2015 Federal Budget Review

On April 21, Finance Minister Joe Oliver unveiled his first Federal Budget entitled "Strong Leadership: A Balanced Budget, Low-Tax Plan for Jobs, Growth and Security". The Budget expects a deficit of $2.0 billion for fiscal 2014-15 and forecasts a surplus of $1.4 billion for 2015-16 and annual surpluses increasing to $4.8 billion in 2019-20. The Budget introduces a number of new tax measures, enhances some existing tax incentives and continues with the themes of recent budgets: namely creating jobs, supporting growth, promoting charity, keeping income taxes low and long term fiscal balance.

From a personal tax perspective, which is the focus of this review, the government enhanced several tax benefits, notably increasing the TFSA contribution limit and the lifetime capital gains exemption for farm or fishing properties. Seniors in particular will benefit from reduced RRIF minimum withdrawals and a new tax credit for expenses to improve home accessibility and safety. Those charitably-inclined will benefit from an extension of the existing exemption of capital gains tax on the donation of publicly-traded securities to encompass donations involving private company shares and real estate. Canadian small businesses will see a decline in the small business tax rates over the next four years. As in other recent budgets, the government continues to focus on measures to maintain the integrity of the tax system and combat aggressive tax avoidance.

The most significant income tax measures affecting individuals and Canadian private companies are summarized below. Note that the measures introduced are only proposals at this stage and may not ultimately be enacted into law. Readers are cautioned to consult with their tax advisors for specific advice on how they may be affected by these proposals.

Summary of Personal Income Tax Proposals

Increase in Tax-Free Savings Account Limit

The Tax-Free Savings Account (TFSA) is a general-purpose registered account that was introduced in 2009 to enhance individual savings. Contributions to a TFSA are not tax-deductible but investment income earned in a TFSA and withdrawals are received tax-free. Unused TFSA contribution room is carried forward and withdrawals from a TFSA can be re-contributed to a TFSA in future years.

The TFSA was introduced with an annual contribution limit of $5,000 per individual, indexed to inflation in $500 increments. In 2013, the TFSA annual contribution limit increased to $5,500 from indexation.

The Budget proposes to increase the TFSA annual contribution limit to $10,000, effective for 2015 and subsequent years. As a result of this increase, the TFSA annual contribution limit will no longer be indexed to inflation.

Home Accessibility Tax Credit

The Budget proposes to introduce a new non-refundable "Home Accessibility Tax Credit" for seniors and persons with disabilities in recognition of the additional costs necessary to support independent living, such as improvements to safety, accessibility and functionality of their dwellings.

The proposed 15% non-refundable tax credit would apply on up to $10,000 of eligible home renovation expenditures per year per eligible dwelling, providing up to $1,500 in federal tax relief. Eligible expenditures will include renovations or alterations of an enduring and integral nature that allow a senior or a person who is eligible for the Disability Tax Credit to be more mobile, safe and functional within their home. Certain individuals upon whom the senior or disabled person is dependent, may also be eligible for this credit. Examples of eligible expenditures include costs associated with the purchase and installation of wheelchair ramps, walk-in bathtubs and grab bars.

The Home Accessibility Tax Credit will apply in respect of eligible expenditures for work performed and paid for and/or goods acquired on or after January 1, 2016.

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Registered Retirement Income Funds – Reduction in Minimum Withdrawal Factors

A Registered Retirement Savings Plan (RRSP) must be converted to a Registered Retirement Income Fund (RRIF), or the savings used to purchase a qualifying annuity, by the end of the year in which the RRSP holder attains 71 years of age. A minimum amount must be withdrawn annually from a RRIF beginning the year after it is established which is determined by applying a percentage factor corresponding to the RRIF holder's age (or the age of their spouse or common-law partner) at the beginning of the year to the value of the RRIF assets at the beginning of the year. The RRIF factors are also used to determine the minimum amount that must be withdrawn annually, starting at age 71, from a defined contribution Registered Pension Plan (RPP) and a Pooled Registered Pension Plan (PRPP).

The Budget proposes to reduce the RRIF minimum withdrawal factors that apply in respect of ages 71 to 94 to be more consistent with long-term historical real rates of return on a portfolio of investments and expected inflation. The new RRIF factors will permit holders to preserve more of their RRIF savings in order to provide income at older ages, while continuing to ensure that the tax deferral provided on RRSP/RRIF savings serves a retirement income purpose. The table on this page shows the existing and proposed new RRIF factors. As noted therein, there will be no change to the minimum withdrawal factors that apply in respect of ages 70 and under, which will continue to be determined by the formula 1/(90 – age).

The new RRIF factors will apply for the 2015 and subsequent taxation years. To provide flexibility, RRIF holders who at any time in 2015 withdraw more than the reduced 2015 minimum amount will be permitted to re-contribute the excess (up to the amount of the reduction in the minimum withdrawal amount provided by this measure) to their RRIFs. Re-contributions will be permitted until February 29, 2016 and will be deductible for the 2015 taxation year. Similar rules will apply to those receiving annual payments from a defined contribution RPP or a PRPP.

Capital Gains Exemption for Qualified Farm or Fishing Property

Individuals are eligible for a lifetime tax exemption for capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The amount of the Capital Gains Exemption (CGE) was increased from $500,000 in the 2007 Budget and was further increased to $800,000 in 2014 to be indexed to inflation thereafter (currently $813,600 for 2015).

Existing and New RRIF % Factors

Age (at start of year)	Existing Factor %	New Factor %
71	7.38	5.28
72	7.48	5.40
73	7.59	5.53
74	7.71	5.67
75	7.85	5.82
76	7.99	5.98
77	8.15	6.17
78	8.33	6.36
79	8.53	6.58
80	8.75	6.82
81	8.99	7.08
82	9.27	7.38
83	9.58	7.71
84	9.93	8.08
85	10.33	8.51
86	10.79	8.99
87	11.33	9.55
88	11.96	10.21
89	12.71	10.99
90	13.62	11.92
91	14.73	13.06
92	16.12	14.49
93	17.92	16.34
94	20.00	18.79
95 & over	20.00	20.00

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The Budget proposes to increase the lifetime Capital Gains Exemption to $1,000,000 of capital gains realized by an individual on the disposition of qualified farm or fishing property, effective for dispositions occurring on or after the date of the Budget.

For taxation years after 2015, the CGE for qualified farm or fishing property will be maintained at $1,000,000 until the indexed CGE applicable to capital gains realized on the disposition of qualified small business shares ($813,600 in 2015) exceeds $1,000,000. At that time, the same CGE limit, indexed to inflation, will once again apply to all three types of property.

In addition to the above personal tax measures, the Budget tweaked some existing personal tax measures, including the following:

- extending the temporary 2012 Budget measure allowing a qualifying family member to become the planholder of a Registered Disability Savings Plan (RDSP) for an adult individual who lacks the capacity to enter into a contract. This measure has been extended to the end of 2018 to allow all provinces and territories the opportunity to address the RDSP legal representation issue.
- amending the penalty for the repeated failure to report income to apply only if a taxpayer fails to report at least $500 of income in the year and in any of the three preceding taxation years.
- Clarifying that the Canada Revenue Agency or the courts may increase or adjust an amount included in an assessment that is under objection or appeal, as long as the overall tax amount assessed does not increase.
- Revising the calculation slightly for the Family Tax Cut (i.e. the new federal non-refundable tax credit, capped at $2,000, for couples with children under the age of 18) for the 2014 and subsequent taxation years to ensure that those couples eligible for this credit who transfer education-related credits between themselves receive the appropriate benefit.

Canadian Private Business Tax Measures

Small Business Deduction

The Budget proposes to continue to stimulate the role of private business in the economy by reducing the tax rate applicable to the first $500,000 of qualifying active business income. The proposals will reduce the current 11% federal small business tax rate by 2% from 11% to 9% phased in over the next four years as follows:

- 10.5% effective January 1, 2016;
- 10% effective January 1, 2017;
- 9.5% effective January 1, 2018; and
- 9% effective January 1, 2019.

The small business deduction limit is shared among associated companies and is clawed back when the associated group of companies has taxable capital in excess of $10,000,000. It should be noted that each province sets its own small business income tax rates and threshold limits.

Ineligible Dividends

The tax rules provide a dividend tax credit to compensate an individual shareholder receiving Canadian dividends for corporate income taxes that are presumed to have been paid on the corporate income that funded those dividends. As such, a reduction in corporate tax often leads to a reduced dividend tax credit. Accordingly, in conjunction with the proposed reductions in the small business tax rate, the Budget also proposes to adjust the dividend gross up and tax credit factors on ineligible dividends as follows:

	2015	2016	2017	2018	2019
Ineligible Dividends	**Current**	**Proposed**			
Small business tax rate %	11	10.5	10	9.5	9
Dividend gross up percentage of the actual ineligible dividend	18	17	17	16	15
Dividend tax credit as a percentage of the grossed up dividend	11	10.5	10	9.5	9

Other Notable Business Income Tax Changes

- The Budget proposes to modify the tax law to ensure that corporations do not realize unintended tax benefits on 'synthetic equity arrangements' (eg. where the taxpayer retains the legal ownership of an underlying Canadian share but has transferred all or substantially all of the risk of loss and opportunity for profit in respect of the share to a counterparty).
- The Income Tax Act contains anti-avoidance rules that can apply to recharacterize tax-free intercorporate dividends into capital gains where one of the main purposes of the dividend was to reduce the capital gain realized on the disposition of shares. As a result of a recent court decision, the Budget proposes to expand these anti-avoidance rules to encompass broader circumstances.
- The Budget announced the government's intention to begin a consultation process in respect of whether certain businesses, the principal purpose of which is to earn income from property, are active or passive in nature for the purposes of claiming the 'small business deduction' discussed above.

Proposals Affecting Charitable Giving Strategies

Donations involving Private Company Shares or Real Estate

As described in our BMO Financial Group publication entitled "Donating Appreciated Securities", donations of publicly-traded securities may be exempt from capital gains tax. The Budget proposes to expand this incentive by exempting donors from capital gains tax in respect of certain dispositions of private corporation shares and real estate. The exemption will be available where:

- cash proceeds from the disposition of the private corporation shares or real estate are donated to a qualified donee within 30 days after the disposition; and
- the private corporation shares or real estate are sold to a purchaser that is dealing at arm's length with both the donor and the qualified donee to which cash proceeds are donated.

The exempt portion of the capital gain will be determined by reference to the proportion that the cash proceeds donated is of the total proceeds from the disposition of the shares or real estate.

The Budget proposals also contain a number of anti-avoidance measures to ensure the legitimacy of these types of donations. The exemption from tax will be reversed if within five years the donor (or a non-arm's length person) reacquires the property, shares or substituted shares from the purchaser or if the shares are redeemed at a time when the donor and corporation are non-arm's length.

This measure will apply to donations made in respect of dispositions occurring after 2016.

Other Measure Affecting Charities

- The Budget proposes to amend the tax law to allow charities and registered amateur athletic associations to invest in limited partnerships in specific circumstances, as currently this type of investment can run afoul of the relevant legislative restrictions on business activities.
- The Budget proposes to allow certain foreign charitable foundations to be registered as qualified donees and issue charitable gift receipts. Such registration will be based on an application process and the foreign charitable foundation must be in receipt of a gift from the federal government and pursue activities related to disaster relief, urgent humanitarian aid or activities in the national interest of Canada.

International Tax Measures

Form T1135 – Foreign Reporting

As outlined in our BMO Financial Group publication "The CRA's Foreign Reporting Requirements", Canadian-resident individuals, corporations, trusts or certain partnerships that, at any time in a taxation year, own specified foreign property with a total cost of more than $100,000 must file a Foreign Income Verification Statement (Form T1135) with the Canada Revenue Agency. Specified foreign property generally includes funds and investments held outside of Canada, but excludes property used exclusively in carrying on an active business and real estate or other property that is held primarily for personal use. Property held in registered plans, such as Registered Retirement Savings Plans and Tax-Free Savings Accounts, are excluded from the Form T1135 reporting requirements.

The Canada Revenue Agency introduced a revised Form T1135 in 2013 which requires more detailed information regarding specified foreign property held. The increased reporting requirements have caused many stakeholders to suggest that this approach has resulted in a compliance burden for some taxpayers that may be disproportionate to the amount of their foreign investments.

Accordingly, the Budget proposes to simplify the foreign asset reporting system for taxation years that begin after 2014. Specifically, if the total cost of a taxpayer's specified foreign property is less than $250,000 throughout the year, the taxpayer will be able to report these assets under a new simplified foreign asset reporting system currently being developed by the Canada Revenue Agency. The existing reporting requirements will continue to apply to taxpayers with specified foreign property that has a total cost at any time during the year of $250,000 or more.

Withholding for Non-Resident Employers

Although the Canadian tax legislation generally requires an employer to withhold income tax in respect of an employee working in Canada, the Budget proposes to provide an exception to this income tax withholding requirement for qualifying non-resident employers in respect of payments (after 2015) made to non-resident qualifying employees who have an exemption from Canadian income tax because of a tax treaty.

The **2015 Federal Budget Review** was developed by our in-house experts in the Enterprise Wealth Planning Group: **John Waters**, Vice-President, Head of Tax & Estate Planning and **Jim Kraft**, Vice-President, Head of Business Advisory & Succession. For more articles visit **bmowealthexchange.com**.

If you have any questions regarding these budget proposals, please consult with your tax advisor for further details.

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