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**FEDERAL BUDGET  
COMMENTARY**

**2014**

## **BUDGET COMMENTARY**

Titled "Canada's Economic Action Plan 2014 – The Road to Balance: Creating Jobs and Opportunities" federal Finance Minister Jim Flaherty tabled his ninth budget in the House of Commons on February 11, 2014. The budget forecasts a deficit of \$16.6 billion for 2014, a \$2.1 billion decrease compared to what was forecasted in the 2013 federal budget, a \$2.9 billion deficit for 2015 and for 2016 the budget projects a surplus of \$6.4 billion.

In the budget speech the Minister indicated that "Canada's Economic Action Plan 2014" sticks to the same principles that his initial 2006 budget adopted when the government was in a surplus position. In that budget surplus funds were used to pay down federal debt, lower taxes for families and create jobs. As a result, Canada was better prepared when economic bad times arrived.

The Minister then indicated that since the depths of the recession Canada has led the G-7 countries in job creation. In addition, Canada has a triple A credit rating which was and still is virtually unmatched among the other countries and Canada has the best net debt to gross domestic product ratio of any G-7 country.

Although there are many signs of recovery, the world economy is still fragile and the Canadian economy has its own challenges which include high unemployment and a high level of household debt.

With those concerns in mind, the budget is once again focusing on job creation, innovation and infrastructure. In addition, there are a few tax measures introduced which are aimed at addressing tax loopholes in the Canadian tax system specifically relating to immigrant trusts, tax rates for testamentary trusts and partnerships generating business and rental income which are being allocated to minors. The government will also reduce direct program spending for the third year in a row.

The budget also introduces additional funding for research and innovation which includes the creation of the Canada First Research Excellence Fund which will receive \$1.5 billion in funding over the next ten years for certain post-secondary institutions, \$229 million for apprenticeships and internships over the next four years, \$500 million over two years to the Automotive Innovation Fund to help Canada's automotive industry, \$305 million over five years to provide broadband internet service to rural and northern communities and \$392 million over five years to improve road, dams and bridges in national parks.

Other budget measures announced, some of which will be discussed in more detail on the following pages, include:

- potential elimination of the graduated tax rates for trusts created by wills and estates;
- minor additions to eligible medical expenses;
- increase to the maximum amount of adoption expenses;
- increased thresholds for accelerated employer source deduction remittances;
- improved application of GST/HST relating to a number of health care services;
- discretionary authority for CRA to register and assign a GST/HST registration number to an entity who fails to comply with the requirement to register;
- increased rate of excise duty on tobacco products;

As was the case in the past three budgets, this budget can be characterized as a stand-pat, cautious or timid budget that contains no major or significant shifts in the government's economic or fiscal policy.

## **PERSONAL TAX CHANGES**

### **Personal tax rates**

There are no changes to personal income tax rates in this budget. However, the budget includes the following personal tax changes:

### **Loss of graduated rates on trusts and estates**

A trust established under a will is considered to be a testamentary trust. Testamentary trusts, subject to certain exceptions, are taxed in a more favourable way than inter vivos trusts. An inter vivos trust is taxed at the top marginal tax rate on every dollar of income, while a testamentary trust enjoys the graduated rates of tax that are also applicable to individuals. The government's intention to eliminate the tax benefits that arise from taxing at graduated rates was originally proposed in the 2013 budget.

The 2014 budget proposes to generally proceed with measures proposed in the 2013 budget and subsequent consultation paper. As a result, flat top-rate taxation will apply to grandfathered inter vivos trusts and testamentary trust for 2016 and subsequent taxation years. Exceptions will exist for the first 36 months of an estate and for testamentary trusts created for the benefit of disabled individuals who are eligible for the federal Disability Tax Credit.

Testamentary trusts that do not already have a calendar year end will have a deemed taxation year end on December 31, 2015 (or the year in which the first 36-month period ends).

### **Medical expenses tax credit**

The budget proposes to expand the list of expenses eligible for the medical expense tax credit to include amounts paid for the design of an individualized therapy plan where the cost of the therapy itself would be eligible for the medical credit and certain conditions are met. In particular, the therapy plan must be designed for an individual with a severe and prolonged mental or physical impairment who is eligible for the disability tax credit.

The budget also proposes to add expenses for service animals specially trained to assist individuals with severe diabetes to the list of expenditures eligible for the medical expense tax credit.

### **Adoption expense tax credit**

The budget proposes to increase the maximum amount of eligible expenses for the 15% Adoption Expense Tax Credit to \$15,000 per child for 2014 (up from \$11,774). This amount will be indexed to inflation for taxation years after 2014.

### **GST/HST credit**

The budget proposes to allow the Canada Revenue Agency (CRA) to automatically determine if an individual is eligible to receive the GST/HST Credit. Each individual who is eligible for the GST/HST Credit will receive a notice of determination rather than having to apply for the credit. This change eliminates the need for an individual to apply for the GST/HST credit on their annual income tax return.

This measure will apply for 2014 income tax returns and for subsequent taxation years.

### **Donation by an estate**

Under the current provision, where a donation is made in an individual's will, the donation is considered to have been made by the individual immediately before death. The donation credit may only be claimed by the individual in the year of death or the preceding year. Where the donation is made by the individual's estate (and not by the terms of the will), the donation credit may only be claimed against the income of the estate.

Effective for 2016 and subsequent years, the budget proposes a new deeming rule so that donations made by will and designation donation will no longer be deemed to be made by an individual immediately before the individual's death. These donations will rather be deemed to have been made by the estate, at the time at which the property that is the subject of the donation is transferred to a qualified donee. As a result, the trustee will have the flexibility to claim the donation in the taxation year of the estate in which the donation is made, an earlier taxation year of the estate or the individual's last two taxation years. Any unclaimed donations can be carried forward and utilized in any of the five following years.

### **Search and rescue volunteers tax credit**

The budget proposes a Search and Rescue Volunteers Tax Credit to allow eligible ground, air and marine search and rescue volunteers to claim a 15% non-refundable tax credit based on an amount of \$3,000.

This measure will apply to the 2014 and subsequent taxation years.

### **Mineral exploration tax credit**

The 15% mineral exploration tax credit helps companies raise capital for mining exploration by providing an incentive to individuals who invest in flow-through shares issued to finance exploration. The credit was scheduled to expire on March 31, 2014. The budget proposes to extend the mineral exploration credit for an additional year, until March 31, 2015.

## **BUSINESS TAX CHANGES**

### **Corporate tax rates**

There are no changes to the corporate income tax rates or to the \$500,000 small business income limit of a Canadian-controlled private corporation (CCPC). However, the budget includes the following business tax changes:

### **Employer source deduction remittances**

Employers are required to remit source deductions for employees' income tax, Canada Pension Plan contributions and Employment Insurance premiums. The frequency of remittance of source deductions depends on the employer's total average monthly withholding amount in preceding calendar years in respect of these source deductions. In an effort to help reduce the tax compliance burden, the budget proposes to reduce the frequency of remittance of source deductions for certain employers by increasing threshold level of average monthly withholdings. The budget proposes to:

- Increase the threshold level of average monthly withholdings at which employers are required to remit up to two times per month to \$25,000 (from \$15,000)
- Increase the threshold level of average monthly withholdings at which employers are required to remit up to four times per month to \$100,000 (from \$50,000).

This measure will apply to amounts to be withheld after 2014.

### **Eligible capital property consultations**

Under the current eligible capital property (ECP) regime, 75% of an eligible capital expenditure is added to the cumulative eligible capital (CEC) pool in respect of the business and is deductible at a rate of 7% per year on a declining-balance basis. The current regime also provides that 75% of an eligible capital receipt is first applied to reduce the CEC pool and then results in recapture of any CEC previously deducted. Any excess receipt is then included in income from the business at a 50% inclusion rate.

The budget outlines a proposal to simplify the income tax rules dealing with ECP. The proposed rules would introduce a new class of depreciable property for CCA purposes. Expenditures that are currently added to CEC (at a 75% inclusion rate) would be added to the new CCA class at 100%. The depreciation rate of the new class would be 5% (instead of 7% under the ECP regime). The existing CCA rules would generally apply to the new CCA class, including rules related to recapture, capital gains and depreciation. The half-year rule would also apply.

## **INDIRECT TAX CHANGES**

### **Improving the application of the GST/HST to the health care sector**

The budget proposes changes concerning the application of GST/HST to certain health-related services and medical and assistive devices. These changes are as follows:

#### *Training series for individuals with a disorder or disability*

The supply of a training service that is specially designed to assist individuals in coping with the effect of a disorder or disability is currently exempted from GST/HST. The budget proposes the GST/HST exemption to include the service of designing the training. This exemption will apply to the initial development and design of the plan and any subsequent adjustments.

#### *Services of acupuncturists and naturopathic doctors*

The budget exempts from GST/HST professional services rendered to individuals by acupuncturists and naturopathic doctors.

*Eyewear to electronically enhance the vision-impaired individuals*

Under the current legislative provision, corrective eyeglasses and contact lenses sold under prescription are zero-rated medical and assistive devices. The budget also adds eyewear specially designed to electronically treat or correct a defect of vision (i.e. macular degeneration) to the list of GST/HST zero-rated medical and assistive devices.

These measures apply to supplies made after February 11, 2014.

**Strengthening compliance with GST/HST registration**

Under current legislative provisions, a business that makes taxable supplies in excess of \$30,000 annually is required to register for GST/HST purposes, collect and remit tax on its taxable supplies. Businesses that are required to register, but choose not to, cannot be compelled to do so.

The budget gives the CRA the discretionary authority to register and assign a GST/HST registration number to a person who fails to comply with the registration requirement, after having been informed by the CRA that it is required to register.

This measure will apply when the enacting legislation receives Royal Assent.

**OTHER LEGISLATION**

**Charities e-filing**

The government will provide funding to the CRA to enable charities to apply for registration and file their annual information returns electronically.

**Consultation on non-profit status**

A non-profit organization (NPO) qualifies for an exemption from income tax if it meets certain conditions. The budget indicates that concerns have been raised that some organizations claiming NPO status may be earning profits that are not incidental to the non-profit purposes. As a result, a review will be carried out to determine whether the income tax exemption for NPOs is properly targeted and whether there is sufficient transparency and accountability. The review will not be extended to registered charities.

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