FEDERAL BUDGET REPORT

"Strong Leadership: A Balanced-Budget, Low-Tax Plan for Jobs, Growth and Security"

HIGHLIGHTS

- Deficit of $2 billion for 2014-15
- Projected surplus of $1.4 billion for 2015-16
- Small business tax rate reduced from 11% to 9% over 4 years
- TFSA contribution limit increased to $10,000
- RRIF minimum withdrawal amount reduced

On April 21, 2015, the Honourable Joe Oliver presented his first budget as Minister of Finance. Following announcements of tax relief in the months leading up to the budget, the government has delivered on its commitment to balance the budget. Even with the steep drop in oil prices, the budget provides additional tax cuts and spending in key areas which will help bolster support for the government in this election year.

The deficit reported for the 2014-15 fiscal year is $2 billion which is down from the deficit of $2.9 billion predicted in last year's budget. The government is predicting a surplus of $1.4 billion for 2015-16 and $1.7 billion for 2016-17. However, there is very little wiggle room as the contingency reserve was reduced to only $1 billion.

Priority spending initiatives will include a significant investment in infrastructure including the new Public Transit Fund program, and increased funding to support the military and the manufacturing industry. With a clear focus on balancing the budget, the government confirmed its intention to introduce balanced budget legislation to help manage finances going forward.

As expected, the Tax-Free Savings Account annual limit will increase to $10,000 for 2015 and subsequent years. As well, seniors will benefit from reductions to minimum withdrawal amounts applicable to Registered Retirement Income Funds. Caregivers will benefit from an extension of the period for Employment Insurance Compassionate Care Benefits from six weeks to six months. Further tax relief included a new Home Accessibility Tax Credit for disabled individuals, seniors and their families.

Small businesses will benefit from a reduction in the small business tax rate. Along with this change, the federal personal tax rate on non-eligible dividends will be increased to maintain tax integration on small business income.

From an international perspective, the government has introduced long-anticipated relief to the administrative burden imposed on non-resident employers with respect to withholdings on treaty-exempt non-resident employees. The government has also responded to stakeholder feedback in respect of the current form T1135 by proposing a new simplified foreign asset reporting system.

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

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Key Economic Statistics

Surplus/(Deficit) in billions $	*2014-2015 Revised*	*2015-2016 Projected*	*2016-2017 Projected*
Budgetary Revenue	279.3	290.3	302.4
Program Expenses	254.6	263.2	274.3
	24.7	27.1	28.1
Public Debt Charges	26.7	25.7	26.4
Budgetary Balance	(2.0)	1.4	1.7
Federal Debt	616.0	617.0	615.3

PERSONAL TAX MEASURES

Tax-Free Savings Account (TFSA)

Contributions to a TFSA do not give rise to a tax deduction and when money is withdrawn, the accumulated contributions and income received are not taxable. Each year, taxpayers are entitled to a specified contribution limit. The annual TFSA dollar limit for the years 2009 through 2012 was $5,000. Due to indexing, this annual contribution limit increased for the years 2013, 2014 and 2015 to $5,500.

In keeping with the government's 2011 election commitment, today's budget proposes to increase the TFSA annual contribution limit to $10,000. This increase will apply as of January 1, 2015, so that a single annual contribution limit of $10,000 applies to the 2015 and subsequent calendar years. The TFSA annual contribution limit will no longer be indexed to inflation.

Home Accessibility Tax Credit (HATC)

The budget proposes to introduce a new HATC. The proposed non-refundable credit will provide tax relief of 15% on up to $10,000 of eligible expenditures per calendar year, per qualifying individual, to a maximum of $10,000 per eligible dwelling. Seniors and persons eligible for the Disability Tax Credit will be considered qualifying individuals for the purposes of the HATC and will be able to claim the credit. The HATC can also be claimed by an eligible individual, which includes an individual who has claimed the spouse or common law partner amount, eligible dependant amount, caregiver amount or infirm dependant amount for the qualifying individual for the taxation year.

An eligible dwelling must be the principal residence of the qualifying individual at any time in the taxation year.

Subject to additional requirements, expenditures will be eligible for the HATC if they are made or incurred in relation to a renovation or alteration of an eligible dwelling, provided that the renovation or alteration allows access or mobility within the dwelling or reduces the risk of harm within or from gaining access to the dwelling.

Expenditures will not be eligible for the HATC if they are for goods or services provided by a person not dealing at arm's length with the qualifying or eligible individual, unless that person is registered for Goods and Services Tax/Harmonized Sales Tax (GST/HST) purposes. The HATC will apply in respect of eligible expenditures for work performed and paid for and/or goods acquired after 2015 and expenditures claimed must be supported by receipts.

Minimum Withdrawal Factors for Registered Retirement Income Funds

Popular amongst Canadians, a registered retirement income fund (RRIF) is a registered arrangement between a taxpayer and a carrier (an insurance company, a trust company or a bank). A RRIF is similar to a Registered Retirement Savings Plan (RRSP) with two main exceptions. The first difference is that, with the exception of certain transfers, contributions cannot be made to a RRIF and second, a minimum amount must be withdrawn from the plan each year.

Today's budget proposes to adjust the RRIF minimum withdrawal factors that apply in respect of ages 71 to 94, on the basis of a 5% nominal rate of return and 2% indexing. The new RRIF factors will permit holders to preserve more of their RRIF savings in order to provide income at older ages, while continuing to ensure that the tax deferral provided on RRSP/RRIF savings serves a retirement income purpose. As an illustration, the minimum withdrawal amount at age 71 will be reduced from 7.38% of the value of a RRIF on January 1st to 5.28%. There will be no change to the minimum withdrawal factors that apply in respect of ages 70 and under.

The new RRIF factors will apply for the 2015 and subsequent taxation years. Transitional rules will allow RRIF holders who at any time in 2015 withdraw more than the reduced 2015 minimum amount to re-contribute the excess to their RRIFs. Re-contributions will be permitted until February 29, 2016 and will be deductible for the 2015 taxation year. Similar rules will apply to those receiving annual payments from a defined contribution Registered Pension Plan or a Pooled Registered Pension Plan.

Lifetime Capital Gains Exemption for Qualified Farm or Fishing Property

The budget proposes to increase the Lifetime Capital Gains Exemption (LCGE) to apply to up to $1 million of capital gains realized by an individual on the disposition of qualified farm or fishing property. This measure will apply to dispositions of qualified farm or fishing property that occur on or after April 21, 2015. The LCGE applicable to capital gains realized on the disposition of qualified farm or fishing property will be the greater of $1 million and the indexed LCGE applicable to capital gains realized on the disposition of qualified small business corporation shares.

Other Changes

Registered Disability Savings Plan – Legal Representation – Budget 2012 introduced a temporary measure to allow a qualifying family member (i.e. a beneficiary's parent, spouse or common-law partner) to become the plan holder of a Registered Disability Savings Plan for an adult individual who may lack the capacity to enter into a contract. This measure will be extended to apply to the end of 2018.

Repeated Failure to Report Income Penalty – Effective for 2015 and subsequent years, the budget proposes to amend the repeated failure to report income penalty to apply in a taxation year only if a taxpayer fails to report at least $500 of income in the year and in any of the three preceding taxation years. The amount of the penalty will equal the lesser of:

- 10% of the amount of unreported income; and
- An amount equal to 50% of the difference between the understatement of tax (or the overstatement of tax credits) related to the omission and the amount of any tax paid in respect of the unreported amount (e.g. by an employer as employee withholdings).

Transfer of Education Credits – Effect of the Family Tax Cut – The previously-announced Family Tax Cut (FTC) rules prevent transferred education related amounts (Tuition, Education and Textbook Tax Credits) from being included in the FTC calculation. Today's budget proposes to revise the calculation of the FTC for the 2014 and subsequent taxation years to ensure that couples claiming the FTC and transferring education-related credits between themselves receive the appropriate value of the FTC.

BUSINESS TAX MEASURES

Small Business Tax Rate

Active business income of a Canadian-controlled private corporation (CCPC) qualifies for a lower small business tax rate up to an income limit of $500,000. This limit must be shared among associated corporations. As well, access to the lower tax rate is phased out on a straight-line basis for CCPCs having between $10 million and $15 million of taxable capital employed in Canada.

To continue to help small businesses grow and create jobs, the government has announced a 2% reduction of the small business tax rate from 11% to 9%, which will be phased-in over 4 years. Accompanying this change are corresponding adjustments to the gross-up factor and dividend tax credit rate applicable to dividends distributed from corporate income taxed at the small business tax rate (i.e. non-eligible dividends). These adjustments will ensure the tax system maintains its current level of integration. This generally means that income earned by a corporation and paid out to an individual as a non-eligible dividend will be subject to approximately the same amount of tax as income earned directly by the individual.

The following chart sets out the proposed reductions to the small business rate and the changes for non-eligible dividends:

Effective Date	Small Business Tax Rate (%)	Non-Eligible Dividend Gross-Up (%)	Non-Eligible Dividend Tax Credit Rate (%)	Top Personal Tax Rate on Non-Eligible Dividends (Federal Only) (%)
Current	11	18	11	21.2
January 1, 2016	10.5	17	10.5	21.6
January 1, 2017	10	17	10	22.2
January 1, 2018	9.5	16	9.5	22.6
January 1, 2019	9	15	9	23.0

Manufacturing and Processing Machinery and Equipment – Accelerated CCA

In 2007, accelerated capital cost allowance (CCA) was introduced to encourage investment in machinery and equipment used in manufacturing and processing. This measure provides a 50% straight-line depreciation rate and is set to expire at the end of 2015. To provide further tax support for manufacturing investment, the budget proposes to provide an accelerated CCA rate of 50% on a declining-balance basis for machinery and equipment acquired by a taxpayer after 2015 and before 2026. Assets will be eligible if they are primarily for use in Canada for the manufacturing and processing of goods for sale or lease. Under this measure eligible assets will be

included in new CCA Class 53. The half-year CCA rule will apply to these assets and they will be considered "qualified property" for purposes of the Atlantic Investment Tax Credit.

Synthetic Equity Arrangements and Dividend Rental Arrangements

The Income Tax Act (ITA) permits a corporation to deduct, subject to certain exceptions, taxable dividends received in computing its taxable income. This inter-corporate dividend deduction is intended to limit the imposition of multiple levels of corporate taxation on earnings distributed from one corporation to another. However, certain taxpayers, typically financial institutions, have entered into arrangements with tax-indifferent investors, such as non-residents or tax-exempt entities, that take advantage of the inter-corporate dividend rules, but which erode the Canadian tax base. Synthetic equity arrangements exist where the taxpayer retains the legal ownership of an underlying Canadian share, but all or substantially all of the risk of loss and opportunity for gain or profit in respect of the Canadian share is transferred to a counterparty using an equity derivative. Some taxpayers take the position that the existing anti-avoidance rules, known as the dividend rental arrangement rules, do not apply to these arrangements.

To protect the Canadian tax base, today's budget proposes to modify the dividend rental arrangement rules to deny the inter-corporate dividend deduction on dividends received by a taxpayer on a Canadian share in respect of which there is a synthetic equity arrangement. This measure will apply to dividends that are paid or become payable after October 2015.

In addition, the government invites stakeholders to submit comments by August 31, 2015 concerning whether the proposed new measures could be simplified, at the cost of broadening the scope of the measures.

Other Changes and Consultations

Agricultural Cooperatives: Deferral of Tax on Patronage Dividends Paid in Shares – The government will extend the temporary measure currently in place that provides a tax deferral on patronage dividends paid to members by an eligible agricultural cooperative in the form of eligible shares. This measure will be extended to apply in respect of eligible shares issued before 2021.

Quarterly Remitter Category for New Employers – Under current rules, new employers must remit payroll withholdings on a monthly basis for the first year, after which they may be eligible for quarterly remitting. To reduce the tax compliance burden on new small employers, the budget proposes to decrease the required frequency of remittances by allowing eligible employers with withholdings of less than $1,000 in respect of each month to remit on a quarterly basis from the start. This measure will apply in respect of withholding obligations that arise after 2015.

Changes to Section 55 – The ITA contains an anti-avoidance rule that re-characterizes a tax-free intercompany dividend into a capital gain in certain circumstances. The government proposes to amend these rules to ensure that they apply where one of the purposes of a dividend is to effect a significant reduction in the fair market value of any share, or a significant increase in the total cost of properties of the recipient of the dividend. In addition, the exception for dividends received in certain related-party transactions will be amended to apply only to dividends arising as a result of the corporation having redeemed, acquired or cancelled the shares. This measure will apply to dividends received by a corporation on or after April 21, 2015.

Small Business Deduction: Consultation on Active versus Investment Business – Stakeholders have expressed concern as to the application of these rules in cases such as self-storage facilities and campgrounds. The budget announced a review of the circumstances in which income from a

business, the principal purpose of which is to earn income from property, should qualify as active business income. The government invites interested parties to comment by August 31, 2015.

Consultation on Eligible Capital Property – In last year's budget, the government announced a public consultation on the proposal to repeal the eligible capital property regime and replace it with a new capital cost allowance class. It is the intention of the government to release detailed draft legislative proposals for stakeholder comment before their inclusion in a bill.

INTERNATIONAL TAX MEASURES

Withholding for Non-Resident Employers

An employer (including a non-resident employer) is generally required to withhold amounts on account of the income tax liability of an employee working in Canada, even if the employee is a non-resident who is expected to be exempt from Canadian tax because of a tax treaty. It may be possible for the employer to obtain an employee-specific waiver from the Canada Revenue Agency (CRA) in order to be relieved from its obligation to withhold. However, there are inefficiencies in this process.

In order to reduce the administrative burden of businesses engaged in cross-border trade and commerce, the budget proposes to provide an exception to the withholding requirements for payments by qualifying non-resident employers to qualifying non-resident employees. An employee will be a qualifying non-resident employee in respect of a payment if the employee is:

- Exempt from Canadian income tax in respect of the payment because of a tax treaty; and
- Not in Canada for 90 or more days in any 12-month period that includes the time of the payment.

To qualify, a non-resident employer must meet the following conditions:

- Be resident in a country with which Canada has a tax treaty (special rules apply for employers who are partnerships);
- Must not carry on business through a Canadian permanent establishment in its fiscal period that includes the time of the payment; and
- Be certified by the Minister of National Revenue at the time of the payment.

In order to be certified, an employer must apply to the government in prescribed form, and the government will then grant certified status. The regulations to enable the certification process were not tabled with the budget. This new measure will apply to payments made after 2015.

In addition, the penalty for failure to withhold on payments to non-resident employees will not apply where a qualifying non-resident employer had reason to believe, after making reasonable inquiries, that the employee would meet the conditions of a qualifying non-resident employee.

This new measure will provide relief to non-resident employers who frequently make payments to treaty-exempt employees since once the employer has been certified, they will not need to apply for a waiver for each qualifying employee.

Although a qualifying non-resident employer will not be obligated to withhold under these circumstances, they will continue to be responsible for preparing and issuing T4s to non-resident employees. Also, certification will not affect the determination of a non-resident's Canadian tax liability and employers will continue to be liable for any withholding in respect of non-resident employees found not to have met the conditions of a qualifying non-resident employee.

Streamlining Reporting Requirements for Foreign Assets

A Canadian-resident individual, corporation or trust that owns specified foreign property at any time in a taxation year with a total cost of more than $100,000 must file a Foreign Income Verification Statement (Form T1135) with the CRA.

The CRA introduced a revised Form T1135 in 2013 which requires taxpayers to provide more detailed information regarding each specified foreign property. This approach has resulted in a compliance burden for many taxpayers. To address this issue, the CRA will redesign the T1135 form such that if the total cost of a taxpayer's specified foreign property is less than $250,000 throughout the year, the taxpayer will be able to report these assets to the CRA under a new simplified system. The current reporting requirements will continue to apply to taxpayers with specified foreign property that has a total cost at any time during the year of $250,000 or more.

Captive Insurance

A specific anti-avoidance rule in the foreign accrual property income (FAPI) regime is intended to prevent Canadian taxpayers from shifting income from the insurance of Canadian risks to a foreign affiliate resident in a lower-tax jurisdiction. This anti-avoidance rule was amended in 2014 to curtail certain sophisticated tax-planning arrangements (sometimes referred to as "insurance swaps"). These arrangements were designed to circumvent the existing anti-avoidance rule while allowing the affiliate to retain its economic exposure to a pool of Canadian risks.

The government has become aware of alternative arrangements that are intended to achieve tax benefits similar to those that the 2014 amendment was intended to prevent. Budget 2015 proposes to amend the existing anti-avoidance rule in the FAPI regime that relates to the insurance of Canadian risks to ensure that profits of a Canadian taxpayer from the insurance of Canadian risks remain taxable in Canada.

Update on the Automatic Exchange of Information for Tax Purposes

The exchange of tax information between countries is an important tool for promoting compliance and combating tax evasion. In November 2014, Canada and the other G-20 countries endorsed a new common reporting standard (CRS) for automatic information exchange developed by the Organisation for Economic Development and Co-operation and committed to a first exchange of information by 2017 or 2018. G-20 Finance Ministers agreed in February 2015 to work towards completing the necessary legislative procedures within the agreed timeframe.

Under the new standard, foreign tax authorities will provide information to the CRA relating to financial accounts in their jurisdictions held by Canadian residents. The CRA will, on a reciprocal basis, provide corresponding information to the foreign tax authorities on accounts in Canada held by residents of their jurisdictions.

Canada proposes to implement the CRS starting on July 1, 2017, allowing a first exchange of information in 2018. As of the implementation date, financial institutions will be expected to have procedures in place to identify accounts held by residents of any country other than Canada and to report the required information to the CRA. Draft legislative proposals will be released for comment in the coming months.

CHARITY MEASURES

Donations Involving Private Corporation Shares or Real Estate

Currently, taxable capital gains can arise on donations of private corporation shares or certain types of real estate. In an effort to increase support for charities, today's budget proposes to provide an exemption from capital gains tax in respect of certain dispositions of private corporation shares and real estate. The exemption will be available where:

- Cash proceeds from the disposition of the private corporation shares or real estate are donated to a qualified donee within 30 days after the disposition; and
- The private corporation shares or real estate are sold to a purchaser that is dealing at arm's length with both the donor and the qualified donee to which cash proceeds are donated.

The exempt portion of the capital gain will be determined by reference to the proportion that the cash proceeds donated is of the total proceeds from the disposition of the shares or real estate. This measure will apply to donations made in respect of dispositions occurring after 2016.

Investments by Registered Charities in Limited Partnerships

Under provincial law, a partnership is generally considered to be a relationship among persons carrying on business in common with a view to profit. Today's budget proposes to amend legislation to provide that a registered charity will not be considered to be carrying on a business solely because it acquires or holds an interest in a limited partnership. To ensure that a registered charity's investment in a limited partnership remains a passive investment, the measure will apply only if:

- The charity – together with all non-arm's length entities – holds 20% or less of the interests in the limited partnership; and
- The charity deals at arm's length with each general partner of the limited partnership.

Similar legislative amendments are also proposed to apply in respect of investments in limited partnerships by registered Canadian amateur athletic associations. In addition, the excess corporate holdings rules, which place limits on shareholdings by private foundations, will be amended to "look through" limited partnerships. This measure applies in respect of investments in limited partnerships that are made or acquired on or after April 21, 2015.

Gifts to Foreign Charitable Foundations

Today's budget proposes to amend the ITA to allow foreign charitable foundations to be registered as qualified donees if they receive a gift from the Canadian government and if they are pursuing activities related to disaster relief or urgent humanitarian aid or are carrying on activities in the national interest of Canada. This measure will apply on Royal Assent to the enacting legislation.

The information in this publication is current as of April 21, 2015.

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