FEDERAL BUDGET REPORT

"The Road to Balance: Creating Jobs and Opportunities"

HIGHLIGHTS

- Deficit of $16.6 billion for 2013-14
- Projected deficit of $2.9 billion for 2014-15
- Graduated rates on testamentary trusts and estates eliminated
- Elimination of tax benefits for Immigration Trusts
- Tax simplification measures introduced

On February 11, 2014, Finance Minister Jim Flaherty tabled the 2014 federal budget. The government continues to show restraint, and with the Winter Olympics well underway, major tax changes were not expected. The focus of today's budget was setting the final path to balancing the books.

The federal government is now predicting a deficit for the 2013-14 fiscal year of $16.6 billion, which is down from the deficit of $18.7 billion predicted in last year's budget. For the 2014-15 fiscal year, a small deficit of $2.9 billion is predicted and a budget surplus of $6.4 billion is projected for 2015-16.

Apart from the focus on balancing the budget, today's announcements covered a number of different areas including initiatives to benefit consumers, enhance innovation and provide additional support for labour expansion.

On innovation, the major change was the announcement of $1.5 billion of funding over the next decade for the Canada First Research Excellence Fund for post-secondary research institutions.

There were a number of initiatives to increase employment such as a new Canada Apprentice Loan to help registered apprentices in Red Seal trades with the cost of training. The government will also fund programs to help older workers and persons with disabilities access the labour market and to create thousands of new paid internships for young Canadians entering the job market.

For consumers, the government announced that it will be introducing legislation to prohibit unjustified cross-border price discrimination. Details on how the government would accomplish this were not discussed but the Finance Minister stated in a press conference that businesses would have to justify unfair mark-ups. The government will also spend $305 million to bring faster broadband internet to rural and Northern Canada and they will eliminate the practice of pay-to-pay billing.

There were a few changes to again close some tax loopholes, such as extending the kiddie tax to apply on arm's length business and rental income allocated by trusts and partnerships to minor children.

From an international perspective, the government announced an end to the longstanding tax advantages provided by immigration trusts and other changes and consultations designed to reduce international tax avoidance.

The following is a summary of the more important items of interest to our clients.

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Key Economic Statistics

(Deficit in billions $)	*2013-2014 Revised*	*2014-2015 Projected*	*2015-2016 Projected*
Budgetary Revenue	264.0	276.3	293.3
Program Expenses	251.2	250.2	256.9
	12.8	26.1	36.4
Public Debt Charges	29.4	29.0	30.0
Budgetary Balance	(16.6)	(2.9)	6.4
Federal Debt	616.0	618.9	612.5

PERSONAL TAX MEASURES

Search and Rescue Volunteers Tax Credit

The budget proposes a Search and Rescue Volunteers Tax Credit (SRVTC) to allow ground, air and marine search and rescue volunteers to claim a 15% non-refundable credit based on an amount of $3,000. An eligible individual will be a search and rescue volunteer who performs at least 200 hours of search and rescue services in a taxation year, for one or more ground, air or marine search and rescue organizations.

An individual who performs both eligible volunteer firefighting services and eligible volunteer search and rescue services for a total of at least 200 hours in the year will be able to claim either the SRVTC or the Volunteer Firefighters Tax Credit (VFTC). Note that an individual who claims either the SRVTC or the VFTC will be ineligible for the existing tax exemption of up to $1,000 for honoraria paid by a government, municipality or public authority to an emergency services volunteer. This measure will apply to the 2014 and subsequent taxation years.

Farming and Fishing Business

Under current rules, the combination of farming and fishing in a single partnership or corporation could block the availability of the lifetime capital gains exemption (LCGE) and the intergenerational rollover rules. Today's budget proposes to adjust the rules for the LCGE and intergenerational transfer of farm and fishing property to allow business entities involved in both farming and fishing to qualify. This measure will apply to the 2014 and subsequent taxation years.

Tax on Split Income

The tax on split income ("kiddie tax") is intended to reduce the ability to split taxable income between a higher-income individual and a lower-income minor by taxing certain income at the top rate. The budget proposes to extend the tax on split income to apply to situations where a minor is paid or allocated income, either directly or indirectly, from a partnership or trust arising from business or rental activities conducted with third parties. This change will apply where a person related to the minor is actively engaged on a regular basis in the activities of the trust or partnership, or has (in the case of a partnership) either a direct or indirect interest in the partnership. This measure will apply to the 2014 and subsequent taxation years.

Other Changes

Adoption Expense Tax Credit – For adoptions finalized in 2014, the budget proposes to increase the maximum amount of eligible expenses to $15,000 per child (from the current maximum of $11,774 for 2014). This amount will be indexed to inflation for taxation years after 2014.

Medical Expense Tax Credit (METC) - Today's budget proposes to make eligible for the METC amounts paid for the design of an individualized therapy plan, if the cost of the therapy itself would be eligible for the METC and if specific conditions are met. The budget also proposes to add to the list of expenditures eligible under the METC expenses for service animals specially trained to assist an individual in managing their severe diabetes. These measures will apply to expenses incurred after 2013.

Mineral Exploration Tax Credit - The budget proposes to extend eligibility for the mineral exploration tax credit for one year to flow-through share investors with respect to agreements entered into on or before March 31, 2015.

GST/HST Credit Administration – For 2014 and subsequent taxation years' tax returns, the budget proposes to eliminate the need for an individual to apply for the GST/HST credit and to allow the Canada Revenue Agency (CRA) to automatically determine whether an individual is eligible to receive this credit. Note that in the case of eligible couples, the GST/HST credit will be paid to the spouse or common-law partner whose tax return is assessed first.

Tax Deferral for Farmers – Current income tax rules allow farmers who dispose of qualifying breeding livestock in a given year due to drought, flood or excess moisture conditions existing in prescribed regions to defer up to 90% of the sale proceeds from inclusion in their taxable income until the year following the sale (or a later year, if conditions persist). Today's budget proposes to extend this tax deferral to bees and to all types of horses that are over 12 months of age and that are kept for breeding. This measure will apply for 2014 and subsequent taxation years.

Amateur Athlete Trusts – The budget proposes to allow income contributed after 2013 to an amateur athlete trust to qualify as earned income for the purpose of determining the RRSP contribution limit of the trust's beneficiary. In addition, an individual will be permitted to elect to have income that was contributed to the trust in 2011, 2012 and 2013 qualify as earned income, if a written election is submitted on or before March 2, 2015.

Pension Transfer Limits – Relieving measures were introduced in 2011 in respect of the determination of amounts that can be transferred from an underfunded defined benefit Registered Pension Plan to an RRSP, RRIF or other defined contribution retirement savings vehicle on a tax-free basis. The changes will be extended to additional situations to ensure the appropriate application of these rules to individuals leaving an underfunded plan. The measure will apply to commutation payments made after 2012.

TRUST TAX MEASURES

Graduated Rate Taxation of Trusts and Estates

The 2013 federal budget announced the government's intention to consult on measures to eliminate the tax benefits arising from the taxation of grandfathered inter-vivos trusts, trusts created by Will, and estates at the graduated tax rates applicable to individuals. A consultation paper was subsequently released, proposing the application of "flat top-rate taxation" to grandfathered inter-vivos trusts and trusts created by Will. "Flat top-rate taxation" refers to the flat income tax rate applicable to other trusts, which is set at the highest federal tax rate applicable to individuals. Flat top-rate taxation is also proposed to apply to estates, following the 36-month administration period after the death of an individual.

Today's budget proposes to generally proceed with the measures described in the consultation paper, with the exception of additional proposals to ensure that graduated rate taxation continues to apply in respect of trusts with disabled beneficiaries. Further details on this exception will be released in the coming months.

The budget also provided clarification with respect to the taxation year-end for testamentary trusts that do not already have a calendar year taxation year. Such trusts will have a deemed taxation year-end on December 31, 2015 (or in the case of an estate for which that 36-month period ends after 2015, the day on which that period ends).

These measures will apply to the 2016 and subsequent taxation years.

Immigration Trusts

If a person resident in Canada contributes property to a non-resident trust, the "deemed residence rules" may apply to treat the non-resident trust as resident in Canada. An exemption from the application of the deemed residence rules applies if the contributor was resident in Canada for a period of not more than 60 months. These trusts are often referred to as immigration trusts.

The budget proposes to eliminate the 60-month exemption for immigration trusts. This measure will apply in respect of trusts for taxation years:

- that end after 2014 if (i) at any time after 2013 and before February 11, 2014 the 60-month exemption applies in respect of the trust, and (ii) no contributions are made to the trust on or after February 11, 2014 and before 2015; or
- that end on or after February 11, 2014 in any other case.

NON-PROFIT ORGANIZATION AND CHARITY MEASURES

Consultation on Non-Profit Organizations

A non-profit organization (NPO) is defined in the Income Tax Act as a club, society or association that is not a charity and that is organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit. NPOs qualify for an income tax exemption if certain conditions are met. Concerns have been raised regarding whether certain NPOs are conducting for-profit activities, which subsidize the NPO's non-profit objectives.

The government announced its intention to review whether the income tax exemption for NPOs remains properly targeted and whether sufficient transparency and accountability provisions are in place. A consultation paper will be released and the government will consult with stakeholders as appropriate.

Estate Donations

Donations made by Will are treated for income tax purposes as having been made by the deceased immediately prior to their death. Similar rules apply when the deceased designated a qualified donee under certain deferred savings plans or a life insurance policy. As a result, the related charitable donation tax credit (CDTC) may only be applied against the deceased individual's income tax otherwise payable. When a donation is made by the deceased's estate, the related CDTC may only be applied against the estate's income tax payable.

The budget proposes new rules to provide more flexibility for claiming donations related to a death that occurs after 2015. Under the proposed measures, donations made by Will and designation donations will be deemed to be made by the estate, at the time at which the donated property is transferred to a qualified donee. In addition, the trustee of the individual's estate will be allowed to allocate the available donation between any of: the taxation year of the estate in which the donation is made; an earlier taxation year of the estate; or the last two taxation years of the individual. A donation by Will or a designation donation will qualify under the proposals if a transfer is made to a qualified donee within the first 36 months after the individual's death.

Other Changes

Donations of Ecologically Sensitive Land – For donations of ecologically sensitive land, or easements, covenants, and servitudes on such land, made on or after February 11, 2014, the five year donation carry-forward period will be extended to ten years.

Donations of Certified Cultural Property – The rule that deems the value of a gift to be no greater than its cost to the donor will be extended to include gifts of certified cultural property acquired under a gifting arrangement that is part of a tax shelter, effective for donations made on or after February 11, 2014.

BUSINESS TAX MEASURES

Consultation on Eligible Capital Property

Certain capital expenditures and receipts, not otherwise accounted for as business revenues or expenses or under the capital property rules, are captured under the eligible capital property (ECP) regime for tax purposes. The regime has become increasingly complex over the years. In response to stakeholder suggestions to reduce the complexity, the budget announced that a public consultation will be launched proposing that the ECP regime be repealed and replaced with a new capital cost allowance (CCA) class available to businesses. The budget sets out the following proposed rules:

- Expenditures currently added to cumulative eligible capital (CEC) would be included in a new CCA class, at an inclusion rate of 100%. A 5% annual depreciation rate would apply and the existing CCA rules would generally be applicable.
- Special rules will be provided for goodwill and for expenditures and receipts that do not relate to a specific property, which would be captured under the ECP regime. Such expenditures and receipts will be accounted for by adjusting the capital cost of the goodwill of the business.
- To effect the transition, existing CEC pool balances would be transferred to the new CCA class as of an implementation date. A 7% CCA rate will apply for the first ten years in respect of expenditures incurred before the implementation of the new rules. Certain qualifying receipts will reduce the balance of the new CCA class at a 75% inclusion rate. This will generally apply where receipts relate to the cost of property which was included in the taxpayer's CEC and to receipts that do not represent the proceeds of disposition of property.

Detailed draft legislative proposals will be released for comment at an early opportunity and timing of implementation will be determined following the consultation.

Other Changes

Remittance Threshold for Employer Source Deductions - Today's budget proposes to reduce the remittance frequency for certain employers, for amounts to be withheld after 2014. The threshold level of average monthly withholdings at which employers are required to remit up to two times per month will increase from $15,000 to $25,000 and the threshold level at which employers are required to remit up to four times per month will increase from $50,000 to $100,000.

Tax Incentives for Clean Energy Generation - The budget proposes to expand Class 43.2 to include water-current energy equipment and equipment used to gasify eligible waste fuel for use in a broader range of applications. These measures will apply in respect of property acquired on or after February 11, 2014 that has not been used or acquired before then.

INTERNATIONAL TAX MEASURES

Captive Insurance

A specific anti-avoidance rule in the foreign accrual property income (FAPI) regime is intended to prevent Canadian taxpayers (e.g. financial institutions) from shifting income offshore from the insurance of Canadian risks. This rule provides that income from the insurance of Canadian risks is FAPI where 10% or more of the gross premium income (net of reinsurance ceded) of a foreign affiliate of the Canadian taxpayer is premium income from Canadian risks.

In an attempt to challenge sophisticated swap arrangements, the budget proposes to amend the existing anti-avoidance rule in the FAPI regime relating to the insurance of Canadian risks. For taxation years beginning after February 10, 2014, clarifications will ensure the rule applies when:

- taking into consideration one or more agreements or arrangements entered into by the foreign affiliate, or by a person or partnership that does not deal at arm's length with the affiliate, the affiliate's risk of loss or opportunity for gain or profit in respect of one or more foreign risks can — or could if the affiliate had entered into the agreements or arrangements directly — reasonably be considered to be determined by reference to the returns from one or more other risks (the tracked risks) that are insured by other parties, and
- at least 10% of the tracked risks are Canadian risks.

Where the anti-avoidance rule applies, the affiliate's income from the insurance of the foreign risks and any income from a connected agreement or arrangement will be included in computing its FAPI.

Offshore Regulated Banks

Income from an investment business carried on by a foreign affiliate of a taxpayer is included in the affiliate's FAPI. Most financial services businesses would be considered investment businesses under the FAPI regime, but for certain exceptions in the definition of investment business. One of those exceptions applies to foreign banks and similar institutions. Certain Canadian taxpayers that are not financial institutions purport to qualify for the regulated foreign financial institution exception (and thus avoid Canadian tax) by establishing foreign affiliates and electing to subject those affiliates to regulation under foreign banking and financial laws.

Today's budget proposes to add new conditions to qualify under the regulated foreign financial institution exception. This measure will apply to taxation years of taxpayers that begin after 2014.

To ensure that the measure is appropriately targeted, stakeholders are invited to submit comments concerning its scope within 60 days after February 11, 2014.

Back-to-Back Loans

Some taxpayers have sought to avoid either or both the thin capitalization rules and Part XIII withholding tax through the use of so-called “back-to-back loan” arrangements. Today’s budget proposes to address back-to-back loan arrangements by adding a specific anti-avoidance rule in respect of withholding tax on interest payments, and by amending the existing anti-avoidance provision in the thin capitalization rules. Specifically, a back-to-back loan arrangement will exist where, as a result of a transaction or series of transactions, certain conditions are met.

Where a back-to-back loan arrangement exists, appropriate amounts in respect of the obligation, and interest paid or payable thereon, will be deemed to be owing by the taxpayer to the non-resident person for purposes of the thin capitalization rules.

The taxpayer will, in general terms, also be deemed to have an amount of interest paid or payable to the non-resident person that is equal to the proportion of the interest paid or payable by the taxpayer on the obligation owing to the intermediary that the deemed amount owing is of that obligation. Part XIII withholding tax will generally apply in respect of a back-to-back loan arrangement to the extent that it would otherwise be avoided by virtue of the arrangement.

This proposed measure will apply in respect of the thin capitalization rules, to taxation years that begin after 2014, and in respect of Part XIII withholding tax, to amounts paid or credited after 2014.

Consultation on Treaty Shopping

In last year’s budget, the government announced its intention to consult on possible measures that would protect the integrity of Canada’s tax treaties by limiting “treaty shopping” while still preserving a business tax environment that is conducive to foreign investment. A consultation paper was publicly released on August 12, 2013 to provide stakeholders with an opportunity to comment on possible measures until December 13, 2013.

In order to further advance the discussion in this area, the government invites comments from interested parties, within 60 days after February 11, 2014, on a proposed domestic rule to prevent treaty shopping. There are a number of examples set out in the budget papers showing the intended application of the proposed rule. The rule is intended to address arrangements identified as an improper use of Canada’s tax treaties in the consultation paper. Details on the proposed domestic rule will be provided in an upcoming tax publication.

Consultation on Tax Planning by Multinational Enterprises

The Organisation for Economic Co-operation and Development (OECD) published a report on “base erosion and profit shifting” (BEPS) in July 2013 at the request of the G20 against the backdrop of the debate on tax revenues. That report proposes an action plan to address perceived weaknesses in the international tax rules. The Canadian government is committed to continuing to improve the integrity of its international tax rules and as a result it has invited interested parties to submit comments on key areas that relate to tax planning by multinational enterprises. As well, the government is inviting comments on what actions should be taken to ensure the effective collection of sales tax on e-commerce sales to residents of Canada by foreign–based vendors.

SALES AND EXCISE TAX MEASURES

GST/HST and Health Care Services

For supplies made after February 11, 2014, the budget proposes:

- To expand the exemption for training that is specially designed to assist individuals with a disorder or disability to include the services of designing such training. The exemption will apply to the initial development and design of the plan and any subsequent adjustments.
- That acupuncturists and naturopathic doctors be added to the list of health care practitioners whose professional services rendered to individuals are exempt from the GST/HST.
- To add eyewear specially designed to treat or correct a defect of vision by electronic means, if supplied on the written order of a physician or optometrist for use by a consumer named in the order, to the list of GST/HST zero-rated medical and assistive devices.

GST/HST Election for Closely Related Persons

Under the GST/HST, a group relief election, generally referred to as the "nil consideration election", is available allowing registrants that are resident in Canada, engaged exclusively in commercial activities and members of a closely related group to not account for tax on certain transactions between them. These elections do not have to be filed with the CRA but rather must be kept with the books and records of the electing parties.

Currently, the election may not be available to a new member of a closely related group at the time of initial acquisition of assets from another member under certain circumstances. Today's budget proposes to extend, effective January 1, 2015, the availability of the group relief to new members that have not yet acquired any property, provided that the new members continue as going concerns engaged exclusively in commercial activities. It is also proposed that a filing requirement in relation to the group relief election be introduced.

Effective January 1, 2015, parties to a new election will be required to file that election in a prescribed manner with the CRA. Parties to existing elections that will continue to be in effect on January 1, 2015 will have until January 1, 2016 to comply with this new filing requirement.

In addition, today's budget proposes that parties to an existing or new group relief election (or persons that conduct themselves as if such election were in effect) be subject to a joint and several (or solidary) liability provision with respect to the GST/HST liability that may arise in relation to supplies made between them on or after January 1, 2015.

Other Changes

Joint Ventures - Currently, only participants in joint ventures that carry on eligible activities are allowed to make an election that simplifies their GST/HST accounting obligations. The government intends to propose new joint venture election measures, as well as complementary anti-avoidance measures, that will allow participants in a joint venture to make the joint venture election as long as the activities of the joint venture are exclusively commercial and the participants are engaged exclusively in commercial activities. The government will release draft legislative proposals later in the year and invite stakeholders to provide their views.

Strengthening Compliance with GST/HST Registration – Today's budget proposes that the Minister of National Revenue be given the discretionary authority to register and assign a GST/HST registration number where a person fails to comply with the requirement to register, even after having been notified of the requirement to register by the CRA. This measure will apply on Royal Assent to the enacting legislation.

Tobacco Taxation – Today's budget proposes a number of changes to restore the effectiveness of the excise duty on tobacco products.

GST/HST Relief for Hospital Parking - Today's budget confirmed the government's intention to proceed with proposed legislation relating to the provision of a GST/HST exemption for hospital parking for patients and visitors.