New Liberal government announces tax measures

December 2015

On December 7, 2015, Finance Minister Bill Morneau tabled a Notice of Ways and Means Motion (NWMM) which includes proposed personal income tax rate changes and a reduction in the Tax Free Savings Account (TFSA) annual contribution limit. Both measures formed part of the Liberal party's election platform. Similarly, the government noted that additional tax measures that were part of its election platform would be included in the 2016 federal budget.[1]

Personal tax measures

Personal tax rates

Effective January 1, 2016, the top marginal income tax rate will increase from 29% to 33% for taxable income over $200,000. In addition, the second-lowest marginal tax rate will decline from 22% to 20.5%. In 2016, the new 20.5% rate will apply to taxable income between $45,282 and $90,563, resulting in federal tax savings of up to $679 per individual.

Table A illustrates the top marginal rates of federal income tax on various types of income for 2015 and 2016:

Table A

Type of income	2015	2016
Interest	29.00%	33.00%
Capital gains	14.50%	16.50%
Eligible dividends	19.29%	24.81%
Regular dividends	21.22%	26.30%

[1] Date not yet announced

Tax free savings account (TFSA)

The NWMM also proposes to return the annual TFSA contribution limit to $5,500 from $10,000[2] effective January 1, 2016, and to reinstate the indexation of the contribution limit. The $10,000 limit will continue to apply to 2015 only.

Donation tax credit

Currently, the donation tax credit rate is 15% on the first $200 of gifts made, and 29% for donations in excess of $200. Effective January 1, 2016, the 29% rate will increase to 33% on the lesser of the amount of donations made in excess of $200 and the individual's taxable income over $200,000.

For example, Bill's taxable income in 2016 is $220,000 and he makes $30,000 in charitable donations. The new 33% donation tax credit rate will apply to $20,000 of the donations made (the amount equal to Bill's taxable income over $200,000), while the 29% rate will still apply to the remaining $9,800 of donations (above the first $200). The 15% rate on the first $200 of donations will remain.

Trust measures

Trust tax rate

Effective for the 2016 and subsequent taxation years, the tax rate payable by a trust (other than a graduated rate estate or qualified disability trust) will be calculated at a 33% flat rate (currently 29%).

Business tax measures

Investment income of private corporations

Investment income of a Canadian-controlled private corporation (CCPC) is initially taxed at a higher rate in order to prevent individuals from deferring tax by earning such income through a corporation. Therefore, a CCPC must pay an additional 6.67% tax on its investment income. A portion of the tax paid by the corporation becomes refundable upon payment of taxable dividends to its shareholders. This system (including the dividend refund mechanism) also applies to tax paid under Part IV by private corporations on certain taxable dividends that are deductible in computing their taxable income.

Consequential to the introduction of the new top marginal personal income tax rate of 33%, the following proposed measures will be effective on January 1, 2016:

- The refundable additional 6.67% income tax on investment income of CCPCs will be increased by 4% to 10.67%. That means the total overall initial tax rate applicable to such income will increase to 38.67% (from 34.67% in 2015).
- The refundable portion of the total income tax rate on investment income of CCPCs will increase by 4% to 30.67% (from 26.67% in 2015).
- The refundable Part IV tax on certain taxable dividends[3] received by private corporations will increase by 5% to 38.33% (from 33.33% in 2015).

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[2] From 2009 to 2012, the annual limit was $5,000. As the annual limit is indexed to inflation in $500 increments, the limit was increased to $5,500 for 2013 and 2014. The $10,000 limit, effective in 2015 and introduced by the previous government, was no longer going to be indexed to inflation.

- The rate at which refunds are made out of a private corporation's Refundable Dividend Tax on Hand Account when it pays taxable dividends will increase by 5% to 38.33% (from 33.33% in 2015).

We will be issuing another tax release before the end of December that will address the overall effect of earning income in a corporation once these changes are implemented.

Given the unexpected increase in tax rates for investment income, the employee test for companies earning income from real estate rentals will become even more relevant. To avoid being a "specified investment business," the business must generally employ more than five full-time employees throughout the year.

Other measures

Tax on split income (kiddie tax)

The tax on split income, the so-called 'kiddie tax', applies the highest personal marginal income tax rate to "split income" paid or payable to a minor. In general, split income includes taxable dividends received directly or indirectly from certain unlisted shares (private companies), capital gains realized from the disposition of such shares to persons not dealing at arm's length with the minor, and certain partnership or trust income.

Effective for the 2016 and subsequent taxation years, the flat rate of tax on split income will be subject to the new top rate of 33% (up from 29% in 2015).

Stock options

The NWMM did not address the Liberal party's platform to cap the amount that can be claimed through stock option deductions. However, the Finance Minister has confirmed that any changes would not apply to options granted before the effective date of any change.

Other measures to be included in 2016 federal budget

New Canada child benefit

The current taxable Universal Child Care Benefit (UCCB) will be replaced with the new Canada Child Benefit, effective July 1, 2016. Unlike the UCCB, the Canada Child Benefit is expected to be income-tested and non-taxable.

Elimination of family tax cut

This annual maximum $2,000 non-refundable tax credit, available in 2014 and 2015 to some families with children under 18, will be cancelled as of the 2016 tax year.

If the increase in the top rate of marginal tax will affect you, there may be steps you can take before the end of this year to benefit from the lower top rate in 2015. However, many of these strategies must be implemented before January 1, 2016.

Please contact us to discuss the steps you can take to reduce your tax burden or if you have any questions about the measures in this release.

[3] Generally, portfolio dividends

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