

What tax measures could we see in the 2016 federal budget?



February 2016

The 2016 federal budget is scheduled to be tabled on March 22. So, what tax measures can we expect to see in this year's federal budget?

Following the Liberal party's win in the October federal election, the government acted quickly to implement a number of the tax measures that were included in their election platform, as well as some new measures, specifically:

- a 4% increase in the top federal rate of tax (from 29% to 33%) for taxable income over \$200,000;
- a reduction in the second federal tax bracket rate from 22% to 20.5%;
- a reduction in the annual Tax-Free Savings Account (TFSA) contribution limit from \$10,000 to \$5,500; and
- some unexpected changes to several tax measures affecting Canadian-controlled private corporations (CCPCs) and other private corporations.

You can read more about these changes in our recent releases titled [New Liberal government announces tax measures](#) and [Liberal government implements measures impacting the taxation of CCPCs](#).

As part of its campaign, the Liberal government commented that it would conduct a wide-ranging review of the tax expenditures that now exist, with the objective of looking for opportunities to reduce tax benefits that help individuals with income of more than \$200,000 per year. Although not an expenditure, the first bullet point above is clearly targeted at this group. It's not clear what additional measures, if any, might be proposed in this year's budget.

Nevertheless, it is expected that the 2016-17 federal budget will fulfil a number of other promises that were included in the Liberal election platform. Some of these tax changes are very likely, as it has already been announced that these changes will be forthcoming. For example, the Liberals have indicated that they intend to eliminate the family tax cut for the 2016 taxation year and replace the Universal Child Care Benefit (UCCB) with a new income-tested Canada Child Benefit.¹ Changes to the stock option rules are also expected. It remains to be seen how many of the other measures will be introduced.

¹ This change will be effective July 1, 2016.

One area we will be watching closely is how the government intends to respond to its statement that it will “ensure that CCPC status is not used to reduce personal income tax obligations for high-income earners, rather than supporting small businesses”. Our release [*2015 election results: What the Liberal tax platform could mean for you and your business*](#) provides more details on how the government could address this issue.

As with any budget, there’s no telling what types of changes the government will include.² However, since proposed measures often take effect on budget day, the best course of action is to address all tax-sensitive transactions before that day. For example, there is some conjecture that there may be an increase in the capital gains inclusion rate (possibly from 50% to 66 2/3% or 75%). Although we can’t comment on any likelihood that this rate will increase, certain pre-budget planning opportunities should be considered where a significant capital asset sale is contemplated post-budget date.

There are also a number of outstanding measures announced by the previous government in last year’s federal budget. These measures include

- amendments to subsection 55(2) to potentially increase the number of situations where a tax-free inter-corporate dividend could be re-characterized as a capital gain;
- an exception to the Regulation 102 employee withholding tax rules when certain conditions are met (although these rules have not yet received Royal Assent, the CRA has started to administer this change);
- proposals to exempt from tax capital gains realized on the disposition of shares of private corporations or real estate where the cash proceeds of disposition are donated to a qualified donee within 30 days after the disposition (applicable to donations made in respect of dispositions occurring after 2016);
- amendments to allow a registered charity to hold an interest in certain limited partnerships; and
- a tightening of the anti-avoidance rules for captive insurance companies.

It will be interesting to see if this budget includes any additional commentary on any of the above tax measures.

The following chart summarizes the possible tax measures that could be included in the upcoming federal budget.

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.

² The House of Commons Standing Committee on Finance is conducting its pre-budget hearings February 16th – 19th. Their report is expected soon after.

Businesses

	Current measures	Possible budget proposals
Small business tax rate	<ul style="list-style-type: none"> Being reduced from 11% to 9% over a four-year period—10.5% (2016); 10% (2017); 9.5% (2018); 9% (2019) 	<ul style="list-style-type: none"> Measures to ensure CCPC status is not used by high income earners as an income splitting tool Changes to the small business tax rate eligibility criteria (there is some concern that professional corporations (e.g., corporations set up by doctors, lawyers and accountants) could be targeted Eligibility could be based on new Quebec laws which have a three employee test
Active versus passive income	<ul style="list-style-type: none"> Active business income qualifies for either the 15% general corporate rate or the small business rate Income from property is subject to higher rates (federal rate of 38.67% as of 2016) and a refundable tax 	<ul style="list-style-type: none"> Changes to situations where income from a business, where the principal purpose is to earn income from property, will qualify as active business income
Employer EI premiums	<ul style="list-style-type: none"> For 2016, the employee premium is \$1.88 for each \$100 of the employee's salary, up to the maximum insurable earnings of \$50,800 Maximum employer contribution of \$1,337.06 (\$955.04 x 1.4). 	<ul style="list-style-type: none"> 12-month break on EI premiums for employers who hire persons between the ages of 18 – 24 into a permanent position (in 2016 to 2018)
Support for clean technology	<ul style="list-style-type: none"> Various existing measures 	<ul style="list-style-type: none"> Enhancements to existing tax measures to generate more clean technology investments
Fossil fuel subsidies	<ul style="list-style-type: none"> The government has been gradually phasing out inefficient fossil fuel subsidies 	<ul style="list-style-type: none"> Additional measures to phase out subsidies for the fossil fuel industry (e.g. permit a Canadian Exploration Expense (CEE) tax deduction only in cases of unsuccessful exploration – and re-direct any savings to investments in new and clean technologies)
Scientific research and experimental development (SR&ED)	<ul style="list-style-type: none"> Capital expenditures no longer qualify for SR&ED treatment 	<ul style="list-style-type: none"> Repeal the exclusion of capital expenditures from SR&ED claims. Explore the feasibility of a “patent box” regime that will tax innovative companies at a lower corporate rate on certain profits earned from commercializing patents.

Repeal of eligible capital property regime	<ul style="list-style-type: none"> • 2014 federal budget announced a public consultation on proposals to repeal the current regime and replace it with a new CCA class • 2015 budget commented that the government was continuing its public consultations 	<ul style="list-style-type: none"> • It's expected that the government will either release draft measures or announce that it is continuing its consultation on these proposals
Base erosion profit shifting (BEPS)	<ul style="list-style-type: none"> • In October 2015, the OECD released its final recommendations • 2015 federal budget included information on how Canada intends to fulfill its obligations to implement the automatic exchange of information requirements • Many countries have already introduced legislation to implement some of the OECD's recommendations 	<ul style="list-style-type: none"> • Federal budget may provide commentary on what policy changes the government may be considering in light of the OECD's recommendations • It's expected that the government will ask for stakeholder input on these recommendations, although we could see something else on the country-by-country reporting rules

Individuals

	Current measures	Possible budget proposals
Stock options	<ul style="list-style-type: none"> • 50% stock option deduction if certain conditions are met 	<ul style="list-style-type: none"> • A cap on how much can be claimed through the 50% stock option deduction (although start-up company employees with up to \$100,000 in annual stock option gains will likely be exempt from such a cap) • Options granted before effective date of change will be grandfathered and can continue to use the current rules
Tax credits for labour-sponsored venture capital corporations (LSVCCs)	<ul style="list-style-type: none"> • Gradual phase-out of 15% credit for the acquisition of shares of LSVCCs on investments of up to \$5,000 per year (from 2014 to 2017) 	<ul style="list-style-type: none"> • Reinstatement of the 15% LSVCC tax credit that is being phased out
Mining exploration credit for flow-through shares	<ul style="list-style-type: none"> • Tax credit of 15% of mineral exploration expenses renounced to flow-through share investors • Introduced in 2000, ending at the end of 2016 	<ul style="list-style-type: none"> • Either extend by another year or make tax credit permanent

Northern residents' deduction	<ul style="list-style-type: none"> Persons who live in a prescribed northern zone can claim \$8.25 for each day in the taxation year that they lived there The residency deduction for persons living in an intermediate northern zone is ½ this amount 	<ul style="list-style-type: none"> Increase and index this deduction
Universal Child Care Benefit (UCCB)	<ul style="list-style-type: none"> Expanded in 2015 to \$160/month per child up to age six; \$60/month per child ages six to 17 Taxable 	<ul style="list-style-type: none"> Eliminate and replace with new Canada Child Benefit (see below)
New Canada Child Benefit	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> Amount of benefit reduced as household income increases Not taxable To commence July 1, 2016
Family tax cut (income splitting)	<ul style="list-style-type: none"> Eligible couples with children under the age of 18 can notionally transfer up to \$50,000 of higher spouse's earnings to lower income spouse Maximum annual non-refundable tax credit of \$2,000 per family 	<ul style="list-style-type: none"> Eliminate, effective for the 2016 taxation year
RRSP withdrawals – Home Buyers' Plan	<ul style="list-style-type: none"> \$25,000 withdrawal to buy a home – first time home owners only 	<ul style="list-style-type: none"> Modify plan to allow withdrawals more than once in certain situations (e.g., persons impacted by significant life changes, such as a job relocation, death of a spouse, marital breakdown, etc.)
New Teacher and Early Childhood Educator School Supply Tax Benefit	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> A new refundable tax credit of up to \$150 each year for teachers and educators who spend up to \$1,000 of their own funds to purchase school supplies
Tuition, education and textbook tax credit	<ul style="list-style-type: none"> Eligible tuition fees plus \$400/month education amount (\$120/month for part-time students) plus \$65/month textbook amount (\$20/month for part-time students) Non-refundable tax credit 	<ul style="list-style-type: none"> Maintain tuition tax credit Eliminate education and textbook tax credits
Student loans	<ul style="list-style-type: none"> Repayments must start no later than six months after graduation or leaving school Interest accumulates during this period 	<ul style="list-style-type: none"> No repayment required until graduate is earning an income of at least \$25,000 per year Federal government will pay interest until then

Old Age Security (OAS)	<ul style="list-style-type: none"> Age of initial receipt gradually increasing from 65 to 67 starting in 2023 	<ul style="list-style-type: none"> Keep at age 65 Increase the Guaranteed Income Supplement (GIS) for single low-income seniors by 10% Index OAS/GIS to new Seniors Price Index
Canada Pension Plan (CPP)	<ul style="list-style-type: none"> Maximum pensionable earnings of \$54,900 for 2016 (basic exemption of \$3,500) Employee and employer contribution rates of 4.95% each Self-employed contribution rate of 9.9% 	<ul style="list-style-type: none"> Although the government has announced that it will work with the Ontario government to improve pensions (assumedly in the form of a renewed national dialogue to enhance the CPP), it's unlikely that any new measures or other CPP enhancements will be announced in this year's budget
Employee Employment Insurance (EI) Premiums	<ul style="list-style-type: none"> 2016 EI premiums are set at \$1.88 per \$100 earned 	<ul style="list-style-type: none"> Reduce EI premiums to \$1.65 per \$100 earned starting in 2017 Overhaul program to enhance EI benefits (reduce wait times from two weeks to one week beginning in 2017; more flexible parental benefits; expanded compassionate care benefits)

Other

	Current measures	Possible budget proposals
Capital gains inclusion rate	<ul style="list-style-type: none"> 50% of a capital gain is taxable Currently a significant discrepancy exists between ordinary income and dividend rates and capital gains rates 	<ul style="list-style-type: none"> Possible increase in capital gains inclusion rate to 66 2/3% or 75%
GST/HST and capital investment in new affordable rental housing	<ul style="list-style-type: none"> New capital investment in rental housing is subject to GST/HST with partial GST rebates 	<ul style="list-style-type: none"> Potentially a 100% GST rebate for qualifying new capital investments in affordable rental housing

<p>GST/HST and legalization of marijuana</p>	<ul style="list-style-type: none"> • Currently, only medical marijuana is legalized • Sales by unlicensed growers and medical cannabis dispensaries are taxable for GST/HST purposes³ 	<ul style="list-style-type: none"> • Possible legalization of marijuana for non-medical purposes • If an ounce of marijuana is taxed at rates similar to a carton of tobacco cigarettes (excise tax rates per cigarette of \$0.10515 federally, and \$0.149 to \$0.295 provincially; plus applicable HST/GST/PST sales tax rates) total federal tax revenue could exceed \$1 billion annually.⁴
<p>Charitable sector</p>	<ul style="list-style-type: none"> • First time donor's super tax credit to encourage an increase in charitable donations 	<ul style="list-style-type: none"> • Additional measures to encourage charitable giving (e.g., a stretch credit for an increase in donations over the prior year) – this has been recommended in both the 2014 and 2015 Finance Committee report • A modernization of the rules for this sector, including a clarification of what constitutes “political activity”

About Grant Thornton in Canada

Grant Thornton LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. We help dynamic organizations unlock their potential for growth by providing meaningful, actionable advice through a broad range of services. Together with the Quebec firm Raymond Chabot Grant Thornton LLP, Grant Thornton in Canada has approximately 4,000 people in offices across Canada. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member and correspondent firms operate in over 100 countries worldwide.

The information contained herein is prepared by Grant Thornton LLP for information only and is not intended to be either a complete description of any tax issue or the opinion of our firm. Changes in tax laws or other factors could affect, on a prospective or retroactive basis, the information contained herein. You should consult your Grant Thornton LLP advisor to obtain additional details and to discuss whether the information in this article applies to your specific situation.

A listing of Grant Thornton offices and contact information can be found on our website at: www.GrantThornton.ca

³ On January 25, 2016, the Federal Court of Appeal ruled in *Gerry Hedges v. The Queen*, 2016 FCA 19 that GST and HST apply to medical marijuana that is “not lawfully sold”. There remains uncertainty as to whether medical marijuana is taxable when it is “lawfully sold” under the regulations governing the sale of marijuana for medical purposes. The CRA’s view is that medical marijuana is taxable.

⁴ Based on a *pro-rata* comparison to the state of Colorado, where marijuana is legalized (assuming sales and prices are similar).