CHARTERED PROFESSIONAL ACCOUNTANTS CANADA
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Federal Budget Brief 2016

Real test for federal government still to come

The first budget of the new federal government is essentially a ‘down payment’ on a long-term fiscal plan that charts a course to strengthen the Canadian economy.

Yet, it is a hefty and costly initial payment. The real test will come in next year’s budget when we will hopefully see the results from the Advisory Council on Economic Growth, more on the Innovation Agenda, and the government’s stated intention to undertake a review of the tax system, even if limited. These must create an environment that is attractive to businesses and talent as well as enhancing Canada’s long-term growth prospects and competitiveness. With combined federal and provincial personal tax rates in excess of 50 per cent in some provinces, we clearly have a long way to go.

The budget deficit is expected to be $29.4 billion in 2016-17, gradually declining to $14.3 billion in 2020–21. Government debt will increase by over $100 billion and annual interest on the debt will increase by $10 billion. The debt/GDP ratio will only decrease slightly by 2020–21.

There is always uneasiness any time a government turns to deficit financing. The governing Liberals ran on a spending platform but also now face a much more challenging economic landscape than anticipated.

Going forward, the government must demonstrate an ability to manage costs and deal with the demographic changes facing Canada. This initial budget outlines a plan where the Liberals will not deliver on key election promises relating to fiscal management. CPA

Canada will closely monitor the government's handling of the finances, especially as the economy grows, and would prefer the books be balanced by the end of its mandate.

Below we summarize some of the key measures in Budget 2016 and their impact on Canadians and Canadian businesses.

Tax system review

In the coming year, government will undertake a review of the tax system to determine whether it works well for Canadians, with a view to eliminating poorly targeted and inefficient tax measures. CPA Canada welcomes this measure, even if the review is not as broad as we have recommended.

Business Tax Measures

Small business tax rate

Budget 2016 cancels previously scheduled cuts to the small business tax rate, maintaining the current rate of 10.5 per cent after 2016. Last year's budget had proposed to reduce the rate in stages to a target rate of 9 per cent as of 2019. In order to preserve the integration of the personal and corporate income tax systems, Budget 2016 also proposes to maintain the current gross-up factor and dividend tax credit rate applicable to non-eligible dividends (generally, dividends distributed from corporate income taxed at the small business tax rate).

The budget also proposes measures to tighten the $500,000 small business deduction tax rules, including measures to prevent business owners from using partnerships and corporations to multiply access to the deduction – see "Improving domestic tax integrity" below.

Eligible capital property

Budget 2016 proposes to simplify the income tax system by repealing the eligible capital property regime and replacing it with a new capital cost allowance (CCA) class. As part of this change, Budget 2016 also proposes to allow small balances of eligible capital property carried over to the new CCA class to be deducted more quickly, and to allow up to $3,000 in incorporation costs to be deducted as a current expense. A complex set of transitional rules is introduced, which will have effect as of January 1, 2017.

Expanding tax support for clean energy

Budget 2016 expands tax support for businesses that invest in clean energy generation and energy efficiency equipment through accelerated capital cost allowance (CCA) rates (i.e., CCA Classes 43.1 and 43.2). Accelerated CCA is expanded to include equipment for electric vehicle charging and electrical energy storage.

The government also confirmed it will allow the current accelerated CCA for liquefied natural gas facilities to expire as scheduled in 2025.

Personal Taxes and Benefits

Canada Child Benefit

The government announced it will replace the current Canada Child Tax Benefit (CCTB) and Universal Child Care Benefit (UCCB) with a new tax-free 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. Benefits will be topped up for children eligible for the disability tax credit and phased out for families with adjusted net family income between $30,000 and $150,000. Payments will begin in July 2016.

At initial glance, the proposed Liberal plan provides a number of advantages over the existing system, including being simpler while still getting money into the pockets of Canadian families in need. However, the benefit is no longer universal, as benefit amounts would decrease as income rises. Canadian families will feel the impacts differently, depending on their income levels and number of children.

Donations of real estate and private corporation shares

Under a surprise change, the government said it will not proceed with the Budget 2015 measure that would exempt capital gains tax on 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.

Personal tax credits

Budget 2016 eliminates several personal tax credits:

- the income splitting tax credit for couples with at least one child under the age of 18, starting in 2016
- the education and textbook tax credits (but not the credit for tuition fees), starting in 2017

- the children's fitness and arts tax credits, which will be reduced for 2016 and eliminated in 2017.

At the same time, however, this budget introduces a new tax credit for the costs of school supplies incurred by teachers and early childhood educators. Eligible educators will be able to claim a 15-per-cent refundable tax credit on up to $1,000 in expenditures they spend on eligible supplies in the year.

Public pension programs for seniors

Budget 2016 proposes to restore the age of eligibility for Old Age Security and Guaranteed Income Supplement benefits to 65 (from 67) and Allowance benefits to 60 (from 62) over the 2023 to 2029 period.

In addition, the Guaranteed Income Supplement top-up benefit will rise by $947 for seniors with annual income (other than Old Age Security and Guaranteed Income Supplement benefits) of about $4,600 or less. The increased benefit will be phased out gradually for seniors with income between $4,600 and $8,400.

The government also plans to launch public consultations on the CPP, with a view to making decisions on enhancing the CPP collectively with the provinces and territories by the end of 2016.

Top marginal tax rate – consequential amendments

As a result of the new top marginal personal tax rate of 33 per cent on income over $200,000, introduced in December 2015, a number of further amendments are made to reflect the new top rate. Among other things, these changes will:

- 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
- increase from 28 per cent to 33 per cent the tax rate on personal services business income earned by corporations

Investment incentives

To encourage investment through tax incentives, Budget 2016 proposes to:

- restore the Labour-Sponsored Venture Capital Corporations (LSVCC) tax credit to 15 per cent for share purchases of provincially registered LSVCCs for 2016 and later tax years
- extend eligibility for the mineral exploration tax credit for one year, to flow-through share agreements entered into on or before March 31, 2017.

Northern residents deduction

To help draw skilled labour to northern and isolated communities, Budget 2016 proposes to increase the maximum daily residency deduction to $22 (from $16.50), as of January 1, 2016

Improving tax administration

Budget 2016 proposes $185.8 million over five years, starting in 2016–17, and $14.6 million ongoing for the Canada Revenue Agency (CRA) to improve services to taxpayers and tax practitioners. Among other things, the funds are earmarked for:

- pilot-testing a new dedicated telephone support line for tax service providers, giving them more access to CRA information to the benefit of their clients
- revamping the structure, design and format of its correspondence to ensure all CRA communication is straightforward and easy to read
- expanding the CRA’s volunteer community tax return preparation programs and doing more to notify low-income non-filers who are likely eligible to receive tax credits
- clarifying the rules on the political activities of registered charities providing service enhancements
- increasing the CRA’s capacity to resolve taxpayer objections more quickly.

CPA Canada applauds these and other recent initiatives to improve the CRA’s administration of the tax system and will continue to work with the CRA, through our formal collaboration, to promote a well-functioning tax system.

Protecting the tax base

Improving tax compliance

CPA Canada supports government efforts to maintain the integrity of the tax system and welcomes this budget’s commitment to invest $444.4 million over five years for the CRA to enhance its efforts to crack down on tax evasion and combat tax avoidance. Budget 2016 says the funds will be used for:

- hiring additional auditors and specialists

- developing robust business intelligence infrastructure
- increasing verification activities
- improving the quality of investigative work that targets criminal tax evaders.

Improving international tax integrity

Base erosion and profit shifting

As part of its commitment to protect the integrity of the Canadian tax base, the government of Canada is acting on certain recommendations of the Organisation for Economic Co-operation and Development's Action Plan on Base Erosion and Profit Shifting (BEPS). CPA Canada supports this commitment and will continue to work closely with the Department of Finance Canada and the CRA to ensure that actions in this area are properly targeted and do not cause unintended consequences for international competitiveness of Canadian businesses and investors.

Budget 2016 includes several measures to enhance international tax integrity:

- New legislation is proposed to strengthen transfer pricing documentation by introducing country-by-country reporting for large multinational enterprises.
- The CRA is applying revised international guidance on transfer pricing by multinational enterprises, which aligns interpretation of the arm's-length principle with the BEPS proposals. The changes aim to ensure better alignment of the profits of international companies with the economic activities that generate them, consistent with the CRA's current practice.
- Canada is participating in international work to develop a multilateral instrument to streamline and expedite the implementation of treaty-related BEPS recommendations, including addressing treaty abuse.

The CRA will also undertake the spontaneous exchange with other tax administrations of tax rulings that could potentially give rise to BEPS concerns.

Additional measures for improved international tax integrity

Additional actions to protect the integrity of Canada's international tax system in this budget include:

- extending application of the income tax back-to-back loan rules to royalty arrangements, and introducing similar rules for shareholder loans
- preventing unintended, tax-free cross-border distributions of paid-up capital to non-residents by narrowing the application of an existing exception to the cross-border anti-surplus-stripping rule.

Improving domestic tax integrity

Closing loopholes

On the domestic front, Budget 2016 proposes a number of measures that aim to prevent individuals from using corporations to reduce or defer tax inappropriately. These include measures that:

- prevent business owners from multiplying access to the $500,000 small business deduction using complex partnership and corporate structures, as noted earlier
- ensure that investment income derived from an associated corporation’s active business is ineligible for the small business deduction (and taxed at the general corporate income tax rate) in certain circumstances
- ensure that associated corporations cannot avoid the $15-million taxable capital limit in certain circumstances
- close loopholes that allow private corporations to use a life insurance policy to distribute amounts tax-free that would otherwise be taxable.

Additional measures in Budget 2016 to improve domestic tax integrity are proposed to:

- preserve the integrity of the foreign exchange computational rules in transactions typically referred to as debt-parking transactions
- prevent the asymmetrical recognition of gains and losses on derivatives for tax purposes
- prevent the deferral of capital gains tax by investors in mutual fund corporations structured as “switch funds”
- introduce a new rule that would effectively treat the portion of any gain realized on the sale of a linked note that is attributable to the variable return on the note as accrued interest on the note
- ensure that excise tax relief for diesel fuel used as heating oil or to generate electricity is targeted to specific instances.

Indirect tax measures

Sales and excise tax changes

Budget 2016 announces a series of targeted sales and excise tax measures that include:

- simplifying special reporting requirements for builders related to the Goods and Services Tax (GST) rebates for new housing and residential rental property
- modifying the zero-rating rules for certain exported supplies of call centre services
- clarifying the closely related test for access to relief from the need to charge or collect GST/Harmonized Sales Tax (HST) on supplies between members of closely related corporations and partnerships
- clarifying the GST reporting rules where a charity supplies property and services in exchange for a donation where GST applies to only a portion of the property or service
- clarifying amounts included in the $1 million threshold for determining whether a person engaged in deposit-making activity should be treated as a de minimis financial institution for GST/HST purposes
- clarifying the application of GST/HST to cross-border reinsurance
- adding insulin pens, insulin pen needles and intermittent urinary catheters to the list of zero-rated medical devices
- clarifying that the GST/HST generally applies to supplies of purely cosmetic procedures provided by all suppliers, including registered charities.

Outstanding tax proposals

Budget 2016 confirms the government's intention to proceed with previously announced but unenacted proposals, including amendments to the income tax rules for certain trusts and their beneficiaries released in draft form on January 15, 2016.

The government also plans to move ahead with a number of other outstanding proposals announced by the previous government. These include measures related 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
- 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 CRA to facilitate the collection of certain non-tax debts
- the GST/HST joint venture election.

Promoting economic growth

Infrastructure

Investing in core public infrastructure provides a measurable boost to the economy by creating jobs, generating growth, and increasing Canada's long-term competitiveness and productivity – all of which enrich the quality of life for Canadians.

Over the course of the next decade, the government will invest more than $120 billion in infrastructure.

The government's infrastructure plan will be implemented in two phases. The first phase will invest $11.9 billion over five years to modernize and rehabilitate public transit, water and wastewater systems, provide affordable housing and protect infrastructure systems from the effects of climate change.

The second phase will focus on longer-term goals, including helping Canada become a low carbon economy. This phase will be announced in the next year, following consultations with other governments, Indigenous partners, global institutional investors and additional stakeholders.

Sustainability – climate change

Canada's professional accountants have long been dealing with matters relating to climate change and sustainability, and have helped to make environmental impacts meaningful to investors and business leaders.

Recognizing that protecting the environment and growing the economy go hand in hand, the government will invest in clean technologies that address climate change, air quality, clean water, and clean soil. In support of the pan-Canadian Framework on Clean Growth and Climate Change, Budget 2016 proposes to provide $2 billion over two years, starting in 2017–18, to establish the Low Carbon Economy Fund.

Innovation

In a fast-changing, competitive world, innovation in both the public and private sectors is critical for creating jobs, growing our economy and preserving our quality of life.

Through 2016 and 2017, the federal government will define a bold new plan – its Innovation Agenda – to build Canada as a centre of global innovation. To help propel Canada's entrepreneurs and innovators, the government will redesign and redefine how it supports innovation and growth – in partnership and coordination with the private sector, provinces, territories and municipalities, universities and colleges, and the not-for-profit sector.

Expanding trade

Canada's prosperity is closely linked to accessing opportunities within Canada's internal market, as well as growing trade opportunities and expanding markets beyond our own borders.

Budget 2016 reaffirms the federal government's commitment to breaking down barriers to trade, both internal and abroad, and expanding trade opportunities. The government will continue to consult Canadians on the merits of ratifying the TPP. Going forward, the government is also committed to deepening trade relationships with large emerging markets, including China and India.

Improving financial literacy

Developing ways to help Canadians gain greater financial knowledge is critical to Canada's ongoing prosperity and growth. Individuals must have the financial skills, knowledge and confidence required to make informed decisions, especially those regarding their long-term financial security. CPA Canada is helping Canadians become better money managers through its award-winning financial literacy program that draws upon the expertise of professional accountants right across the country.

CPA Canada is pleased that the Financial Consumer Agency of Canada will work with stakeholders to enhance consumer education and financial literacy initiatives with a focus on managing household finances and debt.

Funding for First Nations’ training and development

With Canada’s First Nations being one of the fastest growing demographics in the country, it is important that they receive funding to ensure equal access to education opportunities so that they can participate and contribute to a growing, productive and competitive economy. CPA Canada has been playing an active role in helping First Nations individuals succeed by building on a long-standing and collaborative relationship with AFOA Canada along with our continued involvement in a special mentorship program run in conjunction with the Martin Aboriginal Education Initiative.

Budget 2016 takes measures to improve primary and secondary education on reserves for First Nations children through investments totalling $2.6 billion over five years, starting in 2016-17. In addition, to foster better learning environments for children on reserve, nearly $1 billion over five years is dedicated to build and renovate schools on reserve. Moreover, the Aboriginal Skills and Employment Training Strategy – which helps Indigenous peoples develop employment skills and pursue training for lasting employment – will be expanded.

In particular, CPA Canada is pleased to see that $30 million in funding from 2016-17 to 2020-21 has been earmarked for the Martin Aboriginal Education Initiative – which has a proven track record of significantly raising the literacy rate of First Nations children on reserve.

ABOUT CPA CANADA

The new Canadian designation, Chartered Professional Accountant (CPA), is now used by Canada’s accounting profession across the country. The profession’s national body, Chartered Professional Accountants of Canada (CPA Canada), is one of the largest in the world with more than 200,000 members, both at home and abroad. The Canadian CPA was created with the unification of three legacy accounting designations (CA, CGA and CMA). CPAs are valued for their financial and tax expertise, strategic thinking, business insight, management skills and leadership. CPA Canada conducts research into current and emerging business issues and supports the setting of accounting, auditing and assurance standards for business, not-for-profit organizations and government. CPA Canada also issues guidance and thought leadership on a variety of technical matters, publishes professional literature and develops education and professional certification programs. cpacanada.ca