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Insights and business impact of the 2017 Canadian Federal Budget

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Overview

- Budget 2017 included very few significant tax measures affecting Canadian business and personal taxation.
- Our objective is to discuss the potential impact of some of the key tax measures that were included in Budget 2017 and provide insights or identify actions for businesses.
- Key tax measures for businesses include those which affect:
  - disaggregation of switch funds and merger of segregated funds;
  - expenditures for discovery wells;
  - definition of control in fact;
  - recognition of gains and losses on derivatives; and
  - work in progress for professionals.
- International tax measures:
  - extending base erosion rules to foreign branches of life insurers
- Key personal tax measure
  - Expansion of anti-avoidance rules for registered plans
- Key sales and excise tax measures
  - Taxi and ride sharing services
  - Tobacco taxation
  - Alcohol taxation

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Key Tax Measures for Businesses

- Budget 2017 proposed to permit the tax deferred reorganization of switch corporations and to permit the tax deferred merger of segregated funds.
- Budget 2017 proposed to extend accelerated capital cost allowance to equipment that uses geothermal energy to generate heat or a combination of heat and electricity and to qualify as Canadian renewable and conservation expense expenses incurred for the purpose of determining the extent and quality of a geothermal resource and the cost of all geothermal drilling.
- Budget 2017 proposed to deny CEE treatment to expenditures for drilling a discovery well unless the well has been abandoned, has not produced in 24 months or the Minister of Natural Resources has certified that the relevant costs are expected to exceed $5 million and it will not produce within that time frame. CEE treatment will continue to be available for certain expenses such as early-stage geophysical and geochemical surveying.
- Budget 2017 proposed to no longer permit small principal business corporations to treat the first $1 million of CDE as CEE.

Certain of these key business tax measures are favorable and others unfavourable. They in part reflect policy choices regarding fossil fuel subsidies and emissions. Businesses will need to adapt to these changes including from the perspective of access to financing.

Key Tax Measures for Businesses (cont'd)

- Budget 2017 proposed to "clarify" (read expand) the definition of control in fact to allow all relevant factors to be considered and not to require that control in fact be based on the existence of a legally enforceable right or ability to effect a change in the board of directors, or the board's powers, or to exercise influence over the shareholder or shareholders who have that right or ability.
- Budget 2017 proposed to introduce an elective mark-to-market regime for derivatives held on income account. It would apply to <u>all</u> eligible derivatives and could only be revoked with the consent of the Minister of National Revenue.
- Budget 2017 proposed to introduce a specific anti-avoidance rule which would prevent taxpayers from garnering tax benefits from the use of so-called straddle transactions.
- Budget 2017 proposed to prohibit billed basis accounting for designated professionals.

These key business tax measures are intended to block perceived abuses.

- Businesses structured in a manner that falls outside existing notions of control in fact will need to revisit their CCPC status and association with other CCPCs.
- Businesses which enter into derivative transactions will need to determine what their course of action will be under these proposals.

Key Tax Measures for Businesses (cont'd)

- More to come later this year?
- The Liberal government promised to "cancel income splitting and other tax breaks and benefits for the wealthy." The election platform estimated that income splitting costs the federal government $2 billion annually and posited that it delivers benefits to only 15% of Canadian households. In its 2016 budget, the Liberal government committed to undertake a review of tax expenditures in order to, among other things, identify "opportunities" to reduce those "tax breaks and benefits".
- While Budget 2017 indicated that this review has highlighted a number of such "opportunities," there are no measures proposed to address them. Budget 2017 promised that a paper will be released in the coming months setting out the nature of these issues and proposed policy responses. Budget 2017 specifically noted sprinkling of income using private corporations (an income-splitting strategy), holding passive investments through private corporations, and converting a private corporation's regular income into capital gains. Promises, promises.

STAY TUNED – we may soon see additional tax measures intended to curb access to what appear to be viewed as "unfair" tax benefits.

International Tax Measure

- In contrast to Budget 2016 which contained a number of measures to continue to protect the Canadian tax base and also act upon certain recommendations from the BEPS project, Budget 2017 only contains one international tax measure, and it is of limited application, but its theme is also protection of the Canadian tax base.
- Budget 2017 proposes to add a rule, modelled on the equivalent rule in the foreign affiliate regime, which will ensure that income of Canadian-resident life insurers from the insurance of Canadian risks is taxable in Canada even if conducted through a foreign branch. In certain respects, one might find it somewhat surprising that this wasn't already the case.
- Complementary anti-avoidance rules will also be introduced to ensure greater consistency in the taxation of foreign affiliates and foreign branches of life insurers
  - anti-avoidance rules introduced to the foreign affiliate regime regarding the use of insurance swaps or the ceding of Canadian risks will also apply to foreign branches of life insurers
  - a life insurer will be deemed to have insured Canadian risks where it can reasonably be concluded that foreign risks were insured through the foreign branch as part of a transaction or series of transactions one of the purposes of which was to avoid the proposed rule. A similar anti-avoidance rule is proposed in the foreign affiliate context to bolster existing rules.

This measure will impact a small number of Canadian businesses. Canadian-resident life insurers should undertake a careful review of the insurance business conducted through their foreign branches and through their foreign affiliates.

Key Personal Tax Measures

- Expanding to RESPs and RDSPs the advantage, prohibited investment and non-qualified investment rules that currently apply to RRSPs, RRIFs and TFSAs. Subject to certain exceptions, this measure will apply to transactions occurring, and investments acquired, after March 22, 2017.

- Extension of the 15% mineral exploration tax credit to flow-through share agreements entered into on or before March 31, 2018 (from March 31, 2017).

Individual taxpayers and their investment advisors should be aware of these changes and review investments in their RESPs and RDSPs with a view to assessing the potential application of these anti-avoidance rules.

Sales and Excise Tax Measures

- Providers of ride sharing services will be required to register for and collect and remit GST/HST in the same manner as regulated taxi businesses.

- The tobacco manufacturer's surtax (a 10.5% surtax on profits arising from the manufacture of tobacco and tobacco products in Canada) will be eliminated but tobacco excise duty rates will be increased. Inventories held at the end of the day on March 22, 2017 by manufacturers, importers, wholesalers and retailers will generally be subject to an inventory tax. These measures will apply as of March 23, 2017, with a pro-ration of the surtax for taxation years that straddle March 22, 2017.

- Excise duties imposed on alcoholic products are generally imposed at the time of production or packaging, and are generally payable by manufacturers or excise warehouse licensees. Budget 2017 proposes to increase the excise duty rates on alcohol products by 2% effective March 23, 2017, in respect of duty that is payable after that date. It is also proposed that the rates be adjusted by the Consumer Price Index on April 1 of every year, starting in 2018.

Questions?

For more information

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