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# 2017 federal budget: what tax measures can we expect?

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Although the details of the 2017 federal budget have not yet been released, there has been a lot of speculations to-date as to the tax measures that will likely be included.

Some indications of the measures we are likely to see can be drawn from the House of Commons Standing Committee on Finance Report,<sup>1</sup> the government's tax expenditure review,<sup>2</sup> the expected US tax reforms under the new president and the Liberal party's election promises.

## Corporate and personal tax rates

For Canada to remain competitive, while continuing to attract and retain top talent, the government is unlikely to raise tax rates.

The Canadian corporate tax rate is currently competitive when compared to other countries (i.e., generally 15 percent, with most provincial rates averaging 11 to 12 percent). This has attracted investment from other countries and encouraged Canadian companies to remain in Canada. Further, President Trump's proposal to decrease the US corporate rate (i.e., to 20 percent) puts pressure on the government to avoid increasing Canadian tax rates—and to perhaps even lower them. A few weeks ago, in a meeting with private sector economists, Finance Minister Bill Morneau was asked directly if he would lower Canada's corporate tax rate in light of the promised business tax cuts in the United States. His response was that Canada's corporate rate was already "very competitive" globally and he suggested plans for spending for a more innovative and productive economy.

With respect to personal income tax rates, the combined top federal-provincial marginal tax rate for high income earners in Canada is now over 50 percent in more than half of Canada's provinces. President Trump's plans to drop the top US tax rate for high income earners may in turn spur Canada's government to review personal tax rates to assess Canada's ability to retain highly-skilled

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<sup>1</sup> Following presentations from nearly 300 groups and individuals during pre-budget hearings in Ottawa and throughout Canada, and after having received more than 400 online submissions, the Committee presented its report on December 7, 2016, on the budget priorities that should be included in the 2017 federal budget: *Report of the Standing Committee on Finance*, "Creating the Conditions for Economic Growth: Tools for People, Businesses and Communities."

<sup>2</sup> As announced in Budget 2016, the Government of Canada is undertaking a comprehensive review of federal tax expenditures: <http://www.fin.gc.ca/access/tt-it/rfte-edff-eng.asp>

mobile employees and professionals who may be tempted to move to the United States, particularly given the strong US dollar.

### **“Boutique” tax expenditures and credits**

As promised during the Liberal government’s election campaign, the government of Canada is currently undertaking a comprehensive review of federal tax expenditures. The review is part of a broader government commitment to eliminate poorly targeted and inefficient programs, wasteful spending, and ineffective and obsolete government initiatives.

Likely under the microscope are boutique tax expenditures and credits—tax incentives which encourage certain programs/behaviours or target certain groups. Examples of these include tax credits for teachers or educators who purchase school supplies, first-time home buyers, seniors and disabled people who make alterations to their homes to make them more accessible, people who purchase public transit passes and first-time donors to charities.

Boutique tax expenditures and credits have increased over the past decade and, although they are not significant in amount, the Canada Revenue Agency spends considerable time reviewing the claims to ensure they are valid, as opposed to ensuring the benefits are actually received by the taxpayers they were intended for.

Budget 2016 eliminated four such boutique tax credits (i.e., the children’s fitness and arts credits, as well as the education and textbook credits for students), and it is speculated that we will see more of these credits eliminated in budget 2017.

There was speculation that the government was going to eliminate the tax exemption for private health and dental plans, and start taxing those who receive employer-provided group health and dental plans as a taxable employment benefit. However, Prime Minister Justin Trudeau has now confirmed that this will not be the case. During question period in early February he said, “We are committed to protecting the middle class from increased taxes and that is why we will not be raising (those) taxes.”

The Macdonald-Laurier Institute recently published a paper<sup>3</sup> providing some thoughts as to which tax expenditures and credits should stay, change or go. They have suggested that the age credit should be eliminated as we should not be subsidizing people because they are old but rather because they are poor; old age is no longer a proxy for poverty.

The Macdonald-Laurier Institute also suggested the elimination of the public transit tax credit because it is difficult to determine whether the tax credit directly leads to more ridership and the broad-based social benefits derived from greater transit use.

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<sup>3</sup> The Public Purse and the Public Good A framework for reviewing federal tax expenditures, Sean Speer, February 2017

Given that President Trump is proposing to lower taxes in the United States, the government may also want to think carefully about what they do with tax expenditures and credits that could have an impact on competitiveness.

### **Increase in the capital gains inclusion rate**

There are speculations that the capital gains inclusion rate may be increased given that it primarily benefits higher income Canadians who are able to generate substantial revenue from the disposition of capital property such as investments. Similar rumours circulated last year, prior to the release of the 2016 budget, but the capital gains inclusion rate was left untouched.

Currently, only 50 percent of capital gains is included in a taxpayer's income and subject to tax. This has resulted in a significant tax rate differential between ordinary income and dividends compared to capital gains. To curtail this perceived inequality and potential loss in revenues for the government, there is speculation that the government may increase the capital gains inclusion rate to 66 percent, and even as high as 75 percent. To minimize any potential adverse tax implications of such a change, taxpayers may want to consider certain pre-budget planning opportunities. Further details can be found in our release, [Planning around the 2017 federal budget: Possible changes to the capital gains inclusion rate](#).

### **Commercialization of R&D and new technology**

The scientific research and experimental development (SR&ED) program is often considered one of the most rewarding R&D incentive systems globally. However, despite strong subsidies, Canada is failing to generate R&D-related investment as compared to other developed countries. These results seem to indicate a misalignment between the SR&ED program's objective and its implementation. This, along with recognition by the Standing Committee of Finance that Canada needs adequate research and development to grow, has led to speculation that changes are in store to the SR&ED program.

The current SR&ED program could be improved by making the R&D tax credits fully refundable for all businesses, regardless of their size, and by repealing both the latest reduction to the tax credits from 20 percent to 15 percent and the exclusion of capital expenditures as eligible expenses.

Further, Canada's small businesses usually benefit more from R&D credits because they are cash constrained and have more difficulty raising financing compared to their larger counterparts. However, due to the program's complexity and lengthy audit processes, small businesses struggle to fully utilize SR&ED program benefits. The government can assist small businesses by:

- i. reducing the complexity of the current SR&ED program (e.g., reducing the high cost of compliance due to complex technical assessment and comprehensive documentation, and ensuring consistency in the SR&ED claim review process); and
- ii. reducing audit time (e.g., small business often have limited resources, and long audit times consume resources that could otherwise be put to more productive use).

Finally, to increase competitiveness in Canada, the government also needs to provide incentives to commercialize patented products and develop intellectual property. The ability of Canadian

businesses to innovate and adapt will affect how they compete globally. The report by the Standing Committee of Finance recommended the introduction of a first patent program to subsidize expenses incurred by small and medium-sized businesses obtaining a first patent, similar to the program in Quebec.

Together, these changes should provide a greater incentive for businesses to innovate in Canada, which is part of the government's mandate of "Promoting Innovation to Create Jobs, Grow Our Economy".

### **OECD base-erosion and profit shifting (BEPS) recommendations**

On the international front, the 2017 budget may provide guidance as to how the government will address the outstanding recommendations in the OECD's BEPS final reports, such as treaty abuse.

### **What does this mean to you or your business?**

Although, there is no way to determine with certainty what types of changes the government will include, historically, proposed measures often take effect on the date of the budget. As such, taxpayers should consider whether any steps should be undertaken to minimize any potential adverse tax consequences before that day. Please contact one of our tax practitioners if you would like to discuss these possible tax changes and the implications they could have on you or your business.

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