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2014 FEDERAL BUDGET ANALYSIS

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PERSONAL INCOME TAX MEASURES

Adoption Expense Tax Credit

The Adoption Expense Tax Credit is a 15-per-cent non-refundable tax credit that allows adoptive parents to claim eligible adoption expenses relating to the completed adoption of a child under the age of 18.

Budget 2014 proposes to increase the maximum amount of eligible expenses to $15,000 per child for 2014. This maximum amount will be indexed to inflation for taxation years after 2014.

Medical Expense Tax Credit

Budget 2014 proposes that amounts paid for the design of an individualized therapy plan be eligible for the Medical Expense Tax Credit ("METC") if the cost of the therapy itself would be eligible for the METC if certain conditions are met.

Budget 2014 also proposes to add to the list of expenditures eligible under the METC expenses for service animals specially trained to assist an individual in managing their severe diabetes. Eligible expenses will include the cost of the service animal and its care and maintenance, as well as reasonable travel expenses incurred for the individual to attend a facility that trains individuals in the handling of these service animals.

These measures will apply to expenses incurred after 2013.

Search and Rescue Volunteers Tax Credit

Budget 2014 proposes a Search and Rescue Volunteers Tax Credit (SRVTC) to allow eligible ground, air and marine search and rescue volunteers to claim a 15-per-cent non-refundable tax credit based on an amount of $3,000.

Volunteers will be ineligible if the individual also provides search and rescue services, otherwise than as a volunteer, to an organization.

An individual will be able to claim either the Volunteer Firefighters Tax Credit (VFTC) or the SRVTC and will be ineligible for the existing tax exemption of up to $1,000 for honoraria paid by a government, municipality or public authority to an emergency services volunteer.

This measure will apply to the 2014 and subsequent taxation years.

Extension of the Mineral Exploration Tax Credit for Flow-Through Share Investors

The Mineral Exploration Tax Credit is an additional benefit, available to individuals who invest in flow-through shares, equal to 15 per cent of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors.

Budget 2014 proposes to extend eligibility for the Mineral Exploration Tax Credit for one year, to flow-through share agreements entered into on or before March 31, 2015. Under the existing "look-back" rule, funds raised in one calendar year with the benefit of the credit can be spent on eligible exploration up to the end of the following calendar year. Therefore, for example, funds raised with the credit during the first three months of 2015 can support eligible exploration until the end of 2016.

Farming and Fishing Businesses

Budget 2014 proposes to extend eligibility for the intergenerational rollover and the life time capital gains exemption to property of an individual and to an individual's share in a corporation or an interest in a partnership used principally in a combination of farming and fishing.

This measure will apply to dispositions and transfers that occur in the 2014 and subsequent taxation years.

Amateur Athlete Trusts

Budget 2014 proposes to allow income that is contributed to an amateur athlete trust, by an amateur athlete who is the beneficiary of the trust, to qualify as earned income for the purpose of determining the Registered Retirement Savings Plan contribution limit of the trust's beneficiary.

This measure will apply in respect of contributions made to amateur athlete trusts after 2013. In addition, the athlete who contributed to an amateur athlete trust before 2014 will be permitted to make an election to have income that was contributed to the trust in 2011, 2012 and 2013 also qualify as earned income.

An individual will be required to make the election in writing and submit it to the Canada Revenue Agency on or before March 2, 2015.

Pension Transfer Limits

In 2011, the Government introduced a special rule that applies in certain circumstances to allow a member leaving a Registered Pension Plan ("RPP") whose estimated pension benefit has been reduced due to plan underfunding to disregard that benefit reduction in calculating their transferable amount. The transferable amount is the tax-free transfer of a lump sum payment from a defined benefit RPP received by a plan member leaving the plan to a Registered Retirement Savings Plan ("RRSP"). The portion of a plan member's commutation payment that exceeds the transferable amount must be included in the taxpayer's income for the year in which it is received.

Budget 2014 proposes to allow this rule to apply in additional situations. In particular, the rule will be available in respect of a commutation payment to a plan member who is leaving an RPP if that payment has been reduced due to plan underfunding and either:

- where the plan is an RPP other than an individual pension plan, the reduction in the estimated pension benefit that results in the reduced commutation payment is approved pursuant to the applicable pension benefits standards legislation; or
- where the plan is an individual pension plan, the commutation payment to the plan member is the last payment made from the plan (i.e., the plan is being wound up).

The existing requirement that the application of this rule must be approved by the Minister of National Revenue will be maintained.

This measure will apply in respect of commutation payments made after 2012.

GST/HST Credit Administration

Budget 2014 proposes to eliminate the need for an individual to apply for the GST/HST Credit and to allow the Canada Revenue Agency to automatically determine if an individual is eligible to receive the GST/HST Credit. A notice of determination will be sent to each individual who is eligible for the GST/HST Credit. In the case of eligible couples, the GST/HST Credit will be paid to the spouse or common-law partner whose tax return is assessed first.

Notices of determination will not be sent to ineligible individuals. An ineligible individual, however, will be able to obtain a notice of determination upon request, which will preserve their right to object to the determination.

This measure will apply in respect of income tax returns for the 2014 and subsequent taxation years.

Tax on Split Income

Budget 2014 proposes to reduce the ability of a higher income taxpayer to split taxable income inappropriately with lower income individuals. The definition of "split income" will include income that is, directly or indirectly, paid or allocated to a minor from a trust or partnership, if:

- the income is derived from a source that is a business or a rental property; and
- a person related to the minor
  - is actively engaged on a regular basis in the activities of the trust or partnership to earn income from any business or rental property, or
  - has, in the case of a partnership, an interest in the partnership (whether held directly or through another partnership).

This measure will apply to the 2014 and subsequent taxation years.

Graduated Rate Taxation of Trusts and Estates

Budget 2014 proposes to apply flat top-rate taxation to *inter vivos* trusts created before June 18, 1971 trusts created by will and certain estates. Two exceptions to this treatment are proposed. First graduated rates will apply for the first 36 months of an estate that arises on and as a consequence of an individual's death and that is a testamentary trust. This recognizes that estates require a period of administration and that estates are generally administered within their first 36 months. If the estate remains in existence more than 36 months after the death, it will become subject to flat top-rate taxation at the end of that 36-month period.

Second, graduated rates will continue to be provided in respect of such trusts having as their beneficiaries individuals who are eligible for the federal Disability Tax Credit.

Also under this proposal, testamentary trusts (other than estates for their first 36 months) and *inter vivos* trusts created before June 18 1971 will not benefit from special treatment of related tax rules, including but not limited to:

- an exemption from the income tax instalment rules;
- an exemption from the requirement that trusts have a calendar year taxation year and fiscal periods that end in the calendar year in which the period began;

Testamentary trusts that do not already have a calendar year taxation year will have a deemed taxation year-end on December 31, 2015 (or in the case of an estate for which that 36-month period ends after 2015, the day on which that period ends).

This measure will apply to the 2016 and subsequent taxation years.

Non-Resident Trusts

Budget 2014 proposes to eliminate the 60-month exemption from the deemed residence rules, including related rules that apply to non-resident trusts. The 60-month exemption is an exemption from the deemed residence rules applies if the contributors to the trust are individuals each of whom is resident in Canada for a total period of not more than 60 months (i.e., newly resident Canadians).

This measure will apply in respect of trusts for taxation years:

- that end after 2014 if (i) at any time that is after 2013 and before Budget Day the 60-month exemption applies in respect of the trust, and (ii) no contributions are made to the trust on or after Budget Day and before 2015; or

- that end on or after Budget Day in any other case.

CHARITIES AND NON-PROFIT ORGANIZATIONS

Donations of Ecologically Sensitive Land

Budget 2014 proposes to extend to ten years the carry-forward period for donations of ecologically sensitive land, or easements, covenants and servitudes on such land.

This measure will apply to donations made on or after Budget Day.

Estate Donations

Budget 2014 proposes to provide more flexibility in the tax treatment of charitable donations made in the context of a death that occurs after 2015. Donations made by will and designation donations will no longer be deemed to be made by an individual immediately before the individual's death. Instead, these donations will be deemed to have been made by the estate, at the time at which the property that is the subject of the donation is transferred to a qualified donee.

In addition, the trustee of the individual's estate will have the flexibility to allocate the available donation among any of: the taxation year of the estate in which the donation is made; an earlier taxation year of the estate; or the last two taxation years of the individual. The current limits that apply in determining the total donations that are creditable in a year will continue to apply. A qualifying donation will be a donation effected by a transfer, within the first 36 months after the individual's death, of property to a qualified donee.

In the case of a transfer from a Registered Retirement Savings Plan, Registered Retirement Income Fund, Tax Free Savings Account or insurer, the existing rules for determining eligible property for designation donations will apply. In any other case, the donated property will be required to have been acquired by the estate on and as a consequence of the death (or to have been substituted for such property).

This measure will apply to the 2016 and subsequent taxation years.

Donations of Certified Cultural Property

Budget 2014 proposes to remove, for certified cultural property acquired as part of a tax shelter gifting arrangement, the exemption from the rule that deems the value of a gift to be no greater than its cost to the donor. Other donations of certified cultural property will not be affected by this measure.

This measure will apply to donations made on or after Budget Day.

State Supporters of Terrorism

Budget 2014 proposes that where a charity accepts a donation from a foreign state listed as a supporter of terrorism for purposes of the *State Immunity Act*, or from an agency of such a state, the Minister of National Revenue may refuse to register the charity or may revoke its registration.

This measure will apply to donations accepted on or after Budget Day.

Consultation on Non-Profit Organizations

Budget 2014 announces the Government's intention to review whether the income tax exemption for NPOs remains properly targeted and whether sufficient transparency and accountability provisions are in place.

BUSINESS INCOME TAX MEASURES

Remittance Thresholds for Employer Source Deductions

Employers are required to remit source deductions in respect of employees' income tax, Canada Pension Plan contributions and Employment Insurance premiums. An employer is included in a particular category of remitter on the basis of the employer's total average monthly withholding amount in preceding calendar years in respect of these source deductions.

Budget 2014 proposes to reduce the frequency of remittance of source deductions for these employers. In particular, Budget 2014 will:

- increase the threshold level of average monthly withholdings at which employers are required to remit up to two times per month to $25,000 from $15,000; and
- increase the threshold level of average monthly withholdings at which employers are required to remit up to four times per month to $100,000 from $50,000.

This measure will apply in respect of amounts to be withheld after 2014.

Tax Incentives for Clean Energy Generation

Under the capital cost allowance (CCA) regime in the income tax system, Class 43.2 provides an accelerated CCA rate (50 per cent per year on a declining-balance basis) for investment in specified clean energy generation and energy conservation equipment.

Budget 2014 proposes to expand Class 43.2 to include water-current energy equipment and equipment used to gasify eligible waste fuel for use in a broader range of applications.

This measure will apply to property acquired on or after Budget Day that has not been used or acquired for use before that date.

Consultation on Eligible Capital Property

Budget 2014 announces a public consultation on a proposal to repeal the eligible capital property ("ECP") regime, replace it with a new Capital Cost Allowance ("CCA") class available to businesses and transfer taxpayers' existing Cumulative Eligible Capital pools to the new CCA class.

The timing of the implementation of this proposal will be determined following the consultation.

INTERNATIONAL TAX MEASURES

Captive Insurance

Budget 2014 proposes to amend the existing anti-avoidance rule in the foreign accrual property income ("FAPI") regime relating to the insurance of Canadian risks.

This measure will apply to taxation years of taxpayers that begin on or after Budget Day.

Back-to-Back Loans

The Income Tax Act governs the tax treatment of certain interest payments made by taxpayers to non-resident persons.

Some taxpayers have sought to avoid the thin capitalization rules and Part XIII withholding tax through the use of so-called "back-to-back loan" arrangements. These arrangements generally involve interposing a third party (e.g., a foreign bank) between two related taxpayers (such as a foreign parent corporation and its Canadian subsidiary) in an attempt to avoid the application of rules that would apply if a loan were made, and interest paid on the loan, directly between the two taxpayers.

Budget 2014 proposes to address back-to-back loan arrangements by adding a specific anti-avoidance rule in respect of withholding tax on interest payments, and by amending the existing anti-avoidance provision in the thin capitalization rules.

This measure will apply in respect of the thin capitalization rules, to taxation years that begin after 2014, and in respect of Part XIII withholding tax, to amounts paid or credited after 2014.

Consultation on Tax Planning by Multinational Enterprises

Input from stakeholders on issues related to international tax planning by multinational enterprises ("MNEs") – and on other issues, such as ensuring the effective collection of sales tax on e-commerce sales by foreign-based vendors – would help the Government to set its priorities and inform Canada's participation in international discussions. The Government is interested in obtaining views on how to ensure fairness among different categories of taxpayers (e.g., MNEs, small businesses and individuals) and how to better protect the Canadian tax base, while maintaining an internationally competitive tax system that is attractive for investment.

In addition, the Government is inviting input from stakeholders on what actions the Government should take to ensure the effective collection of sales tax on e-commerce sales to residents of Canada by foreign-based vendors.

Consultation on Treaty Shopping

Budget 2013 set out the Government's concerns with the abuse of Canada's tax treaties through "treaty shopping". This term is commonly used to refer to arrangements under which a person not entitled to the benefits of a particular tax treaty with Canada uses an entity that is a resident of a state with which Canada has concluded a tax treaty to obtain Canadian tax benefits.

The Organization for Economic Co-operation and Development (OECD) is expected to issue its recommendations in this regard in September 2014. These recommendations and the continuing consultation process will be relevant in developing a Canadian approach to address treaty shopping.

Update on the Automatic Exchange of Information for Tax Purposes

A new reporting regime will come into effect starting in July 2014, with Canada and the U.S. beginning to receive enhanced tax information from each other in 2015.

In September 2013, G-20 Leaders committed to the automatic exchange of information as the new global standard and endorsed an Organization for Economic Co-operation and Development (OECD) proposal to develop a global model for the automatic exchange of tax information.

SALES AND EXCISE TAX MEASURES

Improving the Application of the GST/HST to the Health Care Sector

Budget 2014 proposes the following changes to the Health Care sector:

Designing Training for Individuals with a Disorder or Disability

Budget 2014 proposes to expand the exemption for training that is specially designed to assist individuals with a disorder or disability to also exempt the services of designing such training. The exemption will apply to the initial development and design of the plan and any subsequent adjustments if certain conditions are met.

This measure will apply to supplies made after Budget Day.

Acupuncturists' and Naturopathic Doctors' Services

Budget 2014 proposes that acupuncturists and naturopathic doctors be added to the list of health care practitioners whose professional services rendered to individuals are exempt from the GST/HST.

This measure will apply to supplies made after Budget Day.

Eyewear Specially Designed to Electronically Enhance the Vision of Individuals with Vision Impairment

Budget 2014 proposes to add eyewear specially designed to treat or correct a defect of vision by electronic means, if supplied on the written order of a physician or optometrist for use by a consumer named in the order, to the list of GST/HST zero-rated medical and assistive devices.
This measure will apply to supplies made after Budget Day.

GST/HST Election for Closely Related Persons

Budget 2014 proposes to extend, effective January 1, 2015, the availability of the group relief to new members of a closely related group that have not yet acquired any property, provided that the new members continue as going concerns engaged exclusively in commercial activities. The group relief extended is to avoid accounting for tax on certain transactions between the new member and the related group.

It is also proposed that a filing requirement in relation to the group relief election be introduced. Effective January 1, 2015, parties to a new election will be required to file that election in a prescribed manner with the Canada Revenue Agency. Parties to an election made before January 1, 2015 that is in effect until that date will also be required to comply with this filing requirement, and will have until January 1, 2016 to do so.

In addition, Budget 2014 proposes that parties to an existing or new group relief election (or persons that conduct themselves as if such election were in effect) be subject to a joint and several (or solidary) liability provision with respect to the GST/HST liability that may arise in relation to supplies made between them on or after January 1, 2015.

Joint Ventures

The Government intends to propose new joint venture election measures, as well as complementary anti-avoidance measures, that will allow the participants in a joint venture to make the joint venture election as long as the activities of the joint venture are exclusively commercial and the participants are engaged exclusively in commercial activities.

The joint venture election simplifies GST/HST accounting obligations in respect of their joint venture activities.

Strengthening Compliance with GST/HST Registration

Budget 2014 proposes that the Minister of National Revenue be given the discretionary authority to register and assign a GST/HST registration number where a person fails to comply with the requirement to register, even after having been notified of the requirement to register by the Canada Revenue Agency.

This measure will apply on Royal Assent to the enacting legislation.

Tobacco Taxation

Budget 2014 proposes to increase the rate of excise duty on cigarettes and to increase excise duty on tobacco products in a duty free market. The excise duty rates will be indexed and adjusted every five years. In addition, inventory tax will be levied on all inventories in excess of 30,000 cigarettes at the end of the budget date.

Standardizing Sanctions Related to False Statements in Excise Tax Returns

Budget 2014 proposes to add a new administrative monetary penalty, and to amend the existing criminal offence, for the making of false statements or omissions in an excise tax return and related offences under the non-GST/HST portion of the *Excise Tax Act*. The non -GST/HST portion of the *Excise Tax Act* includes but is not limited to fuels, fuel-inefficient vehicles and automobile air-conditioners.

These measures will apply to excise tax returns filed after the day of Royal Assent to the enacting legislation.