NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

Highlights

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Budget Canada 2017

March 22, 2017

Capital Gains and Losses

Please note that notwithstanding certain rumors, the capital gains (losses) rate inclusion remains unchanged at 50%.

Individuals

1. Anti-Avoidance Rules for Registered Plans (RESP, RDSP)

The anti-avoidance rules already existing for TFSAs, RRSPs and RRIFs will also be applicable to Registered Education Savings Plans (RESPs) and to Registered Disability Savings Plans (RDSPs), including:

- 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.

This measure will apply to transactions occurring, and investments acquired, after Budget Day. For this purpose, investment income generated after Budget Day on previously acquired investments will be considered to be a "transaction occurring" after Budget Day.

Some transitional measures will be available.

2. Mineral Exploration Tax Credit for Flow-through Share Investors

The mineral exploration tax credit provides an additional income tax benefit for individuals who invest in mining flow-through shares, which augments the tax benefits associated with the deductions that are flowed through. This credit is equal to 15 percent of specified mineral exploration expenses incurred in Canada and renounced in favour of flow-through share investors.

The Government proposes 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.

3. Disability Tax Credit – Nurse Practitioners

Budget 2017 proposes to add nurse practitioners to the list of medical practitioners that could certify eligibility for the disability tax credit. A nurse practitioner would be permitted to certify 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.

4. Medical Expense Tax Credit – Eligible Expenditures

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

Budget 2017 proposes to clarify the application of the medical expense tax credit so that individuals who require medical intervention in order to conceive a child 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. A taxpayer will be entitled to select the year for which this measure applies within any of the immediately preceding ten taxation years.

5. The Canada Caregiver Credit

The Government will replace the Caregiver Credit, Infirm Dependant Credit and Family Caregiver Tax Credit with a single new credit: the Canada Caregiver Credit. This new, non-refundable credit will provide better support to those who need it most, will apply to caregivers whether or not they live with their family member, and will help families with caregiving responsibilities. Families will be able to take advantage of the new Canada Caregiver Credit starting in the 2017 tax year.

6. Tuition Tax Credit

Budget 2017 proposes to extend the eligibility criteria 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. To provide consistency with the rules for certified educational institutions, the tuition tax credit would be available in these circumstances only if the course is taken for the purpose of providing the individual with skills (or improving the individual's skills) in an occupation and if 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.

7. Public Transit Tax Credit

The public transit tax credit provides a 15 percent non-refundable tax credit in respect of the cost of eligible public transit passes, which include annual and monthly passes, as well as weekly passes and electronic fare cards used on an ongoing basis.

Budget 2017 proposes that the public transit tax credit be eliminated, effective July 1, 2017.

8. Ecological Gifts Program

Certain donations of ecologically sensitive land or easements, covenants and servitudes on such land ("ecogifts") are eligible for special tax assistance. Individual donors are eligible for a charitable donation tax credit, while corporate donors are eligible for a charitable donation tax deduction. The amount of the donation, up to 100 percent of net income, may be claimed in a year and unused amounts may be carried forward for up to ten years. In addition, any capital gains associated with the donation of ecologically sensitive land (other than a donation to a private foundation) are exempt from tax.

Budget 2017 proposes measures in order to prevent the avoidance of tax, for example, private foundations will no longer be permitted to receive ecogifts.

9. Home Relocation Loans Deduction

Where a person receives a 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 amount of the taxable benefit is determined by reference to the difference between these two rates. Certain measures allow a tax relief for home relocation loans used to acquire a new residence where the employee starts work at a new location. This new residence must be at least 40 kilometres closer to the new work location than the old residence.

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.

10. Sales and Excise Tax Measures

Alcohol and Tobacco:

Budget 2017 proposes that excise duty rates on alcohol products be increased by 2 percent effective the day after Budget Day 2017, and that rates be automatically adjusted to the Consumer Price Index on April 1 of every year starting in 2018.

Budget 2017 also proposes to adjust excise duty rates for tobacco (and other tobacco products). These measures will be effective as of the day after Budget Day 2017.

Taxi:

Budget 2017 proposes to amend the definition of a taxi business under the Excise Tax Act to level the playing field and ensure that ride-sharing businesses are subject to the same GST/HST rules as taxis.

Companies

1. Review of Tax Planning Using Private Corporations

Note that Budget 2017 has not proposed any measures regarding the following issues. The Government is still reviewing these.

The review of federal tax expenditures highlighted a number of issues regarding tax planning strategies using private corporations, which can result in high income individuals gaining unfair tax advantages. A variety of tax reduction strategies are available to these individuals that are not available to other Canadians. These strategies include:

- *Sprinkling income using private corporations*, which can reduce income taxes by causing income that would otherwise be realized by an individual facing a high personal income tax rate to instead be realized (e.g., via dividends or capital gains) by family members who are subject to lower personal tax rates (or who may not be taxable at all).
- *Holding a passive investment portfolio inside a private corporation*, which may be financially advantageous for owners of private corporations compared to otherwise similar investors.
- *Converting a private corporation's regular income into capital gains,* which can reduce income taxes by taking advantage of the lower tax rates on capital gains.

In addition, the Government will also consider whether there are features of the current income tax system that have an inappropriate, adverse impact on genuine business transactions involving family members.

The Government intends to release a paper in the coming months setting out, in more detail, the nature of the above issues.

2. Investment Fund Mergers

The Income Tax Act contains specific rules to facilitate the reorganization of certain investment funds on a tax-deferred basis. However, these rules apply in a limited number of circumstances.

Merger of switch corporations into mutual fund trusts:

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

The Income Tax Act contains special rules to facilitate the merger of mutual funds on a tax-deferred basis, under which two mutual fund trusts can be merged or a mutual fund corporation can be merged into a mutual fund trust. 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 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. To qualify for this tax deferral, in respect of each class of shares of the mutual fund corporation that is, or is part of, an investment fund, all or substantially all of the assets allocable to that class must be transferred to a mutual fund trust and the shareholders of that class must become unitholders of that mutual fund trust.

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

Segregated fund mergers

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts. Unlike mutual fund trusts, income tax 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.

3. 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. To mitigate the effect on taxpayers, a transitional period will be provided to phase in the inclusion of work in progress into income.

4. Extending the Base Erosion Rules to Foreign Branches of Life Insurers

Budget 2017 proposes to amend the *Income Tax Act* to prevent the avoidance of tax on income from the insurance of Canadian risks (e.g., risks in respect of persons resident in Canada) by extending the foreign affiliate base erosion rules to foreign branches of Canadian life insurers.

This measure will apply to taxation years of Canadian taxpayers that begin on or after Budget Day.

Other Measures

1. Timing of Recognition of Gains and Losses on Derivatives

Aside from the mark-to-market property regime applicable to financial institutions, there are no specific rules in the *Income Tax Act* that govern the timing of the recognition of gains and losses on derivatives held on income account. Budget 2017 proposes two measures that clarify the scheme of the *Income Tax Act* in this regard.

a. Elective use of the mark-to-market method

The budget proposes to provide a clear framework for exercising the choice of using the mark-to-market method and to ensure that this choice does not lead to avoidance opportunities, Budget 2017 proposes to introduce an elective mark-to-market regime for derivatives held on income account. Specifically, an election will allow taxpayers to mark to market all of their eligible derivatives.

b. Straddle transactions

The budget proposes to limit, in certain circumstances, the losses that implicates a straddle transaction. A straddle is a transaction in which a taxpayer concurrently enters into two or more positions that are expected to generate equal and offsetting gains and losses in two different taxation years.

2. Financial sector

Budget 2017 proposes targeted measures to support a resilient financial sector which contributes to a strong and growing economy, including the following.

- Enhancing the Bank Resolution Regime
- Deposit Insurance Review
- Strengthening the Oversight of Financial Market Infrastructures
- Strengthening Corporate and Beneficial Ownership Transparency
- Strengthening Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime
- Phasing out the Canada Savings Bonds Program: Given the decreasing popularity of Canada Savings Bonds among Canadians and following a review of the Program, the Government of Canada will discontinue the sale of new Canada Savings Bonds in 2017. The phasing out of the Program will result in cost savings from reduced Program management and administration costs and will allow the Government of Canada to focus on less costly funding options. All outstanding retail debt will continue to be honoured.