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Federal Budget
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INTRODUCTION

The Minister of Finance, Bill Morneau, tabled on March 22, 2016, the new Government of Canada's first federal budget, *Growing the Middle Class*, a plan that, according to the Government, takes important steps to revitalize the Canadian economy, and delivers real change for the middle class and those working hard to join it.

Here are the highlights of the 2016 budget.

PERSONAL INCOME TAX MEASURES

Canada child benefit

The budget proposes to replace the Canada child tax benefit (CCTB) and Universal child care benefit (UCCB) with a new Canada child benefit (CCB).

The CCB will provide a maximum benefit of $6,400 per child under the age of 6 and $5,400 per child aged 6 through 17. The benefit will be phased out according to the following table.

CCB phase-out rates and adjusted family net income thresholds

	Phase-out rates (%)	
Number of children (for phase-out rates)	$30,000 to $65,000	Over $65,000
1 child	7.0	3.2
2 children	13.5	5.7
3 children	19.0	8.0
4 or more children	23.0	9.5

The budget proposes to continue to provide an additional amount of up to $2,730 per child eligible for the disability tax credit.

Entitlement to the CCB from July 2016 to June 2017 will be based on adjusted family net income for the 2015 taxation year.

The rules governing the CCB will generally be based on those which apply to the CCTB. For example:

- The CCB will be paid monthly to eligible families.
- Amounts received will not be taxable.
- To be eligible for the CCB, an individual must be a resident of Canada and must reside with the qualified dependant and be the parent who primarily fulfils the responsibility for the care and upbringing of the qualified dependant or be a shared custody parent.

Timing of the changes to child benefits

CCB payments under this measure will start in July 2016. The UCCB and CCTB will be eliminated for months after June 2016.

Retroactive payments

The budget proposes to allow a taxpayer to request a retroactive payment of the CCB, CCTB or UCCB in respect of a month on or before the day that is 10 years after the beginning of that month, effective for requests made after June 2016.

Income splitting credit

The budget proposes to eliminate the income splitting tax credit currently offered to couples with at least one child under the age of 18 for the 2016 and subsequent taxation years.

Northern residents deductions

The budget proposes to increase the maximum residency deduction that each member of a household may claim from $8.25 to $11 per day and, where no other member of the household claims the residency deduction, to increase the maximum residency deduction from $16.50 to $22 per day for the 2016 taxation year. Residents of the intermediate zone will be entitled to deduct half of these increased amounts.

Labour-sponsored venture capital corporations tax credit

The budget proposes to restore the federal labour-sponsored venture capital corporation (LSVCC) tax credit to 15% for share purchases of provincially registered LSVCCs prescribed under the *Income Tax Act* for the 2016 and subsequent taxation years.

The federal LSVCC tax credit for federally registered LSVCCs will remain at 5% for the 2016 taxation year and will be eliminated for the 2017 and subsequent taxation years.

Teacher and early childhood educator school supply tax credit

The budget proposes to introduce a teacher and early childhood educator school supply tax credit. This measure will allow an employee who is an eligible educator to claim a 15-per-cent refundable tax credit based on an amount of up to $1,000 in expenditures made by the employee in a taxation year for eligible supplies.

Employers will be required to certify that the supplies were purchased for the purpose of teaching or otherwise enhancing learning in a classroom or learning environment.

Eligible educator

Teachers will qualify as eligible educators if they hold a teacher's certificate that is valid in the province or territory in which they are employed. Likewise, early childhood educators will qualify as eligible educators if they hold a certificate or diploma in early childhood education recognized by the province or territory in which they are employed.

Eligible supplies

Eligible supplies will include the following durable goods: games and puzzles; supplementary books for classrooms; educational support software; or containers (such as plastic boxes or banker boxes for themes and kits). Eligible supplies will also include consumable goods, such as:

> construction paper for activities, flashcards or activity centres;

> items for science experiments, such as seeds, potting soil, vinegar, baking soda and stir sticks;

> art supplies, such as paper, glue and paint; and

> various stationery items, such as pens, pencils, posters and charts.

This measure will apply to supplies acquired on or after January 1, 2016.

Mineral exploration tax credit for flow-through share investors

The budget proposes to extend eligibility for the mineral exploration tax credit for one year, to flow-through share agreements entered into on or before March 31, 2017.

Education and textbook tax credits

The budget proposes to eliminate the education and textbook tax credits as of January 1, 2017. Unused education and textbook credit amounts carried forward from years prior to 2017 will remain available to be claimed in 2017 and subsequent years.

Canada student grants enhancement

The budget proposes to increase Canada Student Grant amounts by 50%:

> from $2,000 to $3,000 per year for students from low-income families;

> from $800 to $1,200 per year for students from middle-income families; and

> from $1,200 to $1,800 per year for part-time students.

Under the new model, the existing low- and middle-income thresholds will be replaced with a single progressive threshold under which grant amounts will gradually decline based on income and family size.

Children's fitness and arts tax credits

The budget proposes to phase out the children's fitness and arts tax credits by reducing the 2016 maximum eligible amounts from $1,000 to $500 for the children's fitness tax credit and from $500 to $250 for the children's arts tax credit. The supplemental amounts for children eligible for the disability tax credit will remain at $500 for 2016. Both credits will be eliminated for the 2017 and subsequent taxation years.

Top marginal income tax rate – consequential amendments

The budget proposes amendments to reflect the new top marginal income tax rate for individuals (33%) that will, for instance:

> provide a 33-per-cent charitable donation tax credit (on donations above $200) to trusts that are subject to the 33-per-cent rate on all of their taxable income;

> apply the new 33-per-cent top rate on excess employee profit sharing plan contributions;

> increase from 28% to 33% the tax rate on personal services business income earned by corporations; and

> amend the recovery tax rule for qualified disability trusts to refer to the new 33-per-cent top rate.

These measures will apply to the 2016 and later taxation years. The charitable donation tax credit measure will be limited to donations made after the 2015 taxation year. In the case of the rate increase on personal services business income earned by corporations in taxation years that straddle 2015 and 2016, the rate increase will be prorated according to the number of days in the taxation year that are after 2015.

Taxation of switch fund shares

The budget proposes to amend the *Income Tax Act* so that an exchange of shares of a mutual fund corporation (or investment corporation) that results in the investor switching between funds will be considered for tax purposes to be a disposition at fair market value. The measure will not apply to switches where the shares received in exchange differ only in respect of management fees or expenses to be borne by investors and otherwise derive their value from the same portfolio or fund within the mutual fund corporation (e.g., the switch is between different series of shares within the same class).

This measure will apply to dispositions of shares that occur after September 2016.

Sales of linked notes

The budget proposes to amend the *Income Tax Act* so that the return on a linked note retains the same character whether it is earned at maturity or reflected in a secondary market sale. Specifically, a deeming rule will apply for the purposes of the rule relating to accrued interest on sales of debt obligations. This deeming rule will treat any gain realized on the sale of a linked note as interest that accrued on the debt obligation for a period commencing before the time of the sale and ending at that time. When a linked note is denominated in a foreign currency, foreign currency fluctuations will be ignored for the purposes of calculating this gain. An exception will also be provided where a portion of the return on a linked note is based on a fixed rate of interest. In that case, any portion of the gain that is reasonably attributable to market interest rate fluctuations will be excluded.

This measure will apply to sales of linked notes that occur after September 2016.

Improving the quality of life for seniors

Increasing the guaranteed income supplement for single seniors

The budget proposes to increase the Guaranteed Income Supplement top-up benefit by up to $947 annually for the most vulnerable single seniors starting in July 2016.

Single seniors with annual income (other than Old Age Security and Guaranteed Income Supplement benefits) of about $4,600 or less will receive the full increase of $947. Above this income threshold, the amount of the increased benefit will be gradually reduced.

Restoring the eligibility ages of the old age security program

The budget proposes to cancel the provisions in the *Old Age Security Act* that increase the age of eligibility for Old Age Security and Guaranteed Income Supplement benefits from 65 to 67 and Allowance benefits from 60 to 62 over the 2023 to 2029 period.

Increased support for senior couples living apart

The budget proposes to introduce amendments to the *Old Age Security Act* that will ensure that couples who receive Guaranteed Income Supplement and Allowance benefits and have to live apart for reasons beyond their control (such as a requirement for long-term care) will receive benefits based on their individual incomes.

BUSINESS INCOME TAX MEASURES

Electric vehicle charging stations

The budget proposes to expand Classes 43.1 and 43.2 by making electric vehicle charging stations eligible to these categories, based upon whether they meet certain power thresholds. Electric vehicle charging stations set up to supply at least 90 kilowatts of continuous power will be eligible for inclusion in Class 43.2. Those charging stations set up to supply more than 10 kilowatts but less than 90 kilowatts of continuous power will be eligible for inclusion in Class 43.1.

The measure will apply in respect of new property acquired for use on or after March 22, 2016.

Electrical energy storage

The budget proposes two changes.

First, it proposes to clarify and expand the range of electrical energy storage property that is eligible for accelerated CCA to include a broad range of short- and long-term storage equipment when ancillary to electricity generation technologies eligible for inclusion in CCA Classes 43.1and 43.2.

Second, it is proposed to allow stand-alone electrical energy storage property to be included in Class 43.1 provided that the round trip efficiency of the equipment is greater than 50 per cent.

The measure will apply in respect of new property acquired for use on or after March 22, 2016.

Small business taxation

Small business tax rate

The budget proposes that the small business tax rate remain at 10.5% after 2016. The budget also proposes to maintain the current gross-up factor and dividend tax credit (DTC) rate applicable to non-eligible dividends. Specifically, the gross-up factor applicable to non-eligible dividends will be maintained at 17% and the corresponding DTC rate at 21/29 of the gross-up amount.

Multiplication of the small business deduction

The budget proposes measures to prevent business owners from multiplying access to the $500,000 small business deduction using complex partnership and corporate structures.

Partnerships

More precisely, the budget proposes to extend the specified partnership income rules to partnership structures in which a CCPC provides services or property to a partnership where the CCPC or a shareholder of the CCPC is a member of the partnership or does not deal at arm's length with a member of the partnership.

This measure will apply to taxation years that begin on or after March 22, 2016.

Corporations

The budget proposes to amend the *Income Tax Act* so that a CCPC's active business income from providing services or property in its taxation year to a private corporation becomes ineligible for the small business deduction if the CCPC, one of its shareholders or a person who does not deal at arm's length with such a shareholder has an interest in the private corporation. However, this private corporation that is a CCPC will be entitled to assign all or a portion of its unused business limit to one or more CCPCs that are ineligible for the small business deduction under this proposal because they provided services or property to the private corporation.

This ineligibility for the small business deduction will not apply to a CCPC if all or substantially all of its active business income for the taxation year is earned from providing services or property to arm's length persons other than the private corporation.

This measure will apply to taxation years that begin on or after March 22, 2016. However, a private corporation will be entitled to assign all or a portion of its unused business limit in respect of its taxation year that begins before and ends on or after March 22, 2016.

Avoidance of the business limit and the taxable capital limit

The budget proposes to amend the *Income Tax Act* to ensure that investment income derived from an associated corporation's active business will be ineligible for the small business deduction and be taxed at the general corporate income tax rate where the exception to the deemed associated corporation rule applies (i.e., an election not to be associated is made or the third corporation is not a CCPC).

This measure will apply to taxation years that begin on or after March 22, 2016.

Consultation on active versus investment business

The examination of the active versus investment business rules is now complete. The Government is not proposing any modification to these rules at this time.

Life insurance policies

Distributions involving life insurance proceeds

The budget proposes to amend the *Income Tax Act* to ensure that the capital dividend account rules for private corporations, and the adjusted cost base rules for partnership interests, apply as intended.

The measure will provide that the insurance benefit limit applies regardless of whether the corporation or partnership that receives the policy benefit is a policyholder of the policy. To that end, the measure will also introduce information-reporting requirements that will apply where a corporation or partnership is not a policyholder but is entitled to receive a policy benefit.

This measure will apply to policy benefits received as a result of a death that occurs on or after March 22, 2016.

Transfers of life insurance policies

The budget proposes amendments to the *Income Tax Act* to ensure that amounts are not inappropriately received tax-free by a policy-holder as a result of a disposition of an interest in a life insurance policy.

The measure will, in applying the policy transfer rule, include the fair market value of any consideration given for an interest in a life insurance policy in the policyholder's proceeds of the disposition and the acquiring person's cost.

This measure will apply to dispositions that occur on or after March 22, 2016.

The budget also proposes to amend the capital dividend account rules for private corporations and the adjusted cost base rules for partnership interests. This amendment will apply where an interest in a life insurance policy was disposed of before March 22, 2016, for consideration in excess of the proceeds of the disposition determined under the policy transfer rule. In this case, the amount of the policy benefit otherwise permitted to be added to a corporation's capital dividend account, or the adjusted cost base of an interest in a partnership, will be reduced by the amount of the excess.

This measure will apply in respect of policies under which policy benefits are received as a result of deaths that occur on or after March 22, 2016.

Valuation for derivatives

The budget proposes to exclude derivatives from the application of the inventory valuation rules while maintaining the status of such property as inventory. A related rule will also be introduced to ensure that taxpayers are not able to value derivatives using the lower of cost and market method under the general principles for the computation of profit for tax purposes.

The measure will apply to derivatives entered into on or after March 22, 2016.

Eligible capital property

The budget proposes to repeal the eligible capital property (ECP) regime, replace it with a new capital cost allowance (CCA) class available to businesses and provide rules to transfer taxpayers' existing cumulative eligible capital (CEC) pools to the new CCA class. The proposal is not intended to affect the application of the Goods and Services Tax/Harmonized Sales Tax (GST/HST) in this area.

Proposed rules

New CCA class

Expenditures that are currently added to CEC (at a 75-per-cent inclusion rate) will be included in the new CCA class (cat. 14.1) at a 100-per-cent inclusion rate. The new class will have a 5-per-cent annual depreciation rate. The existing CCA rules will generally apply, including rules relating to recapture, capital gains and depreciation (e.g., the "half-year rule").

Every business will be considered to have goodwill associated with it, even if there had not been an expenditure to acquire goodwill. An expenditure that did not relate to property will increase the capital cost of the goodwill of the business and, consequently, the balance of the new CCA class.

A receipt that did not relate to a specific property will reduce the capital cost of the goodwill of the business and, consequently, the balance of the new CCA class, by the lesser of the capital cost of the goodwill (which could be nil) and the amount of the receipt. If the amount of the receipt exceeds the capital cost of the goodwill, the excess will be a capital gain. Previously deducted CCA will be recaptured to the extent that the amount of the receipt exceeds the balance of the new CCA class.

Transitional rules

Under the proposal, CEC pool balances will be calculated and transferred to the new CCA class as of January 1, 2017. The opening balance of the new CCA class in respect of a business will be equal to the balance at that time of the existing CEC pool for that business. For the first ten years, the depreciation rate for the new CCA class will be 7% in respect of expenditures incurred before January 1, 2017.

Some receipts received after the time at which the new rules are implemented could relate to property acquired, or expenditures otherwise made, before that time. In this regard, certain qualifying receipts will reduce the balance of the new CCA class at a 75-per-cent rate. Receipts that qualify for the reduced rate will generally be receipts from the disposition of property the cost of which was included in the taxpayer's CEC and receipts that do not represent the proceeds of disposition of property.

The budget also proposes the following special rules to simplify the transition for small businesses:

> A taxpayer will be permitted to deduct as capital cost allowance, in respect of expenditures incurred before 2017, the greater of $500 per year and the amount otherwise deductible for that year. This additional allowance will be provided for taxation years that end prior to 2027.

> A separate business deduction will be provided for the expenditures, such that the first $3,000 of these expenditures will be treated as a current expense.

This measure, including the transitional rules, will apply as of January 1, 2017.

INTERNATIONAL TAX MESURES

Base erosion and profit shifting

Transfer pricing documentation – country-by-country reporting

The budget proposes to implement country-by-country reporting. This measure will apply only to multinational enterprises with total annual consolidated group revenue of €750 million or more.

The country-by-country reporting will be required for taxation years that begin after 2015.

Treaty abuse

The budget confirms the Government's commitment to address treaty abuse in accordance with the minimum standard.

Spontaneous exchange of tax rulings

The budget confirms the Government's intention to implement the BEPS minimum standard for the spontaneous exchange of certain tax rulings. The Canada Revenue Agency will commence exchanging tax rulings in 2016 with other jurisdictions.

Cross-border surplus stripping

The budget proposes to amend the exception in subsection 212.1(4), it will be clarified that, consistent with the policy of the anti-surplus-stripping rule, the exception does not apply where a non-resident both (i) owns, directly or indirectly, shares of the Canadian purchaser corporation, and (ii) does not deal at arm's length with the Canadian purchaser corporation.

The budget also proposes to clarify the application of the anti-surplus-stripping rule by deeming the non-resident to receive non-share consideration from the Canadian purchaser corporation in such situations.

SALES AND EXCISE TAX MEASURES

Health measures

Medical and assistive devices

The budget proposes to add insulin pens, insulin pen needles and intermittent urinary catheters to the list of zero-rated medical devices.

This measure will apply to supplies made after March 22, 2016 and to supplies made on or before March 22, 2016, unless the supplier charged, collected or remitted GST/HST in respect of the supply.

Purely cosmetic procedures

The budget proposes to clarify that the GST/HST generally applies to supplies of purely cosmetic procedures provided by all suppliers, including registered charities.

This measure will apply to supplies made after March 22, 2016.

Exported call centre services

The budget proposes to modify the zero-rating rules for certain exported supplies of call centre services. Specifically, the supply of a service of rendering technical or customer support to individuals by means of telecommunications (e.g., by telephone, email or web chat) will generally be zero-rated for GST/HST purposes if:

> the service is supplied to a non-resident person that is not registered for GST/HST purposes; and
> it can reasonably be expected at the time the supply is made that the technical or customer support is to be rendered primarily to individuals who are outside Canada at the time the support is rendered to those individuals.

This measure will apply to supplies made after March 22, 2016. It will also apply to supplies made on or before March 22, 2016 in cases where the supplier did not, on or before March 22, 2016, charge, collect or remit an amount as or on account of tax under Part IX of the *Excise Tax Act* in respect of the supply.

GST/HST on donations to charities

The budget proposes a change to provide that when a charity supplies property or services in exchange for a donation and when an income tax receipt may be issued for a portion of the donation, only the value of the property or services supplied will be subject to GST/HST. The proposal will apply to supplies that are not already exempt from GST/HST.

This measure will apply to supplies made after March 22, 2016.

In addition, where a charity did not collect GST/HST on the full value of donations made in exchange for an inducement, for supplies made between December 21, 2002 (when the income tax split-receipting rules came into effect) and March 22, 2016, the following transitional relief will be provided:

> If GST/HST was charged on only the value of the inducement, consistent with the income tax split-receipting rules, or if the value of the inducement was less than $500, the donors' and charities' GST/HST obligations will effectively be satisfied, resulting in no further GST/HST owing.
> In other cases, the charity will be required to remit GST/HST on the value of the inducement only (i.e., the relieving split-receipting rules will apply).

Closely related test

The closely related concept is reflected in a test that requires the parent to have nearly complete ownership and voting control over the subsidiary corporation. The current test requires that the parent corporation or partnership own 90% or more of the value and number of the shares of the subsidiary corporation that have full voting rights under all circumstances.

The budget proposes to require that, in addition to meeting the conditions of the current test, a corporation or partnership must also hold and control 90% or more of the votes in respect of every corporate matter of the subsidiary corporation (with limited exceptions) in order to be considered closely related.

This measure will generally apply as of March 23, 2017. The measure will apply as of March 23, 2016 for the purposes of determining whether the conditions of the closely related test are met in respect of elections under section 150 and section 156 of the *Excise Tax Act* that are filed after March 22, 2016 and that are to be effective as of March 23, 2016.

STATUS OF OUTSTANDING TAX MEASURES

The budget confirms the Government's intention to proceed with the following tax and related measures that were announced in the current session of Parliament but have not yet been legislated:

> the common reporting standard established by the Organisation for Economic Co-operation and Development for the automatic exchange of financial account information between tax authorities; and
> legislative proposals on the income tax rules for certain trusts and their beneficiaries (draft legislative proposals were released for comment on January 15, 2016).

The budget also confirms the Government's intention to proceed with tax and related measures, as modified, to take into account consultations and deliberations since their announcement or release, relating to:

> “synthetic equity arrangements” under the dividend rental arrangement rules;
> the conversion of capital gains into tax-deductible inter-corporate dividends (section 55);
> the offshore reinsurance of Canadian risks;
> alternative arguments in support of an assessment;
> an exception to the withholding tax requirements for payments by qualifying non-resident employers to qualifying non-resident employees;
> the repeated failure to report income penalty;
> the acquisition or holding of limited partnership interests by registered charities;
> the qualification of certain costs associated with undertaking environmental studies and community consultations as Canadian exploration expenses;
> the sharing of taxpayer information within the Canada Revenue Agency to facilitate the collection of certain non-tax debts;
> the sharing of taxpayer information with the Office of the Chief Actuary;
> the tax deferral in respect of the commercialization of the Canadian Wheat Board;
> the Goods and Services Tax/Harmonized Sales Tax joint venture election; and
> the relief of the Goods and Services Tax/Harmonized Sales Tax for feminine hygiene products.

The budget also announces the Government’s intention not to proceed with the measure announced in Budget 2015 that would provide an exemption from capital gains tax for certain dispositions of private corporation shares or real estate where cash proceeds from the disposition are donated to a registered charity or other qualified donee within 30 days.