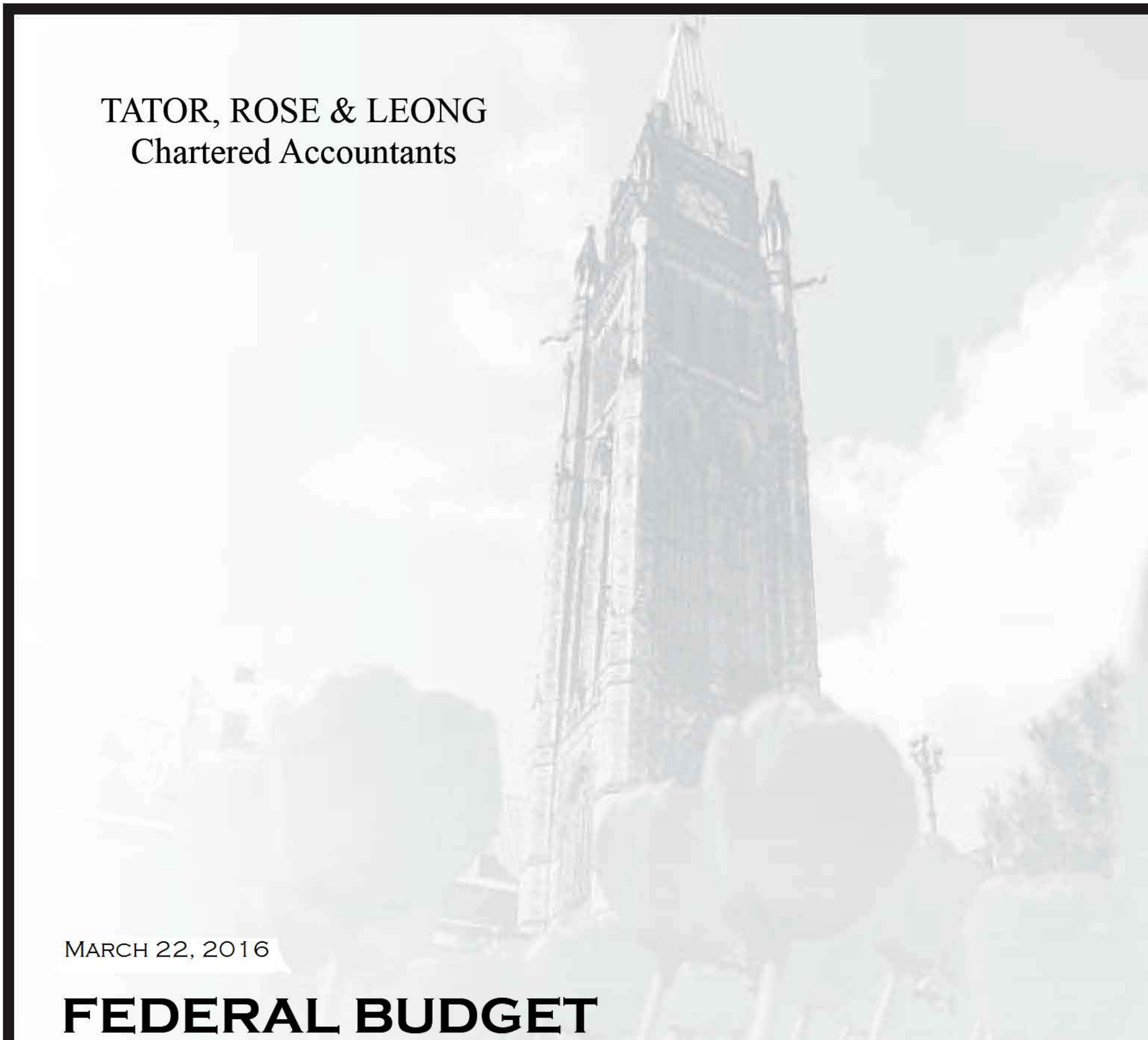

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# FEDERAL BUDGET COMMENTARY

# 2016

**BUDGET COMMENTARY**

On March 22, 2016 Bill Morneau introduced his inaugural budget as Finance Minister entitled "Restoring Hope for the Middle Class". The budget forecasts a deficit of $5.4 billion for 2016, a $6.8 billion increase from the $1.4 billion surplus projected a year ago, a $29.4 billion deficit for 2017 and a $29 billion deficit for 2018. The deficit is projected to be reduced to $14.3 billion by 2021.

The minister indicated that the $5.4 billion forecasted deficit for 2016 is primary due to lower personal income tax revenue, higher employment insurance benefit payments, a significant increase in direct program spending and the weaker economic outlook which is mainly due to the dramatic collapse of the price of oil.

Building on the Liberal election platform the minister outlined plans to make investments in infrastructure, health care, postsecondary education, innovation, clean energy and to introduce the Canada Child Benefit program.

In December 2015 the Liberal party announced the personal income tax rate changes for 2016 which included a 1.5% decrease in the income tax bracket that covers taxable income between $45,283 and $90,563 and a new 33% tax bracket for taxable income in excess of $200,000. These tax brackets will be indexed for inflation in future years. In addition, the maximum annual contribution limit to a tax free savings account has been reduced from $10,000 to $5,500. As a result, there were no additional changes in personal income tax rates proposed in the budget.

With regard to corporate income tax rates, the budget proposes to remove the previously announced reductions to the small business income of a Canadian controlled private corporation. Budget 2016 indicates that the small business rate will remain at 10.5% after 2016. The 2015 budget indicated that the small business rate would decrease from 11% in 2015 to 9% in 2019. No changes were made to the general corporate income tax rate in the budget.

Many other tax changes were introduced including the implementation of the Canada Child Benefit which will replace the Canada child tax benefit and the universal child care benefit, the elimination of the income splitting credit (family tax cut credit), Children's Fitness Credit and the Children's Art Tax Credit. There were no changes introduced relating to the capital gains inclusion rate or the stock option deduction. The budget proposes to cancel the previously announced increases to the eligibility for Old Age Security (OAS) and Guaranteed Income Supplement (GIS) benefits. The eligibility age for OAS and GIS will revert back to age 65 from 67. The corporate income tax measures include revisions to the taxation of small business income and the elimination of the eligible capital property regime which will be replaced with a new capital cost allowance class. These changes and others will be discussed in more detail on the following pages.

Some of the spending initiatives mentioned in the budget included $11.4 billion over five years to modernize public transit infrastructure, $2 billion in a low carbon economy fund and up to $2 billion for a new Post-Secondary Institutions Strategic Fund.

In contrast to the budgets released in recent years, this budget is focused more on increasing infrastructure spending and tax cuts for middle class while at the same time reducing government spending and tax credits for taxpayers near or at the highest tax bracket.

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## PERSONAL TAX CHANGES

### Personal tax rates

As mentioned earlier, there are no individual income tax rate or tax bracket changes in this budget. In December 2015, the federal government announced two tax rate changes for individuals, a reduction in the federal tax rate for income between $45,283 and $90,563 to 20.5% (from 22%) and an increase of 4% in the tax rate for income over $200,000 to 33% (from 29%), effective January 1, 2016.

The budget includes the following personal tax changes:

### Canada Child Benefit

The budget introduces the Canada Child Benefit (CCB) which replaces the Canada Child Tax Benefit (CCTB) and the Universal Child Care Benefit (UCCB). The CCB provides a maximum annual benefit of up to $6,400 per child under the age of 6 and up to $5,400 per child for those aged 6 through 17. The amount of the benefit will be reduced (phase out) when the adjusted family net income exceeds $30,000. The CCB will become effective July 1, 2016. The CCTB and the UCCB will be eliminated for months after June 2016.

### Income splitting

The budget proposes to eliminate income splitting for couples with children under the age of 18 for the 2016 and subsequent taxation years. Pension income splitting will not be affected by this change.

This credit allowed an eligible higher-income spouse or common-law partner to notionally transfer up to $50,000 of taxable income to their spouse or common-law partner to reduce the couple's total income tax liability by up to $2,000.

### Children's Fitness and Arts Tax Credits

The budget reduces the 2016 maximum eligible amounts to $500 (from $1,000) for the Children's Fitness Tax Credit and to $250 (from $500) for Children's Arts Tax Credit. Both credits will be eliminated for the 2017 and subsequent taxation years.

### Education and Textbook Tax Credits

The budget eliminates the Education and Textbook Tax Credits, effective January 1, 2017. Unused education and textbook credits amounts carried forward from years prior to 2017 may be claimed in 2017 and subsequent years. This measure does not eliminate the tuition tax credit.

### Teacher and Early Childhood Educator School Supply Tax Credit

The budget proposes a 15% Teacher and Early Childhood Educator School Supply Tax Credit. This new refundable tax credit will apply to the purchase of up to $1,000 worth of eligible school supplies each year, providing cash benefit of up to $150 each year for licensed and certified teachers and educators. This measure will apply to supplies acquired on or after January 1, 2016.

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## PERSONAL TAX CHANGES (CONTINUED)

### Private Corporation Shares and Real Estate Dispositions

The budget states that the government will not proceed with the 2015 federal budget measure that proposes to provide an exemption from capital gain tax for arm's length disposition of private corporation shares or real estate, where cash proceeds from the disposition are donated within 30 days. Such measure was to be applicable to donations made in respect of disposition occurring after 2016.

### Guaranteed Income Supplements

The budget proposes to increase the Guaranteed Income Supplement top-up benefit by up to $947 annually for low-income single seniors. The budget also proposes to decrease 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.

## BUSINESS TAX CHANGES

### Corporate tax rates

As mentioned earlier, there are no changes to the general corporate income tax rate. The budget proposes that the small business deduction rate will remain at 10.5% (the rate was to decrease to 9% in 2019).

The budget includes the following business tax changes:

### Small Business Deduction

The budget proposes to limit access to the small business deduction under certain corporate and partnership structures that multiply the number of small business deduction limits within a group. An example of a structure targeted by the proposed measures includes a Canadian Controlled Private Corporation (CCPC) owned by a member of a partnership that invoices the partnership for services as an independent contractor. The partner, if incorporated, would otherwise only be entitled to a pro-rata allocation of the $500,000 small business limit. The utilization of the separate CCPC provided access to the full small business limit. The budget proposes to eliminate this opportunity by deeming the CCPC to be a member of the partnership and its income is deemed to be partnership active business income.

### Eligible Capital Property

The budget proposes to repeal the eligible capital property (ECP) regime, and replace it with a new capital cost allowance (CCA) class – Class 14.1. The new rules will provide for a transfer of taxpayer's existing cumulative eligible capital (CEC) pools to the new CCA class. Eligible capital expenditures (ECE) (e.g. cost of goodwill) that are currently added to CEC (at a 75% inclusion rate) will be included in the new Class 14.1 at a 100% inclusion rate. The new class will have a 5% annual depreciation rate (instated of 7% of 75% of ECE). The existing CCA rule will apply to the new class 14.1, including rules relating to recapture, capital gains and the half-year rule.

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**Eligible Capital Property (Continued)**

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 will be equal to the balance at that time of the existing CEC pool. For the first ten years, the depreciation rate for the new CCA class will be 7% for expenditures incurred before January 1, 2017.

The budget also proposes two special rules to simplify the transition for small businesses. The first $3,000 of incorporation cost will be treated as a current expense rather than being added to the new CCA class 14.1. In addition, a taxpayer will be allowed to deduct as CCA, expenditures incurred before 2017, the greater of $500 per year and the amount otherwise deductible for that year.

## INDIRECT TAX AND CUSTOMS CHANGES

**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. As a result, suppliers will not charge purchasers GST/HST on these medical devices. This measure will generally apply to supplies made after March 22, 2016.

**Cosmetic Procedures**

The budget proposes to clarify that the supply of purely cosmetic procedures provided by registered charities is taxable. To be exempt from GST/HST, a cosmetic procedure must be required for medical or reconstructive purposes. Cosmetic procedures paid for by a provincial health insurance plan will continue to be exempt. This measure will apply to supplies made after March 22, 2016.

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