MNP Federal Budget Summary - 2017

ACCOUNTING › CONSULTING › TAX

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FEDERAL BUDGET HIGHLIGHTS

On Wednesday, March 22, 2017, the Honourable Bill Morneau, Minister of Finance, delivered the Liberal government's second Federal Budget, *Building a Strong Middle Class.*

According to the Minister of Finance, *"with its strong focus on innovation, skills, partnerships and fairness, Budget 2017 takes the next steps in securing a more prosperous future for all Canadians."*

The 2017 Federal Budget projects a deficit of $28.5 billion in 2017-18, with a gradual decline to a deficit of $18.8 billion in 2021-22.

A. Corporate Tax Measures

PRIVATE CORPORATIONS

Prior to the 2017 Federal Budget, there was speculation in the marketplace that there would be significant changes with respect to the taxation of private corporations and their shareholders, including a possible increase to the capital gains inclusion rate and further modifications to small business taxation.

While the 2017 Budget does not propose any specific changes with respect to these items, the Government has stated that it is reviewing the use of various tax planning strategies using private corporations to reduce or defer personal taxes of high-income earners.

The Government intends to release a paper in the coming months outlining the nature of the issues in more detail, as well as proposed changes to address these issues.

CORPORATE TAX RATES

No new corporate income tax rate changes have been announced in this year's Budget. The combined Federal and Provincial / Territorial small business tax rates for 2017 are as follows:

	Small Business Corporations		General Corporations	
	Rate	Threshold	Non M&P	M&P
Federal	10.50%	$500,000	15.00%	15.00%
British Columbia	12.62%	$500,000	26.00%	26.00%
Alberta	12.50%	$500,000	27.00%	27.00%
Saskatchewan	12.50%	$500,000	26.75%	24.75%
Manitoba	10.50%	$450,000	27.00%	27.00%
Ontario	15.00%	$500,000	26.50%	25.00%
Quebec	18.50%	$500,000	26.80%	26.80%
New Brunswick	14.00%	$500,000	29.00%	29.00%
Nova Scotia	13.50%	$350,000	31.00%	31.00%

Prince Edward Island	15.00%	$500,000	31.00%	31.00%
Newfoundland	13.50%	$500,000	30.00%	30.00%

BILLED BASIS ACCOUNTING

Professionals, such as dentists, medical doctors, veterinarians, accountants, chiropractors and lawyers are able to exclude the amount of their work in progress when computing their income; colloquially referred to as the "WIP deduction." However, this amount is included in income when billed. Budget 2017 proposes to eliminate the WIP deduction for taxation years that begin on or after Budget Day. This measure may be transitioned by including 50% of the lesser of cost and fair market value of the WIP in income for the first taxation year after March 22, 2017, with the full amount being included in subsequent taxation years.

MEANING OF FACTUAL CONTROL

Factual control of a corporation exists where a person has "directly or indirectly in any manner whatever" influence that, if exercised, would result in a control in fact of the corporation. The factual control test is used for the purposes of determining if two Canadian-controlled private corporations ("CCPCs") are associated.

In each situation, consideration of all relevant factors is required in determining whether there is factual control of a corporation. A significant body of case law has been developed concerning which factors may be useful in determining whether factual control exists.

A recent court decision, *McGillivray Restaurant Ltd*., held that in order for a factor to be considered in determining whether factual control exists, it must include "a legally enforceable right and ability to effect a change to the board of directors or its powers or to exercise influence over the shareholder or shareholders who have that right and ability." This requirement limits the scope of factors that may be taken into consideration in determining whether factual control of a corporation exists.

It is not intended from a policy perspective that the factual control test be dependent on the existence of such a legally enforceable right or that factors that do not include such a right ought to be disregarded.

Budget 2017 proposes that the *Income Tax Act* be amended to clarify that, in determining whether factual control of a corporation exists, factors may be considered that are not limited to the requirement set out above.

CLEAN ENERGY GENERATION EQUIPMENT: GEOTHERMAL ENERGY

Classes 43.1 and 43.2 of Schedule II to the Income Tax Regulations provide 30% and 50% capital cost allowance ("CCA") rates (on a declining-balance basis) for equipment that generates or conserves energy by:

- Using a renewable energy source (e.g. wind, solar or small hydro);

- Using a fuel from waste (e.g. landfill gas, wood waste or manure); or
- Making efficient use of fossil fuels (e.g. high efficiency cogenerations systems).

Budget 2017 proposes three changes:

1. Eligible geothermal energy equipment under Classes 43.1 and 43.2 will be expanded to include geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity (e.g. the cost of completing a geothermal wall);
2. Geothermal heating will be made an eligible thermal energy source for use in a district energy system; and
3. Expenses incurred for the purpose of determining the extent and quality of a geothermal resource and the cost of all geothermal drilling for both electricity and heating projects, will qualify as a Canadian renewable and conservation expense.

CANADIAN EXPLORATION EXPENSE: OIL AND GAS DISCOVERY WELLS

Expenditures associated with drilling an oil or gas well that results in the discovery of a previously unknown petroleum or natural gas reservoir (i.e. the first well in a new reservoir or “discovery well”) are currently treated as a Canadian exploration expense (“CEE”). CEE may be deducted in full in the year incurred. In contrast expenditures associated with drilling a well, other than a discovery well, are generally treated as a Canadian development expense (“CDE”) of which costs may be deducted at a rate of 30% per year on a declining basis.

Budget 2017 proposes that expenditures relating to drilling or completing a discovery well (or building a temporary access road to, or in preparing a site in respect of, any such well), generally be classified as CDE instead of CEE. This will ensure that expenditures more clearly linked to success are deducted gradually over time as a development expense.

Drilling expenditures can continue to be classified as CEE in situations where the well has been abandoned (or has not produced within 24 months) or the Minister of Natural Resources has certified that the relevant costs associated with drilling the well are expected to exceed $5M and it will not produce within 24 months. Early-stage geophysical and geochemical surveying expenses will also still qualify as CEE.

This measure will apply to expenses incurred after 2018. However, the measure will not apply to expenses actually incurred before 2021 where the taxpayer has, before Budget Day, entered into a written commitment to incur these expenses.

RECLASSIFICATION OF EXPENSES RENOUNCED TO FLOW-THROUGH SHARE INVESTORS

An eligible small oil and gas corporation (i.e. with taxable capital employed in Canada of not more than $15 million) can currently treat up to $1M of CDE as CEE when renounced to shareholders under a flow-through share agreement. CEE are fully deductible in the year they are incurred.

Budget 2017 proposes to no longer permit small oil and gas corporations to treat the first $1M of CDE as CEE.

This measure will apply in respect of expenses incurred after 2018 (including expenses incurred in 2019 that could have been deemed to have been incurred in 2018 under the look-back rule) with the exception of expenses incurred after 2018 and before April 2019 that are renounced under a flow-through share agreement entered into after 2016 and before Budget Day.

ELECTION FOR MARK-TO-MARKET RULES FOR DERIVATIVES

The recent Federal Court of Appeal decision of *Kruger Inc.* permitted a non-financial institution taxpayer to compute its gains and losses from derivatives on a mark-to-market basis rather than on a realization basis. In response the government has introduced the ability for taxpayers to elect to use the mark-to-market method with respect to eligible derivatives held on income account. Once the election is made the taxpayer is required to report on a consistent manner unless the election is revoked with the consent of the Minister. The recognition of any accrued gains or losses on eligible derivatives as at the beginning of the taxpayer's election year will be deferred and taxed on a realization basis. The election is available for taxation years that begin on or after Budget Day.

STRADDLE TRANSACTIONS

The realization of gains and losses on derivative transactions can be treated as being on income account depending upon the situation. Certain transactions, for example a straddle transaction, would allow taxpayers to selectively trigger gains and losses. A straddle can be effected over two taxation years such that the taxpayer triggers a loss on its derivative position in the first taxation year with the income realized in the next taxation year. The realized loss can be used to offset other income with the income being deferred to future tax years (and in extreme situations the income could be deferred indefinitely by entering into additional straddle transactions).

The government is currently challenging such transactions under existing provisions including the general anti-avoidance rule; however, Budget 2017 proposes to introduce specific anti-avoidance rules for such transactions. The new stop-loss rules will apply to defer the loss on a taxpayer's "position" to match it with the gain on an unrealized "offsetting position." A taxpayer's position is defined to include one or more properties that are commodities, forward contracts, shares, partnership interests and trusts. An offsetting position is one that is held by a taxpayer (or a non-arm's length, affiliate or connected person) that would eliminate the holder's risk of profit or loss in respect of the position.

These rules will not apply to a position where:

- It is held by a financial institution as defined for purposes of the mark-to-market rules or by a mutual fund trust or mutual fund corporation;

- It is part of hedging transactions entered into in the normal course of the taxpayer's business;
- The taxpayer continues to hold the offsetting position for a specified period (30 days) beginning on the date of disposition (with no other positions being entered into that materially impact the taxpayer); or
- It is part of a series of transactions none of the main purposes of which is to defer or avoid tax.

This is to apply to any loss realized after Budget Day.

INVESTMENT TAX CREDIT FOR CHILD CARE SPACES

A 25% non-refundable credit was available on costs incurred to build or increase child care spaces which were for the benefit of the taxpayer's employees and ancillary to their business. Budget 2017 eliminates this credit for expenditures incurred on or after March 22, 2017 with some transitional rules applicable.

CASH PURCHASE TICKETS

Historically, when a farmer delivers grain to the operator of a licensed elevator, they are issued a cash purchase ticket. Some of these tickets are not settled until the following year and the farmer was not required to include the deferred amount in income until the next year. Because of the deregulation of the grain marketing regime and the commercialization of the Canadian Wheat Board, the delivery for grain is now largely done by the private sector and there is arguably no longer a rationale for the tax deferral. Accordingly, the government has launched a consultation to examine the possible elimination of the tax deferral arising from cash purchase tickets.

INVESTMENT FUND MERGERS

Merger of Switch Funds into Mutual Fund Trusts

Switch corporations are mutual fund corporations with multiple classes of shares, where typically each class is a distinct investment fund.

The *Income Tax Act* contains special rules to facilitate the merger of mutual funds on a tax-deferred basis, under which two mutual fund trusts can be merged or a mutual fund corporation can be merged into a mutual fund trust. However, the rules do not provide for the reorganization of a mutual fund corporation into multiple mutual fund trusts.

Budget 2017 proposes to extend the mutual fund merger rules to facilitate the reorganization of a mutual fund corporation that is structured as a switch corporation into multiple mutual fund trusts on a tax-deferred basis.

Segregated Fund Mergers

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts.

To provide consistent treatment between mutual fund trusts and segregated funds, Budget 2017 proposes to allow insurers to effect tax-deferred mergers of segregated funds such that these rules parallel the mutual fund merger rules.

B. Personal Tax Measures

PERSONAL TAX RATES

No new personal income tax rate changes have been announced in this year's Budget, including the speculated changes to the capital gains inclusion rate. The current top marginal income tax rates are outlined below:

2017 Marginal Tax Rates				
			Canadian Dividends	
2017 Taxable Income	**Other Income**	**Capital Gains**	**Eligible**	**Non-Eligible**
First $45,916	15.00%	7.50%	-0.03%	5.24%
$45,917 to $91,831	20.50%	10.25%	7.56%	11.67%
$91,832 to $142,353	26.00%	13.00%	15.15%	18.11%
$142,354 to $202,800	29.00%	14.50%	19.29%	21.62%
Over $202,800	33.00%	16.50%	24.81%	26.30%

DISABILITY TAX CREDIT – NURSE PRACTITIONERS

The disability tax credit is a 15% non-refundable tax credit that recognizes the impact of non-itemizable disability related costs on an individual's ability to pay tax. An eligible medical practitioner must certify that the effects of an individual's impairment result in the individual meeting the requirements to qualify for the disability tax credit.

Budget 2017 proposes to add nurse practitioners to the list of medical practitioners that can certify eligibility for the disability tax credit.

MEDICAL EXPENSE TAX CREDIT – ELIGIBLE EXPENDITURES

Taxpayers in Canada are entitled to claim a 15% non-refundable tax credit with respect to qualifying medical expenses. Currently, the cost of reproductive technologies are eligible as qualifying medical expenses only where the procedures are medically indicated because an individual has an existing illness or condition.

The Budget proposes to clarify the application of the medical expense tax credit allowing individuals to claim the cost of reproductive technologies where medical intervention is required in order to conceive a child, even in the absence of an existing illness or condition.

CONSOLIDATION OF CAREGIVER CREDITS

Budget 2017 proposes to consolidate non-refundable tax credits available to caregivers into a single credit: the Canada Caregiver Amount.

The current system consists of three separate credits: the Infirm Dependant Credit, the Caregiver Credit and the Family Caregiver Tax Credit. These credits have varying eligibility conditions, and offer different levels of incentives which can be difficult for taxpayers to navigate.

The new, non-refundable Canada Caregiver Amount will provide the following benefits:

- $6,883 in respect of infirm dependants who are parents, grandparents, siblings, aunts / uncles, nieces / nephews or adult children of the claimant or of the claimant's spouse or common law partner.
- $2,150 in respect of:
    - An infirm dependent spouse or common-law partner in respect of whom the individual claims the spouse or common-law partner amount;
    - An infirm dependant for whom the individual claims an eligible dependant credit; or
    - An infirm child who is under the age of 18 years at the end of the tax year.

The Canada Caregiver Credit will be reduced dollar-for-dollar by the dependant's net income above $16,163.

MINERAL EXPLORATION TAX CREDIT FOR FLOW-THROUGH SHARE INVESTORS

Flow-through shares allow resource companies to renounce or "flow" tax expenses associated with their qualifying Canadian exploration activities to investors. The mineral exploration tax credit provides an additional tax benefit equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors. Budget 2017 proposes to extend the eligibility for this tax credit for one year to include flow-through share agreements entered into on or before March 31, 2018, as long as the funds raised are spent on eligible activities by the end of 2019.

TUITION TAX CREDIT

The tuition tax credit is a non-refundable tax credit available to taxpayers for eligible fees paid for tuition and licensing examinations with respect to individuals enrolled at an eligible educational institution, such as a university, college or other institution offering courses at a post-secondary level.

Budget 2017 proposes to extend the eligibility for the tuition tax credit to include fees paid for occupational skills courses. This will include fees paid to a university, college or other post-secondary institution for occupational skills courses that are not at the post-secondary level. In order to be eligible, the course has to be taken for the purpose of providing the individual with skills in an occupation and the individual must be over the age of 16.

ECOLOGICAL GIFTS PROGRAM

The Ecological Gifts Program is intended to provide Canadians with certain incentives with respect to the donation of ecologically sensitive land. Generally, the following rules apply:

- Individual donors are eligible for a charitable donation tax credit of up to 100% of their net income (as opposed to 75% for ordinary donations);
- Corporate donors are eligible for a charitable donation deduction of up to 100% of their net income (as opposed to 75% for ordinary donations);
- Any unused amounts can be carried forward up to 10 years, compared to ordinary donations which can only be carried forward 5 years; and
- Any capital gain that would otherwise be triggered on the donation of ecologically sensitive land, is exempt from tax (unless donation is to a private foundation).

Further, under the current rules, if the use of the land changed after its donation, without consent of Environment and Climate Change Canada ("ECCC"), the *Income Tax Act* provides for a tax of 50% of the value of the land upon the recipient of the donation.

Budget 2017 proposes a number of changes to the current system:

1) The application of the 50% tax on the change of use of the land will be extended to include another organization that subsequently purchases the land from the recipient of a donation;
2) The Budget provides that the Minister of ECCC has the ability to determine whether proposed changes to the use of lands would degrade conservation protections;
3) Subsequent to Budget 2017, private foundations are no longer entitled to receive ecological gifts;
4) To encourage additional ecological gifts in Quebec, Budget 2017 proposes that certain donations of personal servitudes can qualify as ecological gifts.

PUBLIC TRANSIT TAX CREDIT

Prior to 2017, taxpayers were able to claim a 15% non-refundable tax credit in respect of the cost of eligible public transit passes, such as annual, monthly and weekly passes or electronic fare cards used on an ongoing basis.

Budget 2017 proposes to eliminate the Public Transit Tax Credit effective as of July 1, 2017.

ANTI AVOIDANCE RULES FOR REGISTERED PLANS

Currently, Registered Retirement Savings Plans ("RRSPs"), Registered Retirement Income Funds ("RRIFs") and Tax-Free Savings Accounts ("TFSAs") are subject to a number of anti-avoidance rules to prevent taxpayers from receiving excessive, unintended tax advantages under these plans. These anti-avoidance rules do not currently apply to Registered Education Savings Plans ("RESPs") or Registered Disability Savings Plans ("RDSPs").

Budget 2017 proposes to extend the following anti-avoidance rules to apply with respect to RESPs and RDSPs:

- The Advantage Rules – These rules prevent the exploitation of the tax attributes of a registered plan;
- The Prohibited Investment Rules – These rules ensure that investments held by a registered plan are arm's length portfolio investments (i.e. not closely connected private company shares); and
- The Non-Qualified Investment Rules – These rules restrict the classes of investments that can be held by a registered plan.

C. International Tax Measures

EXTENDING THE BASE EROSION RULES TO FOREIGN BRANCHES OF LIFE INSURERS

The income earned by an unincorporated foreign branch of a life insurance company is not included in the Canadian company's income. In this way, foreign branches of Canadian life insurance companies are taxed in a similar fashion to foreign corporate subsidiaries ("foreign affiliates"). The *Income Tax Act* contains measures to prevent shifting income to foreign affiliates in low tax jurisdictions through the foreign affiliate property income (FAPI) regime. The FAPI rules generally apply to passive or property income or income that is specifically treated as passive income, including the insurance of Canadian risks. Previously, the FAPI regime did not apply to foreign branches of life insurance companies. The Budget proposes that Canadian insurers will be taxed currently in Canada on their foreign branches' income from the insurance of Canadian risks. The rule will apply where 10% or more of the gross premium income (net of reinsurance ceded) earned by the foreign branch is from the insurance of Canadian risks.

Previous budgets introduced anti avoidance measures to prevent the insurance of Canadian risk where these risks were swapped for foreign risk. These and other anti-avoidance measures will also apply to the proposed rules for foreign branches.

D. Indirect Tax Measures

OPIOID OVERDOSE TREATMENT DRUG – NALOXONE

The government proposes to provide relief from GST / HST on Naloxone (and its salts). Naloxone (and its salts) is used to treat opioid overdose and as of March 22, 2016, was not required to be prescribed in order to treat such life threatening conditions. As a result of the changes by Health Canada on March 22, 2016, the supply of Naloxone became subject to GST / HST. To zero-rate Naloxone, Budget 2017 proposes to add the drug (and its salts) to the list of GST / HST-free non-prescription drugs.

This is effective March 22, 2016; however, this measure does not apply for any supply of Naloxone (and its salts) occurring on or before Budget Day for which GST / HST was charged, collected, remitted or paid.

TAXI AND RIDE-SHARING SERVICES

GST / HST is required to be charged on a taxi business which is currently defined as a business of transporting passengers who are regulated under the laws of Canada or a province. As a result, ride sharing services are not required to charge GST / HST. However, Budget 2017 proposes to amend the definition of a "taxi business" to include ride sharing services thereby requiring them to collect and remit in the same manner as taxi operators. The changes will not apply to school transportation services or a sightseeing service.

GST / HST REBATE TO NON-RESIDENTS FOR TOUR PACKAGE ACCOMMODATIONS

The current rebate for non-resident individuals and non-resident tour operators for the GST / HST that is payable in respect of the Canadian accommodation portion of eligible tour packages will be eliminated.

Supplies of tour packages or accommodations made after Budget Day will be affected. For transitional purposes, the rebate will continue to be available where a supply of a tour package or accommodations is made after Budget Day but before January 1, 2018, if all of the consideration for the supply is paid before January 1, 2018.

E. Other Tax Measures

ABORIGINAL TAX

The government indicated that to date, they have entered into more than 50 taxation agreements in respect of sales and personal income tax with Aboriginal governments. The government confirms that it is willing to enter into additional agreements with Aboriginal government and will facilitate arrangements between provinces or territories and Aboriginal governments.

ABOUT MNP

MNP is a leading national accounting, tax and business consulting firm in Canada. We proudly serve and respond to the needs of our clients in the public, private and not-for-profit sectors. Through partner-led engagements, we provide a collaborative, cost-effective approach to doing business and personalized strategies to help organizations succeed across the country and around the world.

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