CI Investments

Tax, Retirement and Estate Planning

For wherever life takes you

Tax highlights from the 2017 Federal budget

On March 22, 2017 ("Budget Day"), federal Finance Minister Bill Morneau tabled the Liberal government's second budget since the October 2015 election. The budget, titled "Building a Strong Middle Class," focused primarily on innovation with the goal of building a nation that is both inclusive and innovative.

As for the country's projected financial position, after accounting for Budget 2017 proposals, the budgetary balance is expected to show a deficit of $23.0 billion in 2016-17 and $28.5 billion in 2017-18. Over the remainder of the forecast horizon, the deficit is expected to decline gradually from $27.4 billion in 2018-19 to $18.8 billion in 2021-22. The federal debt-to-GDP ratio is projected to decline gradually after 2018-19 to the end of the fiscal horizon, reaching 30.9% in 2021-22.

The Government's projection for budgetary revenues includes a 4.3% increase in projected revenues in 2017-18, up from a 1.1% decline in 2016-17. Budgetary revenues are projected to grow at an average of 4.0% per year from 2018-19 to 2021-22, in line with the outlook for nominal GDP.

From a tax perspective, there were no changes to personal or corporate income tax rates. The budget did propose changes to certain deductions and credits, and signaled the Government's intention to consult on other matters such as the taxation of private corporations.

To the relief of Canadian investors and contrary to widespread speculation, the Government did not increase the capital gains inclusion rate, which remains at its current level of 50%.

The following is a summary of changes announced in the budget that we feel are relevant to financial advisors and their clients. Please note that these changes are still proposals until passed into law by the Government.

Personal Tax Matters

Personal income tax rates and tax brackets

There were no proposed changes to personal income tax rates. Federal personal income tax rates for 2017 are as follows:

	2017 tax rates			
Taxable income range	**Other income**	**Capital gains**	**Eligible dividends**	**Non-eligible dividends**
First $45,916	15.0%	7.5%	0.0%	5.2%
$45,917 - $91,831	20.5%	10.3%	7.6%	11.7%
$91,832 - $142,353	26.0%	13.0%	15.2%	18.1%
$142,354 - $202,800	29.0%	14.5%	19.3%	21.6%
$202,801 or more	33.0%	16.5%	24.8%	26.3%

Consolidation of caregiver credits

The income tax system provides tax relief to caregivers through a number of non-refundable tax credits. These credits recognize the impact that out-of-pocket expenses incurred by caregivers have on their ability to pay tax. The current system includes three credits, noted below, with varying eligibility conditions based on the circumstances of the caregiver and the dependant:

- Infirm dependant credit
- Caregiver credit
- Family caregiver tax credit

Budget 2017 proposes to simplify the existing system of tax measures for caregivers by replacing the aforementioned three credits with a new Canada Caregiver Credit, which will be:

- $6,883 in respect of infirm dependants who are parents/grandparents, brothers/sisters, aunts/uncles, nieces/nephews, adult children of the claimant or of the claimant's spouse or common-law partner.
- $2,150 in respect of:
  - An infirm dependent spouse or common-law partner in respect of whom the individual claims the spouse or common-law partner amount;
  - An infirm dependant for whom the individual claims an eligible dependant credit; or
  - An infirm child who is under the age of 18 years at the end of the tax year.

These amounts are consistent with the amounts that could have been claimed in respect of these dependants under the current caregiver credit and family caregiver tax credit, respectively.

The Canada Caregiver Credit will be reduced dollar-for-dollar by the dependant's net income above $16,163 (in 2017). The dependant will not be required to live with the caregiver in order for the caregiver to claim the new credit. The Canada Caregiver Credit will no longer be available in respect of non-infirm seniors who reside with their adult children.

The Canada Caregiver Credit will apply for the 2017 and subsequent taxation years. The credit amounts that may be claimed and the income thresholds above which the credit will begin to be phased out will be indexed to inflation for taxation years after 2017.

Disability tax credit – nurse practitioners

The types of medical practitioners that are currently permitted to certify eligibility for the disability tax credit are specified in the *Income Tax Act* and currently include medical doctors, audiologists, occupational therapists, optometrists, physiotherapists, psychologists and speech-language pathologists.

Budget 2017 proposes to add nurse practitioners to the list of medical practitioners that could certify eligibility for the disability tax credit for all types of impairments that are within the scope of their practice. This measure will apply to disability tax credit certifications made on or after Budget Day.

Medical expense tax credit – expanded eligibility

Many of the costs related to the use of reproductive technologies are eligible expenses for the medical expense tax credit. For example, in-vitro fertilization procedures and associated expenses where the procedures are medically indicated because an individual has an existing medical illness or condition are generally recognized as eligible expenses under the credit.

To recognize that some individuals may need to incur costs related to the use of reproductive technologies, even where such treatment is not due to a medical infertility condition, Budget 2017 proposes to clarify the application of the medical expense tax credit so that individuals who require medical intervention to conceive are eligible to claim the same expenses that would generally be eligible for individuals on account of medical infertility.

This measure will apply to the 2017 and subsequent taxation years and a taxpayer will be entitled to elect in a year for this measure to apply for any of the immediately preceding ten taxation years.

Mineral exploration tax credit for flow-through share investors

The budget confirms the Government's March 5, 2017 announcement to extend eligibility for the mineral exploration tax credit for an additional year to flow-through share agreements entered into on or before March 31, 2018.

Electronic distribution of T4 information slips

In order to reduce compliance costs and increase efficiencies for employers, as well as increase convenience for many employees, Budget 2017 proposes to allow employers to distribute T4 (Statement of Remuneration Paid) information slips electronically to current active employees without having to obtain express consent from those employees in advance. An employer will be required to have sufficient privacy safeguards in place before electronic T4s can be sent without express consent in order to ensure that employee information remains confidential. However, employers will be required to issue paper copies to employees who request them.

This measure will apply in respect of T4s issued for the 2017 and subsequent taxation years.

Public transit tax credit

Budget 2017 proposes that the public transit tax credit be eliminated, effective as of July 1, 2017. Specifically, the cost of public transit passes and electronic fare cards attributable to public transit use that occurs after June 2017 will no longer be eligible for the credit.

Tuition tax credit

At present a tuition tax credit is not available for occupational skills courses that are offered by a university, college or other post-secondary institution and that are not at the post-secondary level.

Budget 2017 proposes to extend eligibility for the tuition tax credit to fees for an individual's tuition paid to a university, college or other post-secondary institution in Canada for occupational skills courses that are not at the post-secondary level. The credit would be available in these circumstances only if the course is taken for the purpose of providing the individual with skills in an occupation and the individual has attained the age of 16 before the end of the year.

This measure will apply in respect of eligible tuition fees for courses taken after 2016.

National Child Benefit supplement

Budget 2016 introduced the Canada Child Benefit, replacing the previous child benefit system, which consisted of the Canada Child Tax Benefit, the National Child Benefit supplement and the Universal Child Care Benefit. Payments under the new Canada Child Benefit began in July 2016.

To allow provinces and territories additional time to adjust, Budget 2017 proposes to delay the repeal of the National Child Benefit supplement reference in the Canada Child Benefit rules until July 1, 2018. This modification will have no implications for the calculation of the Canada Child Benefit.

Ecological gifts program

The ecological gifts program provides a way for Canadians with ecologically sensitive land to contribute to the protection of Canada's environmental heritage.

To help ensure that donated land is not subsequently used for other purposes, the *Income Tax Act* imposes a tax of 50% of the fair market value of the land upon a recipient who, without the consent of Environment and Climate Change Canada (ECCC), changes the use of the property or disposes of it. The Canada Revenue Agency is responsible for assessing and collecting the tax in such situations.

Budget 2017 proposes a number of measures in order to better protect gifts of ecologically sensitive land concerning:

- Transfers of ecogifts
- Program administration
- Approval of recipients
- Private foundations; and
- Personal servitudes.

Home relocation loans deduction

Where a person receives an eligible home relocation loan because of their employment, and the interest rate on the loan is below a prescribed rate, that person is deemed to have received a taxable benefit. The taxable benefit is the difference between the prescribed rate and the negotiated loan rate.

The value of any portion of the benefit that is in respect of an eligible home relocation loan may be deductible from taxable income. The amount that may be deductible is generally limited to the annual benefit that would arise if the amount of the loan were $25,000.

Budget 2017 proposes to eliminate the deduction in respect of eligible home relocation loans. This measure will apply to benefits arising in the 2018 and subsequent taxation years.

Anti-avoidance rules for registered plans – RESPs and RDSPs

Registered Education Savings Plans (RESPs) help families accumulate savings for a child's post-secondary education. Registered Disability Savings Plans (RDSPs) allow persons with disabilities – and their families – to better save for their future.

A number of anti-avoidance rules exist for other tax-assisted registered plans (i.e., Tax-Free Savings Accounts (TFSAs), Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs)) to help ensure that the plans do not provide excessive tax advantages unrelated to their respective basic objectives. These include:

- The advantage rules, which help prevent the exploitation of the tax attributes of a registered plan (e.g., by shifting returns from a taxable investment to a registered plan);
- The prohibited investment rules, which generally ensure that investments held by a registered plan are arm's length "portfolio" investments; and
- The non-qualified investment rules, which restrict the classes of investments that may be held by a registered plan.

To improve the consistency of the tax rules that apply to investments held by registered plans, Budget 2017 proposes to extend the anti-avoidance rules described above to RESPs and RDSPs. These proposals are not expected to have an impact on the vast majority of RESP and RDSP holders, who typically invest in ordinary portfolio investments.

Corporate Tax Matters

Corporate income tax rates

There were no proposed changes to federal corporate income tax rates or the small business limit. The table below shows federal tax rates and the small business limit for 2017.

Category	2017 tax rates
General rate	15.0%
Manufacturing & processing rate	15.0%
Investment income	38.7%
Small business rate	10.5%
Small business limit	$500,000

Consultation on tax planning using private corporations

The Government has previously indicated that it is concerned about tax planning strategies using private corporations. With Budget 2017, the Government has expressly identified such strategies as income sprinkling using a private corporation and a shareholder's family members, making passive investments through a corporation (instead of personally) and converting regular corporate income to capital gains.

While the Government has, in recent years, implemented certain measures to limit the perceived tax benefits of such strategies, with Budget 2017 it has signaled that it does not believe such measures have gone far enough. Budget 2017 proposes further review by the Government of tax planning strategies involving private corporations with the announcement of a consultation paper that will be released by the Government in the coming months discussing the issues in this area and proposed policy responses.

Notwithstanding these pronouncements, Budget 2017 is careful to note that the Government will consider whether the current tax system has an "inappropriate, adverse impact on genuine business transactions involving family members" and that corporations contributing to economic growth and job creation will continue to benefit from a "highly competitive tax regime." How exactly the Government will strike this balance between curbing "inappropriate" tax planning with private corporations, maintaining the integrity of genuine intra-family business transactions and providing a highly competitive private corporation tax regime remains to be seen.

Meaning of factual control

The *Income Tax Act* recognizes two forms of control of a corporation: *de jure* (legal) control and *de facto* (factual) control. A person may have factual control of a corporation even though the person does not have legal control of the corporation. Legal control of a corporation generally entails the right to elect the majority of the board of directors of the corporation. Factual control of a corporation exists where a person has "directly or indirectly in any manner whatever" influence that, if exercised, would result in control in fact of the corporation. In each situation, consideration of all the relevant factors is required in determining whether there is factual control of a corporation. A significant body of case law has developed concerning which factors may be useful in determining whether factual control exists.

The concept of factual control is broader than legal control and is generally used to ensure certain corporate tax preferences are not accessed inappropriately. For example, the factual control test is used for the purpose of determining whether two or more Canadian controlled private corporations are "associated corporations" for purposes of the $500,000 small business deduction limit.

A recent court decision held that, in order for a factor to be considered in determining whether factual control exists, it must include "a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability." This requirement limits the scope of factors that may be taken into consideration in determining whether factual control of a corporation exists.

To ensure taxpayers do not inappropriately access certain tax preferences, Budget 2017 proposes that the *Income Tax Act* be amended to clarify that, in determining whether factual control of a corporation exists, factors may be considered that are not limited to the requirement set out above.

This measure will apply in respect of taxation years that begin on or after Budget Day.

Billed-basis accounting

Taxpayers are generally required to include the value of work in progress in computing their income for tax purposes. However, taxpayers in certain designated professions (i.e., accountants, dentists, lawyers, medical doctors, veterinarians and chiropractors) may elect to exclude the value of work in progress in computing their income. This election effectively allows income to be recognized when the work is billed (billed-basis accounting). Billed-basis accounting enables taxpayers to defer tax by permitting the costs associated with work in progress to be expensed without the matching inclusion of the associated revenues.

Budget 2017 proposes to eliminate the ability for designated professionals to elect to use billed-basis accounting. This measure will apply to taxation years that begin on or after Budget Day with transitional provisions over the next two fiscal years.

Investment fund mergers – switch corporations into mutual fund trusts and segregated fund mergers

The *Income Tax Act* contains specific rules to facilitate the reorganization of certain investment funds, including the merger of mutual funds, on a tax-deferred basis. These rules permit funds to be tax-efficiently reorganized so as to achieve economies of scale and avoid the duplication of expenses. However, these rules apply in a limited number of circumstances.

Canadian mutual funds can be in the legal form of a trust or a corporation. While most funds are structured as mutual fund trusts, some are structured as mutual fund corporations. Switch corporations are mutual fund corporations with multiple classes of shares, where typically each class is a distinct investment fund.

At present, the rules do not provide for the reorganization of a mutual fund corporation into multiple mutual fund trusts.

Budget 2017 proposes to extend the mutual fund merger rules to facilitate the reorganization of a mutual fund corporation that is structured as a switch corporation into multiple mutual fund trusts on a tax-deferred basis.

This measure will apply to qualifying reorganizations that occur on or after Budget Day.

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts. At present, the rules do not permit segregated funds to merge on a tax-deferred basis.

To provide consistent treatment between mutual fund trusts and segregated funds, Budget 2017 proposes to allow insurers to effect tax-deferred mergers of segregated funds. It is proposed that these rules generally parallel the mutual fund merger rules.

In order to ensure that the life insurance industry has an opportunity to provide comments on these proposed rules, this measure will apply to mergers of segregated funds carried out after 2017.

Timing of recognition of gains and losses on derivatives

Derivatives are sophisticated financial instruments whose value is derived from the value of an underlying interest. Aside from rules applicable to financial institutions, there are no specific rules in the *Income Tax Act* governing the timing of the recognition of gains and losses on derivatives held on account of income.

Budget 2017 proposes the following two measures to address the reporting of such:

i) **Elective use of the mark-to-market method**

In the past, there was uncertainty as to whether taxpayers could mark to market their derivatives held on account of income under the general principles of profit computation.

A recent decision of the Federal Court of Appeal allowed a taxpayer that was not a financial institution to use the mark-to-market method on the basis that it provided an accurate picture of the taxpayer's income.

Budget 2017 proposes to introduce an elective mark-to-market regime for derivatives held on account of income. Specifically, an election will allow taxpayers to mark to market all of their eligible derivatives. Once an election is made by a taxpayer, the taxpayer will be required to annually include in computing its income the increase or decrease in value of its eligible derivatives. Furthermore, the recognition of any accrued gain or loss on an eligible derivative (that was previously subject to tax on a realization basis) at the beginning of the first election year will be deferred until the derivative is disposed of. Once made, the election will remain effective for all subsequent years unless revoked with the consent of the Minister of National Revenue.

This election will be available for taxation years that begin on or after Budget Day.

ii) Straddle transactions

In its simplest form, a straddle is a transaction in which a taxpayer concurrently enters into two or more positions – often derivative positions – that are expected to generate equal and offsetting gains and losses. There are several variations to a basic straddle transaction, including combining it with an exit strategy that shifts the offsetting gain to a tax-indifferent investor.

Straddle transactions raise significant tax base and fairness concerns. Although these transactions are being challenged using certain judicial principles and existing provisions of the *Income Tax Act*, including the general anti-avoidance rule, these challenges can be time-consuming and costly. Accordingly, specific legislation is proposed to clarify that these transactions contravene the scheme of the *Income Tax Act*.

Budget 2017 proposes to introduce a specific anti-avoidance rule that targets straddle transactions. In particular, a stop-loss rule will effectively defer the realization of any loss on the disposition of a position to the extent of any unrealized gain on an offsetting position. A gain in respect of an offsetting position would generally be unrealized where the offsetting position has not been disposed of and is not subject to mark-to-market taxation. The stop-loss rule will be subject to a number of exceptions.

This measure will apply to any loss realized on a position entered into on or after Budget Day.

Consultation on cash purchase tickets

When a farmer delivers a listed grain (i.e., wheat, oats, barley, rye, flaxseed, rapeseed or canola) to the operator of a licensed elevator, the operator may issue to the farmer a cash purchase ticket or other prescribed form of settlement. If the cash purchase ticket (or other prescribed form of settlement) in respect of a delivery of a listed grain is payable in the year following the year in which the grain is delivered (a "deferred cash purchase ticket"), the taxpayer includes the amount of the ticket in income in the following year. The treatment of deferred cash purchase tickets that are issued in respect of deliveries of listed grains is a departure from the general rule with respect to taxpayers (including other farmers) who are required to include the amount of a security or other evidence of indebtedness received as payment of a currently-payable debt in income in the year in which it is received.

With the deregulation of the grain marketing regime and commercialization of the Canadian Wheat Board, the delivery of the listed grains is now the responsibility of private business rather than the federal government. As a result, there is arguably no longer a clear policy rationale for maintaining the tax deferral accorded to deferred cash purchase tickets received as payment for listed grains.

Budget 2017 will launch a consultation on the income tax deferral available in respect of deferred cash purchase tickets for deliveries of listed grains.

Other Proposals

Combating tax evasion and tax avoidance

Budget 2017 continues the Government's crackdown on tax evasion and tax avoidance activities by proposing an additional $523.9 million investment by the Government over the next five years to combat these activities. Specific initiatives in this regard are to include increasing verification activities and improving investigative work quality targeting criminal tax evaders, among other things.

Budget 2017 also proposes to continue the Government's focus, along with other G20 countries, on combatting base erosion and profit shifting, which generally refers to international tax planning arrangements used by multinational enterprises to unfairly minimize their taxes. Budget 2017 identifies a number of measures that Canada has implemented, or is in the process of implementing, in this regard, including requiring country-by-country reporting by large multinational enterprises, requiring disclosure of specific tax avoidance transactions to the Canada Revenue Agency and enhanced sharing of information with foreign tax authorities, among other things.

Strengthening corporate and beneficial ownership transparency

To combat money laundering, terrorist financing, tax evasion and tax avoidance, Budget 2017 proposes the establishment of a national strategy between the Government and the provinces and territories to strengthen the transparency of legal persons (e.g., corporations) and legal arrangements (e.g., trusts), and to improve the availability of information on their beneficial ownership and control. Budget 2017 also provides that the Government is looking at how to enhance tax reporting requirements for trusts to improve the collection of information on their beneficial ownership.

Strengthening Canada's anti-money laundering and anti-terrorist financing regime

Budget 2017 proposes to amend the *Proceeds of Crime (Money Laundering)* and *Terrorist Financing Act* to: (1) include the Department of National Defence and the Canadian Armed Forces on the list of disclosure recipients that can receive financial intelligence related to security threats to Canada; (2) support more effective intelligence on beneficial owners of legal entities; and (3) strengthen the framework, support compliance, improve the ability of reporting entities to implement the legislation into their operations and ensure the legislation functions as intended.

Phasing out the Canada Savings Bond program

Budget 2017 proposes to discontinue the sales of new Canada Savings Bonds in 2017 due to their declining popularity and confirms that all outstanding retail debt will continue to be honoured by the federal government.

Tobacco taxation

Budget 2017 proposes to eliminate the tobacco manufacturers' surtax. In order to maintain the intended tax burden of the manufacturers' surtax on tobacco products, Budget 2017 also proposes to adjust tobacco excise duty rates, and that inventories of cigarettes held by manufacturers, importers, wholesalers and retailers at the end of Budget Day be subject to a tax of $0.00265 per cigarette, subject to certain exemptions. Manufacturers, importers, wholesalers and retailers should refer to the cigarette inventory tax mechanism in the *Excise Act*, 2001 and Canada Revenue Agency publications for more information. Taxpayers will have until May 31, 2017 to file returns and pay the inventory tax.

These measures will be effective as of the day after Budget Day. A corporation with a taxation year that includes Budget Day and ends after Budget Day will be required to prorate the surtax on its Canadian tobacco manufacturing profits based on the number of days in the taxation year that are on or before Budget Day.

Alcohol taxation

Budget 2017 proposes that excise duty rates on alcohol products be increased by 2% effective the day after Budget Day in respect of duty that becomes payable after that date. No special inventory tax will apply to alcohol products on which duty has been paid. In order to maintain their effectiveness, it is also proposed that the rates be automatically adjusted by the Consumer Price Index on April 1 of every year, starting in 2018.

®CI Investments and the CI Investments design are registered trademarks of CI Investments Inc. Although this publication has been compiled from sources believed to be reliable, we cannot guarantee its accuracy or completeness or that it will be current at all times. All opinions expressed and data provided herein are subject to change without notice. This communication is published by CI for informational and educational purposes, and is not intended to provide, and should not be construed as providing, personal financial, Investment, tax, legal or accounting advice, and should not be relied upon in that regard. Professional advisors should be consulted prior to acting on the basis of the information contained in this publication. CI and its affiliates will not be responsible in any manner for direct, indirect, special or consequential damages, howsoever caused, arising out of the use of this publication. Published March 2017.

CI Investments

2 Queen Street East, Twentieth Floor, Toronto, Ontario M5C 3G7 I **www.ci.com**

Head Office / Toronto 416-364-1145 1-800-268-9374 | **Calgary** 403-205-4396 1-800-776-9027 | **Montreal** 514-875-0090 1-800-268-1602 | **Vancouver** 604-681-3346 1-800-665-6994 | **Client Services** English: 1-800-563-5181 French: 1-800-668-3528

1703-0525_E (03/17)