ECONOMIC GROWTH, JOB CREATION, STRONG MIDDLE CLASS

FEDERAL BUDGET COMMENTARY

MARCH 22, 2017

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BUSINESS INCOME 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.

THEME:

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.

The projected deficit for 2017–18 is $28.5 billion, declining to $18.8 billion by 2021–22 (including an annual $3 billion contingency fund). However, if the government's strong growth scenario plays out, we could see a much smaller deficit between $5 and $8 billion by 2021. Instead of planning to eliminate the deficit as previously proposed, the government says it will maintain a balanced net debt-to-GDP ratio of around 31 per cent over the next five years.

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, applying tax-avoidance rules to Registered Education Savings Plans (RESPs) and Registered Disability Savings Plans (RDSPs), eliminating the additional deduction for gifts of medicine, preventing Canadian life insurers from using foreign branches to avoid tax, repealing the tax exemption for insurers of farming and fishing property, 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.

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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.

Clean Energy Generation Equipment

Capital cost allowance (CCA) classes 43.1 and 43.2 provide for accelerated CCA on clean energy generation equipment. The Budget expands the assets qualifying for these classes to include geothermal energy equipment used primarily for the purpose of generating heat or a combination of heat and electricity and certain equipment in district energy systems that use geothermal heating as an energy source.

Canadian renewable and conservation expenses may be deducted in the year incurred, carried forward indefinitely for use in future years or transferred to investors through a flow-through share mechanism. The Budget proposes to include expenses incurred to determine the quality and extent of geothermal resources and the cost of geothermal drilling for electricity and heating projects in this category.

The measures are applicable for new property acquired for use and expenses incurred after March 21, 2017.

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Resource Measures

Expenditures in respect of drilling or completing a discovery well, including building access roads to or preparing the site for such wells, are currently classified as Canadian exploration expense (CEE, fully deductible in the year incurred). The Budget proposes to classify these expenditures as Canadian development expense (CDE, deductible on a 30 per cent declining-balance basis).
This measure will apply to expenses incurred after 2018, including those incurred in 2019 that could have been deemed incurred in 2018 under the "look-back" rule. Expenses incurred before 2021 pursuant to a written commitment to incur the expenses entered into before March 22, 2017, will still qualify as CEE.

Eligible small oil and gas corporations will no longer be able to treat their first $1 million of CDE as CEE. This measure will apply to expenses incurred after 2018, including those incurred in 2019 that could have been deemed incurred in 2018 under the "look-back" rule. Expenses incurred after 2018 and before April 2019 that are renounced to investors under a flow-through share agreement entered into after 2016 and before March 22, 2017, will be exempt from the new rules.

Child Care Space Investment Tax Credit

The Budget eliminates the investment tax credit for child care space expenditures incurred after March 21, 2017. Expenditures incurred before 2020 pursuant to written agreements entered into before March 22, 2017 will still be eligible for the investment tax credit.

PERSONAL INCOME 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.

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.

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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.

Mineral Exploration Tax Credit for Flow — Through Share Investors

Eligibility for the Mineral Exploration Tax Credit is proposed to be extended for one year under the Budget. The credit will apply to flow-through share agreements entered into on or before March 31, 2018.

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.

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First-Time Donor's Super Credit

The Budget confirms the expiration of the First-Time Donor's Super Credit, as planned, after 2017.

Anti-avoidance Rules for Registered Plans

The anti-avoidance rules that currently exist for Registered Retirement Savings Plans and Tax-Free Savings Accounts are proposed to be extended to RESPs and RDSPs under the Budget. These changes will apply to transactions occurring after March 22, 2017, with the following exceptions.
The advantage rules will not apply to swap transactions occurring on or before June 30, 2017. Further, the proposed changes will not apply to swap transactions undertaken on or before December 31, 2021, where the purpose of the transaction is to ensure that the RESP or RDSP complies with the advantage or prohibited investment rules.

In addition, an RESP or RDSP plan-holder may elect by April 1, 2018, not to pay advantage tax on the distribution of investment income from an investment that was held on March 22, 2017, but instead pay regular personal income tax.

SALES TAX, EXCISE TAX AND OTHER 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.

Thank you for reviewing the
2017 FEDERAL BUDGET COMMENTARY
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clarification you may need.
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