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Canadian tax alert

2015-2016 Federal budget highlights

The Minister of Finance, Joe Oliver, presented the 2015-2016 budget in the House of Commons this afternoon. The government has balanced the budget and will focus on responsible fiscal management in the face of lower oil prices going forward. Nonetheless, a number of measures aimed at helping families, supporting job creation, as well as making investments in infrastructure and transportation are proposed. We are pleased to see that the budget addresses the administrative burden imposed on taxpayers in the context of cross-border investment and commerce. In addition, the budget introduces expenditures to enhance research and innovation in Canada, including the Canada Foundation for Innovation and the Automotive Supplier Innovation Program. As we believe that sustained economic growth in Canada will depend on our country's ability to enhance productivity, we welcome these innovation-friendly measures as a further step in the right direction.

Fiscal/economic outlook

Mr. Oliver indicated that budget is balanced for 2015-2016. This was achieved by counterbalancing the recent fall in oil prices with the sale of the government's shares in General Motors. The deficit for the 2014-2015 fiscal year is an estimated $2 billion. A surplus of $1.4 billion is predicted for 2015-2016.

The federal debt-to-GDP ratio is estimated to be approximately 31.2% for 2014-2015. This ratio is projected to decline to 30.8% in 2015-2016 and to continue to do so thereafter, reaching 25.5% in 2019-2020. Unemployment is currently at the rate of 6.7%.

The following is a summary of the tax highlights contained in the budget.

Measures concerning business

- The budget proposes to reduce the small business tax rate from 11% to 9% by 2019. The rate will decrease by 0.5% each year starting on January 1, 2016, with the changes being prorated for taxation year-ends that do not coincide with the calendar year.
- The budget announces a consultation to review the definition of active versus investment business income for purposes of the small business deduction. The government invites interested parties to submit comments by August 31, 2015.
- It is proposed that the rate at which capital cost allowance (CCA) can be claimed for machinery and equipment acquired after 2015 and before 2026 for use in manufacturing or processing be reduced. While the existing rate of 50% will continue to apply, and not the 30% rate which would otherwise be available under Class 43, CCA will be computed on a declining balance basis, rather than on the straight-line basis currently provided for under Class 29.
- The government continues to receive comments on the proposal to repeal the eligible capital property regime and replace it with a new CCA class. The government intends to release draft legislation for comment before they are included in a bill.
- It is proposed that after 2015, new employers with withholdings of less than $1,000 in source deductions each month will be eligible to remit withholdings on a quarterly basis, rather than on a monthly basis.
- The budget proposes to expand the scope of the anti-avoidance rule in section 55 of the Income Tax Act to prevent corporate taxpayers from using intercorporate dividends to create or increase unrealized capital losses that can be used to shelter capital gains on other properties. The rule will apply to dividends received on or after April 21, 2015, where one of the purposes of a dividend is to significantly reduce the fair market value of any share or significantly increase the total cost of properties of the recipient of the dividend. Certain other related anti-avoidance amendments are also proposed.
- The dividend rental arrangement rules are proposed to be modified to deny the intercorporate dividend deduction on dividends received by a taxpayer on a Canadian share where substantially all risk of loss or opportunity for profit in respect of the share is transferred to a counterparty that is either a tax-exempt entity or a non-resident of Canada. Related anti-avoidance measures are also proposed. This proposal applies to dividends that are paid or become payable after October 2015.
    - As an alternative proposal, the intercorporate dividend deduction could be denied on dividends received by a taxpayer on a Canadian share under any synthetic arrangement, regardless of the tax status of the counterparty. Before this expanded measure is implemented, the government invites interested stakeholders to submit comments by August 31, 2015.
- The tax deferral available on patronage dividends paid to members by an eligible agricultural cooperative in the form of eligible shares is proposed to be extended to apply to eligible shares issued before 2021.

International tax measures

- Starting with payments in 2016, the budget provides relief from personal income tax withholding requirements for a non-resident employer that pays a non-resident employee for services rendered in Canada, in certain situations where treaty relief would otherwise exempt the individual from Canadian personal income tax. A number of conditions must be met for this relief to be applicable, including a requirement that the employee cannot be present in Canada for 90 days or more in any 12 month period that includes the payment, and a requirement that the employer be certified by the Minister of National Revenue at the time of the payment. Employers must not carry on business through a permanent establishment in Canada to be eligible for certification. Payroll reporting requirements will continue to apply.

- The budget proposes to simplify the reporting requirements for taxpayers holding specified foreign property with an aggregate cost of less than $250,000 throughout the year. A simplified foreign income reporting system will be applicable for taxation years that begin after 2014.
- As work on the Organisation for Economic Co-operation and Development (OECD) base erosion and profit shifting project continues, the government has announced its intention to continue holding discussions with the international community on the implementation of the project's recommendations and conclusions. The government has reiterated its commitment to balancing tax fairness and integrity with the continuing competitiveness of the Canadian tax system.
- The budget announces the government's intention to implement, effective July 1, 2017, the OECD's common reporting standard for automatic information exchange between tax authorities in different jurisdictions. By implementation date, financial institutions will be expected to have procedures in place that allow them to identify any accounts held by non-residents of Canada and to report required information to the Canada Revenue Agency (CRA). No reporting will be required in respect of accounts held by Canadian residents with foreign citizenship.
- Building on amendments introduced in last year's budget relating to captive insurance companies, additional measures have been proposed in order to ensure that profits from the insurance of Canadian risks continue to be taxable in Canada. Effective for taxation years that begin on or after April 21, 2015, profits from the ceding of Canadian risks will be included in the foreign accrual property income of a foreign affiliate. Comments on this proposal will be accepted up until June 30, 2015.

Measures concerning individuals

- As anticipated, the tax-free savings account (TFSA) annual contribution limit is proposed to be increased to $10,000 from the current $5,500, applicable as of January 1, 2015. The TFSA contribution limit will no longer be indexed annually to inflation.
- Registered retirement income fund (RRIF) minimum withdrawal factors are proposed to be adjusted, applicable for 2015 and subsequent taxation years. Consequently, the mandatory minimum withdrawal amounts for individuals aged 71to 94 will be lower than under current regulations. A transitional measure will permit individuals to recontribute withdrawals for 2015 that are in excess of the new proposed withdrawal amount. Parallel amendments will be made in respect of mandatory withdrawal amounts for registered pension plans and pooled registered pension plans.
- The budget proposes to increase the lifetime capital gains exemption in respect of the disposition of qualified farm or fishing property to $1 million from the current indexed amount of $813,600. This change will apply to dispositions occurring on or after April 21, 2015.
  - The exemption will be the greater of (i) $1 million and (ii) the indexed lifetime capital gains exemption in respect of qualified small business corporation shares.
- In order to maintain integration in connection with the reduction in the small business tax rate, changes to the gross-up factor and dividend tax credit rate in respect of non-eligible dividends are proposed which will result in non-eligible dividends being taxed at higher rates.
- A new non-refundable home accessibility tax credit is introduced in respect of work done or goods acquired after 2015. The credit is equal to 15% of eligible expenditures up to $10,000 per calendar year per qualifying individual and per eligible dwelling.
  - Eligible expenditures are those that enduring in nature and integral to the dwelling that relate to a renovation or alteration that allows a qualifying individual to gain access to or be more mobile within the dwelling or reduces the risk of harm within or in gaining access to the dwelling.
  - An eligible dwelling is generally the principal residence ordinarily inhabited by a qualifying individual.

    - Qualifying individuals are individuals aged 65 or older at the end of a taxation year and persons eligible for the disability tax credit at any time in a taxation year.
    - Qualifying or eligible individuals will be entitled to claim the credit. Eligible individuals are generally individuals who have or could have claimed a spouse or common law credit, eligible dependant amount, caregiver amount or infirm dependant amount in respect of a qualifying individual.
- Temporary measures introduced in the 2012 budget permitting a qualifying family member to be the holder of a registered disability savings plan for an adult individual lacking capacity to enter into the contract have been extended such that the family member may become the plan holder until the end of 2018 rather than the end of 2016.
- Applicable to the 2015 and subsequent taxation years, the penalty for repeatedly failing to report income is proposed to only apply if a taxpayer fails to report at least $500 of income in the year and any of the three preceding years. The penalty will be the lesser of 10% of unreported income and 50% of the difference between the resulting understatement of tax (or overstatement of credits) and the amount of tax paid in respect of the unreported amount.
- The family tax cut calculation is proposed to be amended to ensure that the transfer of education credits does not adversely affect the amount of the family tax cut. The amendment will be effective after Royal Assent but will apply to the 2014 and subsequent taxation years.
- The budget proposes to allow the CRA or the courts to increase or adjust an amount in an assessment under objection or appeal at any time, as long as the total assessment amount is not increased. Similar amendments are proposed in respect of the Excise Tax Act and the Excise Act, 2001. These amendments will apply after Royal Assent.
- Administrative changes are proposed to allow information sharing among CRA personnel so that the same individuals can collect both tax and non-tax debts. These amendments will apply after Royal Assent.

Measures concerning charities

- Starting in 2017, when a taxpayer disposes of real estate or shares of a private corporation to an arm's length party, the budget proposes to exempt the resulting capital gain from income tax to the extent that cash proceeds from the sale are donated to a qualified donee within 30 days. The purchaser must also deal at arm's length with the donee, and additional anti-avoidance measures have also been proposed.
- A number of amendments designed to permit registered charities, private foundations and registered Canadian amateur athletic associations to hold investments in limited partnerships are proposed, effective April 21, 2015. Permissible investments must represent less than 20% of the interests in a particular limited partnership, taking into consideration interests held by parties not dealing at arm's length with the charity or association. The charity must also deal at arm's length with each general partner of the limited partnership.
- The budget proposes to extend qualified donee status to certain foreign charitable foundations that have received a gift from the Canadian government, provided that such foundations are either pursuing activities related to disaster relief or urgent humanitarian aid, or are carrying on activities that are in Canada's national interest. Donations made by taxpayers to organizations with qualified donee status are eligible for the charitable tax credit or deduction. This proposal will be effective on Royal Assent.

Other measures

- The government has announced its intention to lower the Employment Insurance (EI) premium rate in 2017 via a seven-year break-even rate setting mechanism.
- Compassionate care benefits under the EI program are proposed to be expanded from the current six weeks to six months beginning January 2016.

For further details on the measures contained in the federal budget, we refer you to the **Ministry of Finance website**.

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With the right tax policy, we believe that Canada can be more productive and globally competitive. The key lies in creating a tax ecosystem capable of fostering innovation and investment while supporting the objective of a balanced budget.

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