TaxTalk

2017 FEDERAL BUDGET HIGHLIGHTS

On March 22, 2017, Federal Finance Minister Bill Morneau presented the 2017 Federal Budget. Titled "*Building a Strong Middle Class*".

The Federal Government's 2017–18 Budget gives Canadians a taste of what they might expect over the next couple of years: attempted efficiencies, closed tax loopholes, steady deficits, and a touch of caution. Budget 2017 outlines only $200 million in net new spending, but also an increase to the deficit of more than $5 billion for 2017–18, partly due to commitments from the previous budget, reduced revenues and increased general expenses.

There are no changes to corporate or personal income tax rates or the small business deduction threshold and no changes to capital gains taxation. In addition, the government did not address in the Budget a number of tax issues it has discussed since Budget 2016, indicating it will release more details on its plans to limit tax-planning strategies later this year. Concerns over potential changes to taxes, trade agreements and regulations in the United States have no doubt caused Canada's Federal Government to reconsider its own tax strategy.

The Budget proposes to address a range of tax loopholes and inefficiencies, including: eliminating billed-basis accounting for certain professionals, preventing tax avoidance through straddle transactions, eliminating the tax deduction for home relocation loans, eliminating the additional deduction for gifts of medicine, and eliminating the Public Transit Tax Credit.

In order to advance the twin goals of reducing tax evasion and improving compliance, the government plans to give the Canada Revenue Agency an additional $523.9 million over the next five years. The government anticipates a five-fold return on its investment, hoping the CRA will recover $2.5 billion for its efforts.

We can expect to see more substantial proposals for change as the year progresses. The government has clearly signaled that it will be looking for additional ways to prevent tax avoidance.

The tax highlights of the budget are as follows:

BUSINESS TAX MEASURES

The Budget makes no changes to corporate tax rates. In addition, no changes are made to eligibility for the small business rate.

Tax Planning Using Private Corporations

The government's review of federal tax expenditures highlighted issues in respect of tax planning strategies available to owners of private corporations. The government feels that these strategies can result in high-income individuals gaining unfair tax advantages not available to other Canadians. As the Budget papers indicate, measures have been put in place over the years to limit the scope of certain of these arrangements. However, the government is of the opinion that such measures have not always been as effective as desired. Accordingly, the government is further reviewing the use of private corporation tax planning strategies that may reduce the personal tax of high-income earners in a manner considered inappropriate. In particular, the government has identified the following strategies for review:

- Income sprinkling — causing income that would be taxable to an individual at a high rate to be realized by, and therefore taxed in the hands of, a family member subject to a lower marginal tax rate, commonly achieved through dividends or capital gains.

- Holding of portfolio investments — corporate tax rates on ordinary business income are generally much lower than personal rates; retaining income in a private corporation can therefore facilitate accumulation of a larger pool of funds for investment.

- Conversion of regular income into capital gains — causing income that would normally be paid to the shareholder as salary or dividend to be converted to capital gains, taxed at a significantly lower tax rate.

As part of its review of this area, the government will also examine current legislation that may have inappropriate tax consequences in connection with genuine business transactions between family members, including inter-generational transfers of family businesses. In the coming months, a paper will be released that will review these issues in detail and provide proposed policy responses.

Billed-Basis Accounting

Members of designated professions (accountants, dentists, lawyers, medical doctors, veterinarians and chiropractors) may elect to exclude the value of their work in progress (WIP) in computing their income. Where this election is made, a tax deferral is achieved as the costs associated with the WIP are deducted as incurred whereas the revenue is recognized only when the WIP is actually billed to clients.

The Budget proposes to eliminate the WIP exclusion over a two-year period, effective for taxation years beginning after March 21, 2017. For the first affected taxation year, WIP will be valued at 50 per cent of the lesser of its cost and fair market value and must be recognized for tax purposes and not excluded from income. For subsequent years, WIP, valued at the lesser of its cost and fair market value, must be recognized for tax purposes and cannot be excluded from income.

These provisions will require a determination of the cost of the WIP, which may not be readily available.

Meaning of Factual Control

There are two main definitions of control for tax purposes — de jure or legal control and de facto or factual control. Some provisions rely on de jure control whereas others rely on de facto control.

De facto control is broader than legal control and takes into account influence that, if exercised, would result in control in fact of a corporation. It is particularly relevant for purposes of determining whether or not corporations are associated and therefore required to share the annual $500,000 small business deduction limit and certain other limits.

Recent jurisprudence essentially restricted control in fact to circumstances where the potential controller has an enforceable right to change the board of directors or its powers or can exercise influence over shareholders who have the right and ability to make such changes. The Budget proposes to effectively override the case law. For taxation years beginning after

March 21, 2017, all factors relevant in the particular situation, not just those that meet the criteria set out in the recent jurisprudence, shall be included in assessing whether or not de facto control is present.

Distribution of T4 Information Slips

Effective for 2017, employers will not be required to obtain express consent from employees to electronically distribute T4s (Statement of Remuneration Paid). Privacy policy safeguards specified by the Minister of National Revenue will be required to be in place before an employer can electronically distribute T4s without employee consent.

Timing of Recognition of Gains and Losses on Derivatives

Derivatives are sophisticated financial instruments whose value is derived from the value of an underlying security. The Budget proposes two measures that clarify the timing of the recognition of gains and losses from derivatives held on income account.

In the past, there was uncertainty as to whether taxpayers could mark to market their derivatives held on income account under the general principles of profit computation. A recent Federal Court of Appeal decision allowed the use of the mark-to-market method for a taxpayer which was not a financial institution on the basis that it provided an accurate picture of the taxpayer's income.

To provide certainty regarding the choice of using the mark-to-market method, the Budget proposes an elective mark-to-market regime for derivatives held on income account so that taxpayers will be allowed to mark to market all of their eligible derivatives for taxation years beginning after March 21, 2017. Once made, the election will remain effective for all subsequent years unless revoked with the consent of the Minister of National Revenue.

A straddle transaction is one in which a taxpayer concurrently enters into two or more positions, often derivative positions, that are expected to generate equal and offsetting gains and losses on account of income. In order to obtain a tax deferral, the position with the accrued loss would be disposed of in one taxation year to realize the loss and the offsetting position with the accrued gain would be disposed of to realize the gain in the following taxation year. In addition, the taxpayer could attempt to indefinitely defer the recognition of the gain by entering into successive straddle transactions.

The Budget proposes to introduce a specific anti-avoidance "stop-loss" rule, which will effectively defer the realization of any loss on the disposition of a position to the extent of any unrealized gain inherent in an offsetting position. This proposal will apply to any loss realized on a position entered into after March 21, 2017.

PERSONAL TAX MEASURES

The Budget did not propose a number of changes that were the subject of heavy speculation. In particular, the capital gains inclusion rate will not increase and remains at 50 per cent. A dollar limit is not imposed on the employee stock option deduction and thus it will continue to be calculated as half the stock option benefit amount.

Personal income tax rates will not increase under the Budget.

2017 Top Marginal Personal Tax Rates

Type of Income	Over $220,000
Eligible dividends	39.34%
Non-eligible dividends	45.30%
Capital gains	26.76%
Salary and other income	53.53%

Tuition Tax Credit

Effective January 1, 2017, the Budget proposes to expand the types of courses that are eligible for the Tuition Tax Credit.

The Tuition Tax Credit can currently be claimed with respect to occupational skills courses taken at a non-post-secondary institution. In contrast, the credit cannot be claimed for similar non-post-secondary level courses taken at a college or university.

The Budget proposes to allow the Tuition Tax Credit to be claimed in the latter instance and, further, to allow the scholarship exemption for bursaries related to such courses, provided that all other conditions for the exemption are met.

Simplifying the Caregiver Credit System

The existing Caregiver Credit, Infirm Dependent Credit and Family Caregiver Tax Credit each have different eligibility rules. The Budget proposes to simplify these existing credits by replacing them with a single new, non-refundable credit, the Canada Caregiver Credit. This credit will provide tax relief of up to 15 per cent of $6,883 (in 2017) for expenses for care of dependent relatives with infirmities, and up to 15 per cent of $2,150 (in 2017) for expenses for care of a dependent spouse/common-law partner or minor child with an infirmity. There is no requirement for the dependent to live with the caregiver to claim the credit.

This new credit will start to be reduced when the dependent's net income is above $16,163 (in 2017, indexed to inflation for taxation years after 2017).

Disability Tax Credit — Certification by Nurse Practitioners

The Budget proposes to allow nurse practitioners to certify impairments for purposes of the Disability Tax Credit. This measure will be effective for certifications made after March 21, 2017.

Medical Expense Tax Credit — Fertility-Related Expenses

For the 2017 taxation year and beyond, the Budget proposes to clarify the types of fertility-related expenses that are eligible for the Medical Expense Tax Credit. In particular, persons who require medical intervention to conceive, even if not infertile, will explicitly be allowed to claim the credit for expenses that would generally be eligible for someone who has an infertility condition.

Public Transit Tax Credit

The Public Transit Credit is proposed to be eliminated under the Budget for transit use after June 30, 2017.

Home Relocation Loans Deduction

The Budget proposes to eliminate the home relocation loans deduction for benefits realized on January 1, 2018, and beyond. Accordingly, an individual who receives a loan from their employer that qualifies as an eligible home relocation loan will no longer be entitled to offset any imputed interest benefit in the 2018 taxation year and beyond.

CHARITIES

Ecological Gifts Program

The Budget proposes changes to protect gifts of ecologically sensitive property made after March 21, 2017:

Gifts of Medicine

The additional corporate deduction for gifts of medicine from their inventory is eliminated for such gifts made after March 21, 2017.

SALES AND EXCISE TAX MEASURES

Taxi and Ride-Sharing Services

To ensure that the GST/HST applies consistently to taxi services and ride-sharing services, effective July 1, 2017, the definition of a taxi business will be amended to require providers of ride-sharing services to register for the GST/HST and charge tax on their fares in the same manner as taxi operators.

Elimination of Non-Resident GST/HST Rebate for Tour Package Accommodations

The GST/HST rebate available to non-resident individuals and tour operators in respect of the accommodation portion of eligible tour packages will be repealed effective March 23, 2017, subject to a transitional exemption in respect of eligible tour packages supplied and paid for prior to January 1, 2018.

Offices: 20 Bay Street, Suite 1510
Toronto, Ontario M5J 2N8
Phone: 416-362-0515
Fax: 416-362-0539

1900 Minnesota Court, Suite 116
Mississauga, Ontario L5N 3C9
Phone: 905-451-4788
Fax: 905-451-3299

TaxTalk is prepared by our Tax Group (taxtalk@mgca.com). Please visit our web site at www.mgca.com.

McCarney Group LLP is an independent member of Morison KSi