Budget 2017 – Less is more…more or less.

Introduction

Finance Minister, Bill Morneau, delivered the majority Liberal government's second Federal Budget on March 22, 2017. There were no increases in either personal or corporate tax rates. Like last year, speculation that the capital gains inclusion rate would increase was false.

The Budget focused on closing tax loopholes, cracking down on tax evasion, providing tax relief for the middle class, and eliminating measures that are ineffective, inefficient and that disproportionately benefit the wealthy. But even in these areas, there really wasn't that much!

Surprisingly, of most interest, may be what is not in the Budget. For example, the Budget signals that a review of tax planning strategies using private corporations is underway and that specific measures may result from this in the future.

The following represents a summary of measures of interest to investment and insurance advisors.

Business Tax Measures

Tax Planning Using Private Corporations

As part of the 2016 Budget the government committed to do a review of the tax system specifically addressing the ability of high-net-worth individuals who use private corporations to inappropriately reduce or defer tax. Budget 2017 followed up on the results of this study indicating that the review highlighted a variety of tax reduction strategies that are available to high income individuals using a private corporation that are not available to other Canadians. These strategies include:

- Sprinkling income using private corporations – causing income that would otherwise be realized by an individual taxable at a high personal income tax rate to instead be realized by a family member subject to a lower rate of tax.

- Holding a passive investment portfolio inside a private corporation – since corporate income tax rates are generally lower than personal tax rates, this strategy can facilitate the accumulation of earnings that can be invested.
- Converting a private corporation's regular income into capital gains – income that would normally be paid as a salary or dividends to an owner-manager being converted into corporate capital gains, that would have a much lower tax rate.

The government is further reviewing the use of these planning strategies and intends to release a paper in the coming months setting out the nature of these issues in more detail as well as proposed policy responses. Time will tell what impact this may have on corporate investment and corporate insurance planning opportunities.

Billed-Basis Accounting

Generally, taxpayers are required to include the value of work in progress in calculating their taxable income. However, certain professionals (i.e. accountants, dentists, lawyers, medical doctors, veterinarians, and chiropractors) may elect to exclude their work in progress from income, instead recognizing the income for tax purposes when billed (billed-basis accounting). This results in a deferral of tax by allowing the costs associated with the work in progress to be deducted, and the associated income being deferred.

Budget 2017 proposes to eliminate the ability for designated professionals to elect to used billed-basis accounting for taxation years that begin after Budget Day and includes a transitional period.

Personal Tax Measures

In an effort to make the tax system simpler and fairer for all Canadians Budget 2017 proposes the following tax measures for individuals:

Canada Caregiver Credit

The Budget proposes to simplify the current caregiver credit system by replacing the Infirm Dependent Credit, Caregiver Credit and Family Caregiver Tax Credit with a new Canada Caregiver Credit. The new credit is consistent with the amounts that could have been claimed previously and better targets those who need it the most.

Disability Tax Credit

The Budget proposes to add nurse practitioners to the list of medical practitioners who can certify eligibility for the credit.

Public Transit Tax Credit

The Budget proposes to eliminate the credit effective June 30, 2017.

Tuition Tax Credit

The Budget proposes to extend the range of courses eligible for the Tuition Tax Credit. The credit now applies to tuition paid for occupational skills courses that are below the post-secondary level at a college or university.

Charitable Giving

Budget 2017 proposes the following measures relating to charities:

First-Time Donor's Tax Credit

Confirmation that the first-time donor's tax credit will expire after 2017.

Ecological Gifts

The donation of ecological gifts are eligible for enhanced tax treatment. Due to concerns about potential conflicts of interest, Budget 2017 proposes that private foundations are no longer permitted to receive ecological gifts.

Anti-Avoidance Rules for Registered Plans

A number of anti-avoidance rules exist for registered plans (i.e. Tax Free Savings Accounts (TFSA), Registered Retirement Savings Plans (RRSP) and Registered Retired Income Funds (RRIF)) to help ensure that the plans are in place for the right reasons and do not provide excessive tax advantages. 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 the 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.

Budget 2017 proposes to extend these anti-avoidance rules to Registered Education Savings Plans (RESPs) and Registered Disability Savings Plans (RDSPs). Subject to certain exceptions, this measure will apply to transactions occurring, and investments acquired, after Budget Day.

Investment Fund Mergers

Merger of switch corporations into mutual fund trusts

Canadian mutual funds can be in the legal form of a trust or a corporation. If you recall the 2016 Budget eliminated the ability for a shareholder in a mutual fund corporation (i.e. a switch corporation) to exchange shares of one class for another (i.e. from one fund to another) on a tax deferred basis.

The Income Tax Act contains special rules to facilitate the merger of mutual funds on a tax-deferred basis. 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, all or substantially all of the assets allocable to a class of a mutual fund corporation 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 March 22, 2017.

Segregated fund mergers

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts. However, unlike mutual fund trusts, segregated funds cannot merge on a tax-deferred basis. To provide consistency, Budget 2017 proposes to allow tax-deferred mergers of segregated funds.

It also proposes that segregated funds be able to apply non-capital losses arising in taxation years beginning after 2017 to other taxation years beginning after 2017 subject to normal limitations for the carry forward and carryback of non-capital losses. As is the case with the mutual fund merger rules, the use of these losses will be restricted following a segregated fund merger.

These measures will be effective on January 1, 2018.

Previously Announced Measures

The Budget documents confirm that the October 3, 2016, Notice of Ways and Means motion that proposed changes to the principal residence exemption will proceed as planned. The main impacts are to narrow the ability to claim the principal residence exemption for non-residents and the types of trusts that can qualify for claiming the exemption.

Also, the Budget confirms the intention to proceed with “information-reporting requirements for certain dispositions of life insurance policies.” This was announced in Budget 2016 as relating to situations where there is a different owner and beneficiary corporation and at the same time that the measures involving life insurance policy transfers were introduced. It is still unclear what information will be requested and from whom. No further guidance was provided.

Conclusion

There is much less here than expected. But it seems like there might be more to come.