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2017 Federal Budget Special Report

March 22, 2017

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2017 FEDERAL BUDGET OVERVIEW:

The Devil is in the Details: Budget 2017 gives to some, but business pays more again.

THE ECONOMY BY THE NUMBERS

- Income tax revenues are projected to increase to $178.6 Billion
- Corporate tax revenues will increase by $50.1 Billion
- Net debt is projected to be $757 Billion by the end of the reporting period
- Cost of servicing the debt is expected to rise to over $30 Billion annually starting in 2021
- GDP growth rate is projected to average only 1.7% over the period
- Nominal GDP growth rate is projected to average 3.5%
- The Consumer Price Index will average 1.9%
- The Canadian to US dollar exchange rate is expected to average 77.4
- Crude oil prices will average US $56 per balance
- The three month treasury bill rate will average 1.2%
- The 10 year government bond rate will average 2.4%
- The unemployment rate will average 6.7%

The theme of the 2017 Federal Budget announced on March 22 forged a positive message towards an era of incredible change in "Building a Strong Middle Class" in which innovation, skills, and partnerships must be forged to prepare Canadians with the skills need for the new jobs that will come with a rapidly advancing new economy. Unfortunately, the document itself is short on specific tax incentives to address the new economy, and in fact continues to make significant changes to cash flows of certain small business owners.

It may be a budget that is remembered for what it doesn't contain in relation to the theme: there are no tax credits to offset income taxes paid by employers who hire people with "new economy" skills or to encourage investments by new entrepreneurs with great ideas to invest in new capital as they build forward in a new economy.

Further, the document predicts tepid growth in the economy going forward to the end of the forecast period ending in 2022, while it raises personal taxes significantly: personal tax revenues will increase faster than the growth in nominal GDP (3.5%) and GDP inflation (1.8%) to average 4.5% annual growth. This budget also raises EI premiums. The rate-setting mechanism that ensures EI premiums are no higher than needed to pay for the program over time is estimated to increase in 2018, not just because the forecast for the economy is weaker than in 2017, but because this budget calls for new spending under the EI program. All of that means higher premiums for business and taxpayers around the time that CPP premiums are also set to rise dramatically.

Specifically, the Employment Insurance Act will be broadened to provide eligibility to more workers including under-represented groups to access EI funded skills training and employment supports. The Act will also be broadened to provide eligibility to more workers including under-represented groups to access EI funded skills training and employment supports.

This budget also continues its focus how to close legitimate tax preferences previously extended to small business corporations. Included here are changes to work-in-progress rules for professionals including medical doctors, accountants and lawyers, and new scrutiny on associated corporations for the purposes of minimizing access to the Small Business Deduction when factual control can be linked to the enforceable rights of two related people. .

Those who provide training, may see a spike in enrolments, though. Certain prospective students will be very happy with today's budget news: if you are an honorably discharged veteran, you will be happy about generous new education benefits for you.

But, unfortunately, there is no new support for parents who help their adult kids who are students: the budget does not index the $5000 tuition transfer to supporting individuals, despite the fact that 2017 will be the year in which the monthly education and textbook amounts will disappear.

Also, there is a tweak in the tuition fee credit: those who pay for skills training that is not at a post-secondary level will be able to claim their tuition.

Further, there will be an increase in the Canada Student Grants available for part time students and adult learners, with new eligibility thresholds for non-repayable grants for students with dependent children. Therefore, employers should be able to find more skilled employees soon.

Investors will be happy that the capital gains inclusion rate remains at 50% and there are no new changes to dividend taxation or the capital gains exemption rules for those who sell a qualifying small business, farming or fishing enterprise.

However, small business owners should confer with their tax professional about the prospect of further change in common tax planning strategies. Specifically, income splitting with family members, the tax rates applied to passive investments held in a private corporation, and the conversion of salary or dividends into capital gains will be reviewed shortly, as the government plans to release a paper on how to eliminate or curtail these opportunities.

Finally, tax provisions relating to the caregiving of a sick family member have been reorganized and notably no longer claimable for parents who are over age 65 and not infirm. Certain tax measures have been eliminated because they have been deemed inefficient or no longer effective – the public transit amount stands out, for example. Others have been enhanced; specifically, new provisions enhance claims for medical expenses allowed for couples who are infertile.

SPECIFIC TAX MEASURES: FOR INVESTORS

Capital Gains Inclusion Rates

Good news, there are no changes here! The 50% inclusion rate remains untouched in this budget for now at least.

Canada Savings Bonds — Effective: Phased out in 2017

These investments will be phased out in 2017.

Mutual Funds — Effective: March 22, 2017

Mutual funds can be structured in a trust or a corporation. Switch corporations are defined as mutual fund corporations with multiple classes of shares where each class is usually a distinct investment fund. Mergers of two mutual funds into a trust or from a trust to a corporation can be done on a tax deferred basis; this treatment will continue. However effective budget day, the reorganization of a mutual fund corporation into a multiple mutual fund trusts will also be allowed on a tax deferred basis in respect of each class of shares, if all or substantially all of the assets in the class are transferred. Also, the shareholders must all be unitholders of the mutual fund trust.

Segregated Fund Mergers — Effective: After 2017

Tax deferred mergers will be allowed to parallel the mutual fund rules above for mergers after 2017. As well for non-capital losses that arise in taxation years that begin after 2017, a segregated fund is able to carry over those losses and apply them to its taxable years that begin after 2017.

Derivatives — Effective: March 22, 2017

Timing of recognition of capital gains and losses will change. The value of derivatives comes from the value of an underlying interest, making its taxation complex. An election will allow taxpayers to "mark to market" all eligible derivatives. In addition a specific anti-avoidance rule will target straddle transactions . A stop loss rule will defer the realization of any loss on the disposition of a position up to the unrealized gain on an offsetting provision. Further detail will be provided in future editions of KBR.

Anti-Avoidance Rules Extended to RESPs and RDSPs **Effective: March 22, 2018**

For transactions occurring after March 22, 2018, the anti-avoidance rules that currently apply to RRSPs, RRIFs and TFSAs will apply to RESPs and to RDSPs. These rules include the advantage rules, prohibited and non-qualifying investment rules.

Where the plans currently hold what are now prohibited investments, plan holders may elect by April 1, 2018 ordinary tax on investment income distributions rather than pay the advantage tax on such distributions.

Swap transactions will be allowed until the end of 2021 if undertaken to ensure that the plans comply with the new rules by removing investments that are now prohibited or give rise to advantages under the new rules.

SPECIFIC TAX MEASURES: FOR BUSINESS

Professionals – Work in Progress **Effective: March 21, 2017**

For business years that begin after March 21, 2017, professional tax payers may no longer exclude from income their work in progress. As a transitional provision, in the first business year that begins after March 21, 2017, 50% of the less of the cost and fair market value of work in progress must be included in income of the professional. These professionals include Accountants, dentists, lawyers, medical doctors, veterinarians, and chiropractors.

For business years that begin after March 21, 2017, professional tax payers may no longer exclude from income their work in progress. As a transitional provision, in the first business year that begins after March 21, 2017, 50% of the less of the cost and fair market value of work in progress must be included in income of the professional.

Meaning of Factual Control — Effective: March 22, 2017

A person can have factual control of a corporation without having legal control. As per the budget document Legal control generally entails the right to elect the majority of the board of directors of the corporation where as factual control of a corporation exists where a person has "directly or indirectly in any manner whatever" influence that would result in control in fact of the corporation.

As per the Budget document "A recent court decision 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."

The Income Tax Act will be amended to clarify that taxpayers do not inappropriately access certain preferences in determining whether factual control of a corporation exists and factors are not limited to the requirement set out above. The objective is to test whether companies are associated for the purposes of the multiplication of the Small Business Deduction and specifically in cases where an owner of a separate corporation has an enforceable right in certain cases over another. Effective on or After Budget Day.

EI Premiums Are Going Up

A deficit is expected in the EI Operating Account in 2017 – to the tune of $2.7 billion – after a surplus of $1.1 billion in 2016, when the premium rate was 1.88. The 2017 rate had been reduced to $1.63, but due to a weaker economy, a deficit occurred. The rate is now poised to increase to 1.68 per $100 of insurable earnings, from the 2017 premium rate of 1.63.

Tax Benefits to Small Business Corporations to go Under the Microscope

The government is planning to review the tax planning strategies common to small business corporations in the release of a paper over the next several months to review:

- The sprinkling of income amongst family members via dividends and capital gains
- The benefits of holding a passive investment portfolio inside a private corporation
- The converting of salary or dividend income into capital gains

Electronic Distribution of T4 Slips **Effective: 2017 and future tax years**

For the 2017 and future tax years, employers will be allowed to distribute T4 slips electronically, without express consent, as long as there are adequate privacy safeguards, to active employees. The safeguards will be specified later by CRA and employers will be required to provide hard copy if employees want this.

Mineral Exploration Tax Credit for Flow-Through Share Investors

Announced in early March, this provision was extended to flow through agreements entered into on or before March 31, 2018. This is a benefit extended to individuals who invest in mining flow-through shares, equal to 15% of specified mineral exploration expenses incurred in Canada.

Clean Energy Generation Equipment **Effective: March 22, 2017**

Effective On or After Budget Day:

- Eligible geothermal energy equipment under Class 43.1 and 43.2 is proposed to be expanded to include geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity; as well as the cost of completing a geothermal well and for systems that produce electricity.
- Geothermal heating will be made an eligible thermal energy source for use in a district energy system.
- Canadian renewable and conservation expenses will include those expenses incurred for the purpose of determining the extent and quality of a geothermal resource and the cost of geothermal drilling.

Canadian Exploration Expense: Oil and Gas Discovery Wells **Effective: 2018**

Effective in 2018, expenditures related to drilling or completing a discovery well (or in building a temporary access road to, or preparing a site in respect of, any such well) should be classified as Canadian development expense (CDE) instead of the current classification of Canadian exploration expense (CEE). Expenditures associated with a discovery well are typically related to success and should be deducted gradually over time as development expenses.

This will apply to expenses incurred after 2018, however will not apply to expenses where the taxpayer has entered into a written commitment before budget day to incur those expenses.

Reclassification of Expenses Renounced to Flow-Through Share Investors

Eligible small oil and gas corporations will no longer be able to treat the first $1 million of CDE as CEE. Currently, flow-through share agreements allow an eligible small oil and gas corporation to treat up to $1 million of CDE as CEE when renounced to shareholders. Flow-through agreements also allows a corporation to renounce CEE or CDE that is incurs after the agreement date to investors, who can then deduct the expenses in calculating their own taxable income. This measure will apply in respect to expenses incurred after 2018 (including expenses incurred in 2019 that could have been deemed to be incurred in 2018 because of the look-back rule). 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 are excluded.

Consultation on Cash Purchase Tickets

With the deregulation of the grain market regime and commercialization of the Canadian Wheat Board in Manitoba, Saskatchewan and Alberta, the delivery of the listed grains is now the responsibility of a private business rather than the federal government. As per the budget document, "any interested parties are invited to submit comments by May 24, 2017 to the government. Please send your comments to consultation_tax_2017@canada.ca."

Fee Setting for Government Services Used by Business

The government plans to implement an automatic inflation escalator on existing business fees.

In GST News

GST ON TAXI RIDE SHARING SERVICES will be subject to GST as of July 1, 2017.

GST ON MEDICAL TREATMENTS – GST is not charged on non-prescription drugs that are used to treat life-threatening conditions. This will now include Naloxone and its salts used to treat an opioid overdose as of March 22, 2016.

GST/HST REBATE TO NON-RESIDENTS FOR TOUR PACKAGE ACCOMMODATIONS – on that portion of the package that applies to accommodations is repealed as of Budget Day. However, a transitional provision will apply before January 1, 2018 if all the consideration is paid before January 1, 2018.

SPECIFIC TAX MEASURES: FOR FAMILIES

Home Relocation Loan Deduction — Effective: 2018 and beyond

The value of a benefit that occurs when an employer provides to an employer a low interest loan to assist in a move to a new employment location is has previously been offset through a home relocation deduction from taxable income. The value of the deduction was limited to the annual benefit arising on loans up to $25,000 if the employee moved at least 40 kilometers closer to a new work location. This deduction will be eliminated for the 2018 and subsequent years. Existing home relocation loans will continue to have the taxable benefit but will not be eligible for the deduction.

Disability Tax Credits — Effective: March 22, 2017

To provide time relief to the medical practitioners who are able to certify eligibility for the disability tax credit, nurse practitioners will be added to the list of qualified professionals who may certify the T2201 Disability Tax Credit form effective March 22, 2017.

This is 15% federal non-refundable tax credit which offsets the financial impact of medical conditions that markedly restrict daily living activities. It is a base credit of $8,113 in 2017 which translates to a federal real dollar amount of $1,217. Currently eligible practitioners are identified as:

<table>
<tr><th colspan="2">Basis of Disability Tax Credit Certification</th><th>Type of Medical Practitioner</th></tr>
<tr><td colspan="2">Vision</td><td>Medical doctor (MD) or optometrist</td></tr>
<tr><td rowspan="6">Marked restriction:</td><td>Speaking</td><td>MD or speech-language pathologist</td></tr>
<tr><td>Hearing</td><td>MD or audiologist</td></tr>
<tr><td>Walking</td><td>MD, occupational therapist or physiotherapist</td></tr>
<tr><td>Elimination of bodily waste</td><td>MD</td></tr>
<tr><td>Feeding or dressing</td><td>MD or occupational therapist</td></tr>
<tr><td>Mental functions</td><td>MD or psychologist</td></tr>
<tr><td colspan="2">Life-sustaining therapy</td><td>MD</td></tr>
<tr><td colspan="2">Cumulative effects of significant restrictions</td><td>MD (all restrictions) or occupational therapist (walking, feeding and dressing only)</td></tr>
</table>

Source: Budget document

Medical Expenses **Effective: 2017 and beyond**

Couples experiencing medical infertility issues have previously been allowed to claim prescribed fertility medication and in-vitro fertilization procedures and their associated costs as a medical expense under the medical expense tax credit. This is a non-refundable amount in which qualifying expenses in excess of the lesser or $2,268 and 3% of net income can be claimed for the patient and/or family members.

For 2017 and subsequent tax years, taxpayers may elect to claim the costs of reproductive technologies even where the treatment is not medically indicated because of a medical infertility condition. In addition, the taxpayer may elect to apply the expenses in any of the immediately preceding ten tax years.

Canada Caregiver Tax Credit – Consolidation of Caregiver Tax Credits

Currently three tax credits cover the economic costs of caregiving in the tax system:

- **The Infirm Dependant Credit for Adults other than a Spouse** – There is no requirement to live with the supporting individual. The maximum claim is $6,883 and it is reduced by net income over $6,902; with a complete phase out at income of $13,785.
- **The Caregiver Credit** – Family members who give care in their home to parents or grandparents (age 65 or older) or those dependent by way of infirmity could make this claim. The credit is $4,732 when there is no infirmity (age eligibility at 65) or $6,882 where there is infirmity. The credit is clawed back when income is above $16,165 and completely phased out when net income is over $20,895 or $23,045 for an infirm person.
- **Family Caregiver Tax Credit**. This is a non-refundable tax credit of $2,150 as well. It is a top up of other credits when a family member has a mental or physical infirmity. The additional amount is added to the spousal amount, caregiver amount, infirm adult amount. It is the only credit available for minor children. (Those who have minor children who are not infirm receive no additional credit and are compensated through the tax system with the Canada Child Benefit). There is no clawback based on income in this case.

A new **Canada Caregiver Credit** will replace these credits in the 2017 tax year. Notably it will not be extended to those who give care in their home for parents age 65 or older who are healthy, and there will no longer be a requirement for the infirm person to live with the supporting person in order to make this claim.

The amounts to be claimed are as follows:

- $6883 for infirm parents, grandparents, siblings, aunts, uncles, nieces, nephews, adult children of the claimant of the claimant's spouse/common law partner.
- $2150 for infirm spouse or common law partner for whom a spousal amount is claimed, a dependant claimed for the eligible dependant amount, or an infirm minor child.
- The amount will be reduced dollar for dollar when net income is above $16,163.

The person who claims the spouse or eligible dependent cannot share the new Canada Caregiver Amount with another taxpayer; otherwise the new amount will be shareable with multiple caregivers as long as the total claim does not exceed the maximum annual amount. No claim is allowed by a spouse claiming deductible spousal support.

Students – Tuition Fee Amount **Effective: 2017 and beyond**

The tuition fee amount is being extended to include fees paid to organizations that provide occupational skills courses that are not at a post-secondary level provided that the courses are taken for the purposes of providing skills or improving skills in an occupation. The student must also be at least 16 years of age. This measure will apply to 2017 and future years.

New Veterans Education and Training Benefit **Effective: April, 2018**

Starting in April 2018, veterans who are honorably discharged will qualify for a $40,000 benefit if they have 6 years of eligible service and $80,000 if there is 12 years of eligible services. The budget does not indicate whether this is tax free.

New Caregiver Recognition Benefit for Veterans

Replacing the Family Caregiver Relief Benefit, a non-taxable $1000 monthly benefit will be paid directly to informal caregivers including family members.

Public Transit Tax Credit **Effective: July 1, 2017**

The current non-refundable tax credit for public transit passes will be eliminated as of July 1, 2017.

Currently taxpayer's may claim the cost of monthly transit passes (or weekly transit passes if for four or more consecutive weeks). A taxpayer may claim their own transit passes, transit passes for their spouse and transit passes for their dependants if the dependant is under 19 at the end of the taxation year. For 2017, only passes purchased prior to July 1 will be eligible for the credit.

National Child Benefit Supplement **Effective: Immediately**

To accommodate the need for provinces to calculate their social assistance and child benefit programs, the National Child Benefit supplement calculations will be retained until July 1, 2018 – they were set to expire in July 2017. This will have no affect on the calculation of the federal Canada child Benefit.

Donations Penalty **Effective: Immediately**

Certified gifts of ecologically sensitive land are eligible for a donation calculated as 100% of net income in a year and may be carried forward for ten years. Taxpayers who have benefited from this provision and then use the land for another purpose or dispose of it, will attract a tax of 50% of the fair market value of the land. This penalty will now also apply to the recipient of such properties that are subsequently transferred.

The current 50% tax on the unapproved change of use of donated ecologically sensitive land will persist even if the land is transferred to another organization. The minister of Environment and Climate Change Canada (ECCC) is responsible for determining if the change in use would degrade conservation protections. The ECCC must also approve recipients of such gifts. Effective immediately, the approval requirement will be extended to include municipalities and municipal and public bodies performing the function of government. Previously such recipients were automatically approved.

In addition, effective immediately, private foundations will no longer be eligible to receive ecological gifts. For donors in Quebec, personal servitudes will also be qualify as ecological gifts, so long as the servitude will run for a minimum of 100 years.

SPECIFIC TAX MEASURES: IN OTHER NEWS

New Taxes on Certain Allowances for Members of Legislative Assemblies and Certain Municipal Officers Effective: 2019

A portion of allowances received by these taxpayers to cover costs incurred in the course of carrying out the duties of office or employment will become taxable for some. Specifically, non-accountable allowances received cannot exceed more than half of the official's salary or other remuneration to be tax exempt. Effective 2019, any non-accountable portion of these allowances will be fully taxable; accountable allowances will remain non-taxable.

Consumers Will Pay More for Tobacco and Spirits

Here's a synopsis of the new provisions.

TOBACCO TAXES – An increased excise duty rate will replace a 10.5% surtax on manufacturer's profits on tobacco and tobacco products. The increases will be from $21.03 to $21.56 for 200 cigarette). Existing inventories will be subject to a tax of .00265 per cigarette. This tax must be paid by March 31, 2017 with proper return filings. In addition, the cost of tobacco sticks go up from $21.03 to $21.56 per 200, chewing tobacco and cigars are also amongst the products affected after budget day.

WINE AND SPIRITS – excise duties are going up 2% on budget day.

Excise taxes on cigarettes and tobacco will increase effective immediately and future alcohol tax increases be automatic on April 1 each year based on changes to the consumer price index.

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