relating to a taxpayer's transactions or series of transactions with a non-arm's length non-resident if they include "actual conditions different from arm's length conditions." For this purpose, "arm's length conditions" means the conditions that would have applied had the parties been dealing at arm's length in comparable circumstances, including the possibility that the parties would not have entered into the transaction or series at all, or would have entered into a different one, had they been dealing at arm's length. Notably, the collapsed rule appears intended to allow for substitution of an alternative transaction (or no transaction) without the need to prove either that no arm's length parties would enter into the same transaction (an objective standard endorsed in *Cameco*) or that there was a tax

avoidance motive. Although vague, Budget 2025 does note that “[i]n accordance with the Transfer Pricing Guidelines, and consistent with the interpretation rule, an in-scope transaction or series accurately analysed and determined should be replaced with an alternative transaction or series, or no transaction or series at all, only in exceptional circumstances.”

Under the proposals, the term “conditions” (used in place of “terms and conditions” under the current rules), in reference both to the taxpayer’s “actual conditions” and to the comparison “arm’s length conditions”, is to be construed broadly. In addition to traditional conditions such as prices and rates, the term includes (without being limited to) various measures of profit and contribution as well as “any commercial or financial information” that is relevant to determining the quantum and nature of amounts. The proposals also deem the actual conditions to be different from arm’s length conditions if a condition is missing from the transaction or series that would have been included had the parties been dealing at arm’s length.

## ‘Actual conditions’ and economically relevant characteristics

The proposed amendments include a number of definitional components that de-emphasize the contractual rights and obligations of the transactions and prioritize the parties’ “conduct” and the performance of functions. It was apparently necessary to specify, as the proposals do, that the term “actual conditions” refers to conditions that “actually” apply between participants in a transaction or series. The proposals also provide that a transaction or series of transactions is to be “analyzed and determined” — described as the “delineation” of the transaction or series — with reference to its “economically relevant characteristics”.

The term “economically relevant characteristics” also appeared (with some definitional differences) in the 2023 proposals, as it does (with more significant definitional differences) in the OECD Transfer Pricing Guidelines. In the Budget 2025 proposals, economically relevant characteristics are defined to include

- contractual terms (as long as they are consistent with “actual conduct”) of the transaction or series plus other relevant transactions or series that involve at least one of the parties or members of the multinational enterprise group
- the “actual conduct” of the parties, including their functions (including assets used, risks assumed, relationship between the functions and value generation, surrounding circumstances and industry practices)
- characteristics of the property transferred/services provided
- economic and market context
- business strategies of the parties

Aspects of this definition depart from the OECD Transfer Pricing Guidelines, which identify the “contractual terms of the transaction” as the first item in the definition of economically relevant characteristics, without explicitly allowing for an override by the “actual conduct” of the parties. The consultation paper had explained that the proposed reference to “actual conduct” was intended to prevent an overly narrow reading of the OECD Transfer Pricing Guidelines that might restrict the analysis to only intra-group contracts.

It is far from clear how the interpretation and application of these concepts (if adopted) would work in practice and how the courts would approach the proposed rules. It is worth noting, however, that Canadian courts have confirmed that transactions are to be priced under the existing legislation having regard to all of their economically relevant characteristics, making specific reference to the guidance in the OECD Transfer Pricing

## Consistency with OECD Transfer Pricing Guidelines

Similar to the 2023 proposals, Budget 2025 would introduce a rule requiring the analysis and determinations conducted pursuant to the key provisions of section 247 to be done so as to best achieve consistency with the OECD Transfer Pricing Guidelines (defined as the 2022 version, or any other text prescribed by regulation). A new rule would also require that the “most appropriate method” be selected and applied in accordance with the OECD Transfer Pricing Guidelines to determine whether actual conditions differ from arm’s length conditions.

## Penalties and contemporaneous documentation

Under the existing legislation, a penalty equal to 10% of a transfer pricing adjustment applies if the amount of the adjustment exceeds the lesser of a relative threshold and an absolute threshold of C\$5 million, unless the taxpayer made reasonable efforts to use arm’s length pricing and met the contemporaneous documentation requirements.

Consistent with the potential measures discussed in the 2023 consultation paper, Budget 2025 proposes to increase the absolute penalty threshold to C\$10 million. It also includes a proposed rule that would allow for alternative, simplified documentation requirements to be prescribed by regulation. While the consultation paper had discussed introducing simplified documentation requirements for lower-value transactions and smaller taxpayers, Budget 2025 does not identify any specific circumstances for such simplification at this time.

The proposals include amendments to the existing contemporaneous documentation requirements. Chief among these is a requirement to document (and make reasonable efforts in respect of) a series of transactions (rather than only a “transaction” under the existing rule) and to provide transfer pricing documentation to the CRA within 30 days of a request (currently three months). The latter proposal comes as a surprise, not having been foreshadowed in the consultation paper or otherwise, and is unlikely to be welcomed by taxpayers who are already overburdened by tax compliance. The deadline to make or obtain the necessary records by the applicable documentation due date (i.e., the tax return filing due date for the year) remains unchanged.

The proposals also modify the specifics of the contemporaneous documentation requirements to include language from the new definitions (including items described in “economically relevant characteristics”) and the new reference to selecting the most appropriate method in accordance with the Transfer Pricing Guidelines.

The consultation paper had discussed introducing streamlined pricing approaches for low value-adding intra-group services, routine distribution activities and intra-group loans. However, these proposals are not included in Budget 2025, nor is there mention of Canada adopting Amount B from Pillar One.

## FAPI treatment for investments in Canadian insurance risks

Paragraph 95(2)(a.2) of the ITA provides that income of a non-resident affiliate from the insurance or reinsurance of specified Canadian risks is included in computing foreign accrual property income (FAPI). A Canadian taxpayer must include in computing income its participating percentage of FAPI earned by a controlled foreign affiliate.

Budget 2025 proposes to amend this provision to additionally include in computing FAPI any income from any property held by a foreign affiliate “in connection with” the insurance or reinsurance of specified Canadian risks by “any person or partnership”. This amendment applies to taxation years of a foreign affiliate that begin after November 4, 2025.

## Global Minimum Tax Act

Budget 2025 includes a brief reference projecting that revenue primarily related to the *Global Minimum Tax Act* (GMTA) will increase to \$2.1 billion by 2029–2030. Budget 2025 also confirms the intention to proceed with proposed amendments to the GMTA released in August 2025 and August 2024. These proposed amendments include the undertaxed profits rule (UTPR), a measure intended to serve as a back-stop rule for the two enacted GMTA measures — namely, the domestic minimum top-up tax (DMTT) and the income inclusion rule (IIR) — by requiring payment of a residual top-up tax to the extent tax has not already been paid under the DMTT and IIR. This confirmation is notable because the United States has indicated that it may impose retaliatory measures against countries that impose a UTPR.

## Sales tax measures

### Carousel schemes

The 2024 Fall Economic Statement noted the government was considering how to address “carousel schemes,” which Budget 2025 describes as “a series of real or fraudulent transactions where at least one person, often known as the ‘missing trader’, collects GST/HST in respect of a supply of property or services but does not remit it to the government.”

Budget 2025 sets out a high-level description of how it proposes to address carousel schemes and invites stakeholders to provide their feedback on the proposed design by January 12, 2026, after which time the government will finalize the design of the new rules and bring forward enacting legislation.

The proposed changes centre on using a reverse charge mechanism (RCM), similar to how the *Excise Tax Act* already deals with emission allowances. GST/HST owing on the supply of services to which the RCM applies would be self-reported by the recipients of such services, not the suppliers, and, similarly, any input tax credits available in respect of such supplies would generally be claimable by the recipient on the same tax return when they accounted for the GST/HST payable. Under the proposed new rules, suppliers would be required to note on their invoices that the supply is subject to the RCM.

Under these new rules (and the existing rules for dealing with emission allowances), if a supplier charges tax in error, the recipient cannot claim an input tax credit and cannot claim a rebate for tax paid in error. The recipient can only get the amounts of tax paid in error back from the supplier directly. Thus, these rules create significant issues where a supplier charges tax in error.

One concern with the proposed changes is that they initially only apply to the supply of certain telecommunication services: services allowing the instant or near-instant transmission of speech, and the transmission of related information such as text and images provided in connection with such speech communications (in other words, the supply of voice-over Internet protocol (VoIP) minutes). Presumably this was done to deal with the decision of the Supreme Court of Canada in *Iris Technologies*, 2024 SCC 24. There are a number of other industries that have also seen significant amounts of fraud (such as precious metals). While we believe it would be desirable to extend these rules to these other

industries, we have significant concerns with the changes being made by regulation rather than by amendments to the *Excise Tax Act*. Specifically, due to the fairly unforgiving results where a supplier charges the tax in error, we have concerns that changes to regulations will not receive the same amount of public attention as an amendment to the *Excise Tax Act* itself. Further, changes to the regulations can generally be done much faster than legislative amendments, which may not give taxpayers supplying these goods or services enough time to change their processes in order to stop charging tax on these supplies.

## Underused Housing Tax Act and Select Luxury Items Tax Act

Budget 2025 proposes to eliminate the Underused Housing Tax effective for the 2025 taxation year and to amend the Select Luxury Items Tax Act so that it no longer applies to subject aircraft and subject vessels effective as of Budget Day. As a result, the *Underused Housing Tax Act* will only be relevant for the 2022–2024 taxation years.

The *Select Luxury Items Tax Act* will remain applicable to subject vehicles. In respect of subject aircraft and vessels, registered vendors for those items will be required to file a final return for the reporting period that includes Budget Day. They can continue to claim rebates after that time but will no longer be required to file returns for later reporting periods. All registrations will automatically be cancelled on February 1, 2028, and no rebates will be available after that date.

## Personal income tax measures

### Qualified investments for registered plans

Budget 2024 announced a consultation process for improving the clarity and coherence of the qualified investments rules that restrict investments that can be made by registered plans. Budget 2025 proposes a series of amendments as a result of this consultation.

### Investment funds

Units of a “mutual fund trust” are qualified investments for registered plans. Where a trust cannot reach mutual fund trust status because it is not sufficiently widely held, units of the trust may alternatively become qualified investments for registered plans if the trust is a “registered investment” for such plans.

Budget 2025 proposes to add two new categories of trusts that would be qualified investments (without requiring registration), namely:

- units of a trust that is subject to the requirements of National Instrument 81-102 published by the Canadian Securities Administrators (which regulates certain mutual funds and non-redeemable investment funds) (category 1)
- units of a trust that is an investment fund (as defined in the ITA) managed by a registered investment fund manager as described in National Instrument 31-103 published by the Canadian Securities Administrators (category 2)

Category 1 would generally consist of units of (i) investment funds, the units of which are redeemable at a price determined with reference to NAV, and (ii) a non-redeemable investment fund that is prospectus-qualified and whose primary purpose is to invest money provided by its securityholders and that does not control, and is not actively involved in the

management of, any entity (other than another category 1 fund).

Category 2 would generally consist of private investment funds that are managed by a registered investment fund manager, provided the trust qualifies as an “investment fund” as defined in the ITA. Among other conditions, to qualify as an “investment fund” under the ITA, the trust must be resident in Canada, issue fixed-interest units to investors, follow a reasonable policy of investment diversification and restrict its activities to investing in property. In addition, the trust cannot have discretionary beneficiaries, must not control corporations and is subject to strict limits on the types and amounts of property it can hold, including restrictions on holding real property, resource property and significant interests in other entities.

These new categories of qualified investments would apply as of Budget Day.

## Registered investment regime

With the introduction of the new categories of qualified investments, Budget 2025 also proposes to repeal the registered investment regime as of January 1, 2027. Budget 2025 states that it is generally expected that units or shares of funds that were registered investments would continue to be qualified investments, either under existing qualified investment rules or under one or both of the new categories of qualified investments. The registered investment regime would be repealed as of January 1, 2027.

## Clarifying the qualified investment rules and investments in small businesses

Budget 2025 includes additional proposals to make a number of technical legislative amendments to the qualified investment rules, including

- consolidating into one definition the qualified investment rules for all registered investment plans (except DPSPs)
- updating and reorganizing the list of qualified investments prescribed in the *Income Tax Regulations* by asset class, with the stated objective of making the rules clearer
- simplifying the qualified investment rules that apply to investments in small businesses across all investment plans (including RDSPs)

These changes would apply as of January 1, 2027.

## Classification of workers

Budget 2025 proposes to amend the information sharing provisions of the ITA and the *Excise Tax Act* to allow the CRA to share taxpayer information and confidential information with Employment and Social Development Canada for the purposes of the administration and enforcement of the *Canada Labour Code* as it relates to the classification of workers. This measure is stated to, in part, target deliberate misclassification of employees as independent contractors to avoid the withholding and remittance of amounts of income tax and employment taxes. Budget 2025 further announces additional funding for the CRA to implement a program that addresses non-compliance in these matters related to personal services business.

## Trust 21-year rule anti-avoidance

Generally, personal trusts are deemed to have disposed of their capital property and certain other property at fair market value on the 21<sup>st</sup> anniversary of their creation, and every 21<sup>st</sup> anniversary thereafter (the so-called “21-year rule”). This rule prevents the use of a personal trust to defer tax on accrued gains on such properties indefinitely. The ITA provides that where a trust transfers such properties to another trust on a tax-deferred basis, the transferee trust inherits the 21-year anniversary of the transferor trust. In this way, the 21-year rule is not avoided by a transfer to a new trust to reset the 21-year period.

Budget 2025 proposes to broaden this rule to include indirect transfers of trust property to other trusts. It cites the transfer of property to a corporation owned by a trust as a transaction that would now be caught by the expanded anti-avoidance rule. The new measure applies to transfers of property that occur on or after Budget Day.

## Automatic federal benefits for lower-income individuals

Budget 2025 includes a proposal for the 2025 and subsequent taxation years that would grant the CRA the discretionary authority to file a tax return for a taxation year on behalf of an individual (other than a trust). The rule would apply to a taxpayer whose taxable income for the taxation year is below the lower of either the federal basic personal amount or the provincial equivalent, and who otherwise meets certain additional criteria in the year. The rule would only apply where, at least once in the three preceding taxation years, the individual has not filed a tax return. This proposal is intended to ensure that such individuals receive the benefit and credit payments delivered through the tax system, given that the CRA determines entitlement for most benefits based on reported net income.

## Other measures

### Canada Revenue Agency

Budget 2025 proposes to “modernize [the CRA’s] administrative approach to enable greater productivity”. Savings from this process, as well as from winding down business units for taxes that have been or will be rescinded, such as the *Digital Services Tax Act*, will in part be reinvested in the CRA “to improve services, strengthen compliance, and reduce tax debt.” Proposed improvements include the use of “AI and process automation”—for example, to automate tasks in the risk scoring process.

The total fiscal impact of reducing the CRA’s expenses and the additional revenues resulting from reinvesting some of those savings is projected to be almost \$700 million in 2026–2027, rising to over \$1.1 billion annually from 2028–2029 onward.

## Increased threshold for informal appeals

Budget 2025 states that the Department of Justice will review the thresholds for taxpayers to access the informal procedure at the Tax Court of Canada for income tax and GST appeals. The current thresholds are \$25,000 of amounts in issue under the ITA, and \$50,000 of losses under the ITA or amounts in dispute in respect of GST. These thresholds have not been increased since 2013, when they were roughly doubled from \$12,000 and \$24,000 (applicable to ITA appeals only).

## Confirmation of intention to proceed

Budget 2025 reaffirms the federal government's intention to proceed with numerous previously announced tax measures, including the following:

- legislative and regulatory proposals released on August 15, 2025, including with respect to the following measures:
  - [capital gains rollover on small business investments](#)
  - [reporting by non-profit organizations](#), subject to a deferred application date for taxation years beginning January 1, 2027, or later (the government is reviewing the feedback it received from consultations with stakeholders and will release final proposals in due course that minimise any additional administrative burden and clarify which organizations are, or are not, subject to the new requirement)
  - [scientific research and experimental development tax incentive program](#)
  - [cryptoasset reporting framework and the Common Reporting Standard](#) (subject to a deferred application date of January 1, 2027)
  - tax exemption for sales to [employee ownership trusts](#)
  - [tax exemption for sales to worker cooperatives](#)
  - [CRA information requests](#)
  - [excessive interest and financing expenses limitation \(EIFEL\) rules](#)
  - [substantive CCPCs](#)
  - Goods and Services Tax/Harmonized Sales Tax (GST/HST) rules for the [redemption of coupons](#)
  - technical tax amendments to the *Income Tax Act* and the *Income Tax Regulations* (subject to a deferred application date for [reporting by bare trusts](#), so that it would apply to taxation years ending on or after December 31, 2026)
  - technical amendments to the [Global Minimum Tax Act](#)
  - technical amendments relating to the GST/HST and excise levies
- the extension of the mineral exploration tax credit announced on March 3, 2025
- legislative and regulatory proposals announced in the 2024 Fall Economic Statement, including with respect to the following measures:
  - exempting the Canada Disability Benefit from income
  - expanding eligibility under the [clean electricity investment tax credit](#) to the Canada Infrastructure Bank
  - modifying the small nuclear energy eligibility under the clean technology investment tax credit
  - expanding eligibility under the [clean hydrogen investment tax credit](#) to methane pyrolysis
  - extension of the [accelerated investment incentive and immediate expensing measures](#)
- legislative and regulatory proposals released on August 12, 2024, including with respect to the following measures:
  - [Alternative Minimum Tax](#) (other than changes related to resource expense deductions)
  - [avoidance of tax debts](#)

- [mutual fund corporations](#)
- [synthetic equity arrangements](#)
- [bankruptcy and debt forgiveness rules](#)
- [accelerated capital cost allowance for certain classes](#)
- [accelerated capital cost allowance for purpose-built rental housing](#)
- [withholding on services](#)
- regulations related to the application of the Enhanced (100%) GST Rental Rebate to cooperative housing corporations
- [clean electricity investment tax credit](#)
- expanding eligibility under the [clean technology investment tax credit](#) to support generation of electricity and heat from waste biomass
- [proposed expansion](#) of eligibility for the clean technology manufacturing investment tax credit to support polymetallic extraction and processing
- amendments to the [Global Minimum Tax Act and the Income Tax Conventions Interpretation Act](#)
- [technical tax amendments](#) to the *Income Tax Act* and the *Income Tax Regulations*
- [technical amendments relating to the GST/HST, excise levies and other taxes and charges](#)
- the [proposed exemption](#) from the Alternative Minimum Tax for certain trusts for the benefit of Indigenous groups announced in Budget 2024
- the proposed [increase in the lifetime capital gains exemption](#) to apply to up to \$1.25 million of eligible capital gains announced in Budget 2024
- legislative and regulatory proposals announced in Budget 2024 with respect to a new importation limit for packaged raw leaf tobacco for personal use
- tax measures to amend the *Excise Tax Act*, the *Air Travellers Security Charge Act*, the *Excise Act, 2001* and the *Select Luxury Items Tax Act* to give effect to the proposals relating to [CRA information requests](#) and to [avoidance of tax debts](#) announced in Budget 2024
- legislative proposals released on August 4, 2023, including with respect to the following measures:
  - [technical amendments to GST/HST rules for financial institutions](#)
  - [revised luxury tax draft regulations to provide greater clarity on the tax treatment of luxury items](#)
- legislative proposals released on August 9, 2022, including with respect to the following measures:
  - [technical amendments](#) to the *Income Tax Act* and *Income Tax Regulations*
  - remaining legislative and regulatory proposals relating to the GST/HST, excise levies and other taxes and charges
- legislative amendments to implement the [hybrid mismatch arrangements](#) rules announced in Budget 2021
- other technical amendments as required to improve the certainty and integrity of the tax system

If you have any questions or require additional analysis on Budget 2025, please contact any member of our [National Tax Department](#).