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CPA CANADA FEDERAL BUDGET COMMENTARY

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The Federal Government's 2017–18 Budget gives Canadians a taste of what they might expect over the next couple of years: attempted efficiencies, closed tax loopholes, steady deficits, and a touch of caution. Budget 2017 outlines only $200 million in net new spending, but also an increase to the deficit of more than $5 billion for 2017–18, partly due to commitments from the previous budget, reduced revenues and increased general expenses.

The projected deficit for 2017–18 is $28.5 billion, declining to $18.8 billion by 2021–22 (including an annual $3 billion contingency fund). However, if the government's strong growth scenario plays out, we could see a much smaller deficit between $5 and $8 billion by 2021. Instead of planning to eliminate the deficit as previously proposed, the government says it will maintain a balanced net debt-to-GDP ratio of around 31 per cent over the next five years.

There are no changes to corporate or personal income tax rates or the small business deduction threshold and no changes to capital gains taxation. In addition, the government did not address in the Budget a number of tax issues it has discussed since Budget 2016, indicating it will release more details on its plans to limit tax-planning strategies later this year. Concerns over potential changes to taxes, trade agreements and regulations in the United States have no doubt caused Canada's Federal Government to reconsider its own tax strategy.

The Budget proposes to address a range of tax loopholes and inefficiencies, including: eliminating billed-basis accounting for certain professionals, preventing tax avoidance through straddle transactions, eliminating the tax deduction for home relocation loans, applying tax-avoidance rules to Registered Education Savings Plans (RESPs) and Registered Disability Savings Plans (RDSPs), eliminating the additional deduction for gifts of medicine, preventing Canadian life insurers from using foreign branches to avoid tax, repealing the tax exemption for insurers of farming and fishing property, and eliminating the Public Transit Tax Credit.

In order to advance the twin goals of reducing tax evasion and improving compliance, the government plans to give the Canada Revenue Agency an additional $523.9 million over the next five years. The government anticipates a five-fold return on its investment, hoping the CRA will recover $2.5 billion for its efforts.

We can expect to see more substantial proposals for change as the year progresses. The government has clearly signaled that it will be looking for additional ways to prevent tax avoidance.

BUSINESS INCOME TAX MEASURES

The Budget makes no changes to corporate tax rates. In addition, no changes are made to eligibility for the small business rate.

Tax Planning Using Private Corporations

The government's review of federal tax expenditures highlighted issues in respect of tax planning strategies available to owners of private corporations. The government feels that these strategies can result in high-income individuals gaining unfair tax advantages not available to other

Canadians. As the Budget papers indicate, measures have been put in place over the years to limit the scope of certain of these arrangements. However, the government is of the opinion that such measures have not always been as effective as desired. Accordingly, the government is further reviewing the use of private corporation tax planning strategies that may reduce the personal tax of high-income earners in a manner considered inappropriate. In particular, the government has identified the following strategies for review:

- Income sprinkling — causing income that would be taxable to an individual at a high rate to be realized by, and therefore taxed in the hands of, a family member subject to a lower marginal tax rate, commonly achieved through dividends or capital gains
- Holding of portfolio investments — corporate tax rates on ordinary business income are generally much lower than personal rates; retaining income in a private corporation can therefore facilitate accumulation of a larger pool of funds for investment
- Conversion of regular income into capital gains — causing income that would normally be paid to the shareholder as salary or dividend to be converted to capital gains, taxed at a significantly lower tax rate

As part of its review of this area, the government will also examine current legislation that may have inappropriate tax consequences in connection with genuine business transactions between family members, including inter-generational transfers of family businesses. In the coming months, a paper will be released that will review these issues in detail and provide proposed policy responses.

Billed-Basis Accounting

Members of designated professions (accountants, dentists, lawyers, medical doctors, veterinarians and chiropractors) may elect to exclude the value of their work in progress (WIP) in computing their income. Where this election is made, a tax deferral is achieved as the costs associated with the WIP are deducted as incurred whereas the revenue is recognized only when the WIP is actually billed to clients.

The Budget proposes to eliminate the WIP exclusion over a two-year period, effective for taxation years beginning after March 21, 2017. For the first affected taxation year, WIP will be valued at 50 per cent of the lesser of its cost and fair market value and must be recognized for tax purposes and not excluded from income. For subsequent years, WIP, valued at the lesser of its cost and fair market value, must be recognized for tax purposes and cannot be excluded from income.

These provisions will require a determination of the cost of the WIP, which may not be readily available.

PERSONAL INCOME TAX MEASURES

The Budget did not propose a number of changes that were the subject of heavy speculation. In particular, the capital gains inclusion rate will not increase and remains at 50 per cent. A dollar limit is not imposed on the employee stock option deduction and thus it will continue to be calculated as half the stock option benefit amount.

Personal income tax rates will not increase under the Budget.

Tuition Tax Credit

Effective January 1, 2017, the Budget proposes to expand the types of courses that are eligible for the Tuition Tax Credit.

The Tuition Tax Credit can currently be claimed with respect to occupational skills courses taken at a non-post-secondary institution. In contrast, the credit cannot be claimed for similar non-post-secondary level courses taken at a college or university.

The Budget proposes to allow the Tuition Tax Credit to be claimed in the latter instance and, further, to allow the scholarship exemption for bursaries related to such courses, provided that all other conditions for the exemption are met.

Simplifying the Caregiver Credit System

The existing Caregiver Credit, Infirm Dependent Credit and Family Caregiver Tax Credit each have different eligibility rules. The Budget proposes to simplify these existing credits by replacing them with a single new, non-refundable credit, the Canada Caregiver Credit. This credit will provide tax relief of up to 15 per cent of $6,883 (in 2017) for expenses for care of dependent relatives with infirmities, and up to 15 per cent of $2,150 (in 2017) for expenses for care of a dependent spouse/common-law partner or minor child with an infirmity. There is no requirement for the dependent to live with the caregiver to claim the credit.

This new credit will start to be reduced when the dependent's net income is above $16,163 (in 2017, indexed to inflation for taxation years after 2017).

Disability Tax Credit — Certification by Nurse Practitioners

The Budget proposes to allow nurse practitioners to certify impairments for purposes of the Disability Tax Credit. This measure will be effective for certifications made after March 21, 2017.

Medical Expense Tax Credit — Fertility-Related Expenses

For the 2017 taxation year and beyond, the Budget proposes to clarify the types of fertility-related expenses that are eligible for the Medical Expense Tax Credit. In particular, persons who require medical intervention to conceive, even if not infertile, will explicitly be allowed to claim the credit for expenses that would generally be eligible for someone who has an infertility condition.

Public Transit Tax Credit

The Public Transit Credit is proposed to be eliminated under the Budget for transit use after June 30, 2017.