

2017 Federal Budget analysis

The 2017 Federal Budget was tabled by the Liberal Party on Wednesday, March 22, 2017. It was the second budget of the Liberal government and Finance Minister Bill Morneau.

This report and analysis was prepared by Invesco from within the budget lock-up in Ottawa. As is our practice, we focus our report and analysis on the key issues that are relevant to personal taxation, financial planning, investment portfolios and related private corporation taxation.

As happened last year in the lead-up to the budget, there was much speculation about a potential change to the capital gains inclusion rate. But, once again, there was no such change.

And though some may see it as an “Uber”-budget (you’ll see what we mean near the end), there are, in fact, relatively few tax measures in this document. What is included might be characterized as generally corrective or consolidative in nature, rather than being entirely novel. One item that should have lasting benefit is the Canada Caregiver Credit, designed to make tax and caregiving more coherent to families in need.

However, despite the lack of immediate tax changes, it is clear that change is on the horizon. The government has announced its intention to release a policy paper in the coming months on tax-planning strategies using private corporations. During the 2015 election campaign, and since, the Liberals have expressed their general concerns about how such tax strategies are used, so - like it or not - this budget should finally allow those corporations and shareholders to plan with greater certainty.

For now, we’ll begin with some issues directly relevant to investments.

1. Federal income tax brackets 2017

There were no changes to federal income tax brackets and rates, other than the usual annual indexing of brackets from 2016. The 2017 tax brackets and rates are as follows:

Income from	Rate
\$11,635	15.0%
\$45,916	20.5%
\$91,831	26.0%
\$142,353	29.0%
\$202,800	33.0%

2. Investment fund mergers

Merger of switch corporations into mutual fund trusts

In what is clearly a follow-on from last year's changes to mutual fund corporations, the government is loosening the rules relating to the reorganization of investment funds.

The *Income Tax Act* (Canada) contains special rules to facilitate the merger of mutual funds on a tax-deferred basis, under which two mutual fund trusts can be merged or a mutual fund corporation can be merged into a mutual fund trust. These rules permit funds to be tax-efficiently reorganized so as to achieve economies of scale and avoid the duplication of expenses. 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 into multiple mutual fund trusts on a tax-deferred basis. To qualify for this tax deferral, in respect of each class of shares of the mutual fund corporation that is, or is part of, an investment fund, all or substantially all of the assets allocable to that class must be transferred to a mutual fund trust and the shareholders of that class must become unitholders of that mutual fund trust.

This will allow some manoeuvrability for investment managers that may wish to make changes to their offerings. This measure will apply to qualifying reorganizations that occur on or after March 22, 2017 ("Budget Day").

Segregated fund mergers

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts. Unlike mutual fund trusts, income tax rules do not permit segregated funds to merge on a tax-deferred basis.

To provide consistent treatment between mutual fund trusts and segregated funds, Budget 2017 proposes to allow insurers to effect tax-deferred mergers of segregated funds. It is proposed that these rules generally align with the mutual fund merger rules. In order to ensure that the life insurance industry has an opportunity to provide comments on these proposed rules, this measure will apply to mergers of segregated funds carried out after 2017.

3. Business notes

Tax planning with private corporations - Policy paper coming

Budget 2017 reiterates the government's concern with tax-planning strategies using private corporations that may result in high-income individuals gaining unfair tax advantages. Three specific areas are noted:

- Sprinkling income to family members who are subject to lower personal tax rates
- Holding a passive investment portfolio inside a private corporation
- Converting a private corporation's regular income into capital gains

The government intends to release a paper in the coming months setting out the nature of these issues in more detail, as well as any proposed policy responses.

Factual control - Associated corporations and the small business deduction

If corporations are associated, they must share certain tax benefits, including the \$500,000 small business deduction limit. A recent court decision narrowly interprets the test for factual control. From the government's policy perspective, that factual control test is not intended to be viewed so narrowly. Budget 2017 proposes to introduce amendments to the **Income Tax Act** (Canada) to clarify its broader intention. This measure will apply in respect of taxation years that begin on or after Budget Day.

Billed-basis accounting - Effect on professionals

Taxpayers are generally required to include the value of work in progress in calculating their income for tax purposes. However, taxpayers in certain designated professions (e.g., accountants, dentists, lawyers, medical doctors, veterinarians and chiropractors) may elect to exclude the value of work in progress from their income calculations. This enables taxpayers to defer tax by permitting the costs associated with work in progress to be expensed without the matching inclusion of the associated revenues.

Budget 2017 proposes the elimination of billed-basis accounting for designated professionals. This measure will apply to taxation years that begin on or after Budget Day. To mitigate the effect on taxpayers, a transitional period will be provided to phase in the inclusion of work in progress into income.

4. Canada Caregiver Credit - Consolidation of caregiver credits

In a move that is reminiscent of how last year's Canada Child Benefit replaced several supports to families with children, a revamp to caregiving credits is included in this Budget.

Tax relief for caregivers is provided in the income tax system through a number of non-refundable tax credits. These credits recognize the impact that non-discretionary, out-of-pocket expenses have on a caregiver's ability to pay tax.

The current system includes three credits, with varying eligibility conditions based on the circumstances of the caregiver and the dependant:

- **Infirm dependant credit** - For individuals supporting an adult family member (other than a spouse or common-law partner) who is dependent on the caregiver by reason of physical or mental infirmity
- **Caregiver credit** - For individuals providing in-home care to family members who are either senior parents or grandparents (65 years of age or over) or certain adult family members who are dependent on the caregiver by reason of infirmity
- **Family caregiver credit** - For caregivers of family members who are dependent on them by reason of infirmity, through a top-up to the other dependency-related credits

Budget 2017 proposes to simplify the existing system of tax measures for caregivers by replacing the existing caregiver credit, infirm dependant credit and family caregiver tax credit with a new Canada Caregiver Credit. The amount will be:

- \$6,883 in respect of infirm dependants who are parents/grandparents, brothers/sisters, aunts/uncles, nieces/nephews, adult children of the claimant or of the claimant's spouse or common law partner
- \$2,150 in respect of a qualifying infirm spouse or common-law partner, eligible dependant credit or child who is under the age of 18 years

These amounts are consistent with the amounts that could have been claimed in respect of these dependants under the current programs. It will be reduced dollar-for-dollar by the dependant's net income above \$16,163 (in 2017). The Canada Caregiver Credit will apply for the 2017 and subsequent taxation years.

5. Medical matters

Disability tax credit (DTC) - *Certification*

The DTC is a 15% non-refundable tax credit that recognizes the impact of disability-related costs on an individual's ability to pay tax. For many Canadians, nurse practitioners are the first and most frequent point of contact in the system. In recognition of this situation and to improve access to this credit, nurse practitioners will be added to the list of medical practitioners who can certify the impacts of impairments for DTC applicants.

Medical expense tax credit (METC) - *Fertility treatment*

The METC is a 15% non-refundable tax credit that recognizes the effect of above-average medical or disability-related expenses on an individual's ability to pay tax. In the case of fertility issues, expenses may not be related to medical infertility where single individuals or same-sex couples are involved. To address this inequity, the budget proposes to clarify the application of the METC so that individuals who require medical intervention in order to conceive a child are eligible to claim the same expenses that would generally be eligible for individuals on account of medical infertility.

6. Taxation of derivatives

Use of mark-to-market method

The government intends to clarify the use of the mark-to-market method for derivatives. Specifically, an election will allow taxpayers to mark to market all of their eligible derivatives. Once made, the taxpayer will be required to annually include the increase or decrease in value of eligible derivatives in income calculations. This election will be available for taxation years that begin on or after Budget Day.

Straddle transactions

In its simplest form, a straddle is a transaction in which a taxpayer concurrently enters into two or more positions - often derivative positions - that are expected to generate equal and offsetting gains and losses. By disposing the losing leg in one year and the winning leg in the subsequent year, the taxpayer can defer taxation. Budget 2017 proposes to introduce a stop-loss anti-avoidance rule that will effectively defer the realization of any loss on the disposition of a position to the extent of any unrealized gain on an offsetting position. This measure will apply to any loss realized on a position entered into on or after Budget Day.

7. Potpourri

Anti-avoidance rules for registered plans

A number of anti-avoidance rules exist for tax-free savings accounts (TFSAs), registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs). These include advantage rules, prohibited investments and non-qualified investments.

To improve the consistency of the tax rules that apply to investments held in registered plans, Budget 2017 proposes to extend the anti-avoidance rules described above to registered education savings plans (RESPs) and registered disability savings plans (RDSPs). These proposals are not expected to have an impact on the vast majority of RESP and RDSP holders, who typically invest in ordinary portfolio investments.

Public transit tax credit - *Eliminated*

The public transit tax credit provides a 15% non-refundable tax credit in respect of the cost of eligible public transit passes, which include annual and monthly passes, as well as weekly passes and electronic fare cards used on an ongoing basis.

Budget 2017 proposes that the public transit tax credit be eliminated, effective July 1, 2017. The direct savings over the next six years is estimated at over \$1 billion. The cost of public transit passes and electronic fare cards attributable to public transit use that occurs after June 2017 will no longer be eligible for the credit.

Mineral exploration tax credit - *Flow-through shares*

The government proposes to extend eligibility for the mineral exploration tax credit for an additional year to flow-through share agreements entered into on or before March 31, 2018.

Uber taxation - *Ride-sharing and GST/HST rules*

Commercial ride-sharing services facilitated by web applications, such as Uber, provide passenger transportation services that are similar to taxi services but may not meet the GST/HST definition of a taxi business.

To ensure that the GST/HST applies consistently to both taxi services and ride-sharing services, Budget 2017 proposes to amend the definition of a taxi business to require providers of ride-sharing services to register for the GST/HST and charge tax on their fares in the same manner as taxi operators. In this regard, it is proposed that the GST/HST definition of a taxi business be amended. The amendment will be effective as of July 1, 2017.



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