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2014 FEDERAL BUDGET

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Tax highlights from the 2014 federal budget

Finance Minister James Flaherty tabled the 2014 federal budget on February 11, 2014. The budget projects a deficit of $16.6 billion for the soon-to-end 2013-2014 fiscal year and forecasts a deficit of $2.9 billion for the 2014-2015 fiscal year. The minister reiterated the government's previously stated position that the budget would return to a surplus position in 2015. The budget forecasts a surplus of $6.4 billion for the 2015-2016 fiscal year followed by surpluses of $8.1 billion in each of the two subsequent years.

The budget, or Economic Action Plan 2014 as it is referred to by the government, focuses on the four following areas:

- Balancing the budget.
- Keeping taxes low.
- Promoting jobs and economic growth.
- Standing up for families and communities.

There were no increases to personal or corporate tax rates in the budget; however, there was a continuing focus on measures that will increase tax "fairness" and close perceived tax "loopholes". Excise duties on some tobacco products were increased for the first time since 2002 as part of the Government's health strategy to discourage smoking among Canadians.

To put the economic effect of these budget provisions into context, the budget documents estimate the potential tax impact of the various proposed measures over the next five years. The top five sources of cumulative incremental tax revenue are projected to be:

- Increased excise duties on tobacco products - $3.3 billion
- New anti-avoidance measures in the international sphere - $1.2 billion
- Cessation of graduated rate taxation for trusts and estates - $245 million
- Broadening the definition of split income for kiddie tax purposes - $190 million
- Repeal of the immigrant trust exception - $110 million

The following pages are a summary of the changes announced in the budget. Please note that these changes are still proposals until passed into law by the federal government.

PERSONAL TAX MATTERS

Personal income tax rates

There were no changes announced with respect to personal income tax rates in this budget, although tax brackets have been indexed by 0.9% to reflect the impact of inflation. The effective rates for 2014 and corresponding tax bracket thresholds are shown in the following table.

Taxable income range	2014 tax rates
$11,139 - $43,953	15%
$43,954 - $87,907	22%
$87,908 - $136,270	26%
$136,271 or more	29%

Graduated rate taxation of trusts and estates

A common estate planning strategy involves the use of testamentary trusts created in a deceased person's will to hold a beneficiary's inheritance. These trusts can be more tax efficient than receiving an outright inheritance because the trusts are subject to taxation at graduated rates, similar to individuals, and essentially allow for the splitting of income between the trust and the beneficiaries. The effects can be magnified in cases where deceased individuals with significant estates create multiple trusts. This tax benefit can be contrasted with inter-vivos trusts created during the person's lifetime. Inter-vivos trusts are subject to taxation at the highest marginal rates applicable to individuals, serving to prevent tax-motivated use of these trusts.

The 2013 budget indicated the Department of Finance's concern with the increasingly tax-motivated use of testamentary trusts and the impact on the tax base. Accordingly, that budget announced that the government would consult on possible measures to eliminate the tax benefits arising from the use of these trusts based on proposed measures contained in a consultation paper released for comment on June 3, 2013.

This budget proposes to generally proceed with the measures described in the consultation paper, effective in 2016 and subsequent years. Those measures include the application of flat top-rate taxation to grandfathered inter-vivos trusts, trusts created by will and certain estates. There are two specific exceptions to these rules:

- graduated rates will continue to be available for the first 36 months of an estate that is a testamentary trust arising as a consequence of an individual's death, and
- graduated rates will continue to be available for testamentary trusts that have beneficiaries who are individuals eligible for the federal disability tax credit.

In addition, this proposal will restrict benefits to testamentary trusts and grandfathered inter-vivos trusts from various special tax rules, including:

- an exemption from the income tax installment rules;
- an exemption from the requirement that trusts have a calendar year tax year and fiscal periods that end in the calendar year in which the period began;
- the basic $40,000 exemption in computing alternative minimum tax;
- preferential treatment under part XII.2 of the Income Tax Act;
- classification as a personal trust regardless of how the interests in the trust were acquired;
- the ability to make investment tax credits available to a trust's beneficiaries; and
- a number of other administrative rules that otherwise apply to individuals.

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

Tax on split income (kiddie tax)

The kiddie tax currently does not apply in cases where a minor child is allocated income from a trust or partnership that carries on business or rental activities with third parties. Effective in 2014 and subsequent taxation years, the budget proposes to extend the definition of "split income" to 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 rental property; and
- a person related to the minor is actively involved in the activities of the trust or the partnership to earn income from the business or rental property, or, in the case of a partnership, has an interest in the partnership.

Non-resident trusts

Although the Income Tax Act contains rules to prevent the use of non-resident trusts to avoid Canadian tax, there is an exception that applies to trust contributors who were not resident in Canada for at least 60 months. The 60-month exception created what are known as "immigrant trusts". The budget proposes to eliminate the 60-month exception from the deemed residence rules that apply to non-resident trusts for taxation years that end after 2014 in the case of existing trusts, where no contributions are made on or after February 11, 2014 and before 2015. In all other cases, the measure comes into effect for trusts with taxation years that end on or after February 11, 2014.

Tax deferral for farmers

Farmers who dispose of breeding livestock due to drought, flood or excess moisture conditions existing in prescribed regions in a given year are permitted to defer up to 90% of the sale proceeds from inclusion in taxable income until the year following sale, or a later year if the conditions persist. The budget proposes to extend application of this tax deferral to bees and to all types of horses kept for breeding that are over 12 months of age. This measure will apply to 2014 and subsequent tax years.

Farming and fishing businesses

There are provisions in the Income Tax Act that allow for intergenerational transfers of farming or fishing property. Qualifying farming or fishing properties are also eligible for the $800,000 lifetime capital gains exemption. The budget proposes to simplify these rules for taxpayers involved in a combination of farming and fishing activities. The new rules apply to dispositions and transfers that occur in 2014 and subsequent years. These rules apply to interests owned personally, shares of a qualifying corporation, or interests in a qualifying partnership.

Adoption expense tax credit

The budget proposes to increase the current maximum expense level for the 15% non-refundable tax credit from $11,774 per child to $15,000 per child for 2014. This maximum amount will be indexed to inflation for taxation years after 2014.

Medical expense tax credit

The budget proposes an addition to the list of expenses eligible for the 15% non-refundable medical expense tax credit. The cost of designing an individual therapy plan will qualify as a medical expense if the cost of the therapy itself is eligible for the credit, and the following conditions are met:

- the individualized therapy plan is required to access public funding for specialized care;
- the plan is designed for an individual with a severe and prolonged mental or physical impairment who is eligible for the disability tax credit; and

- the amounts are paid to persons ordinarily engaged in the business of providing these types of services to unrelated individuals.

The budget also proposes to add expenses in respect of service animals specially trained to assist an individual in managing severe diabetes to the list of qualifying expenditures.

Both of the above proposals will apply to expenses incurred after 2013.

Search and rescue volunteers tax credit

The budget proposes a new 15% non-refundable tax credit for eligible ground, air, and marine search and rescue volunteers. The credit will be based on $3,000 and will be available to individuals who perform at least 200 hours of volunteer search and rescue services in a taxation year, for one or more search and rescue organizations. Volunteer hours will be ineligible to the extent that the individual also provides non-volunteer service to that particular organization.

An individual who performs both volunteer firefighting and volunteer search and rescue services for a total of at least 200 hours in a year will be able to claim either the volunteer firefighters tax credit or this tax credit.

In addition, an individual who claims either of these credits will be ineligible to claim the existing tax exemption of up to $1,000 for honoraria paid to an emergency services volunteer. This new tax credit will be available in 2014 and subsequent years.

Mineral exploration tax credit for flow-through share investors

The budget extends this credit for flow-through share arrangements scheduled to expire on March 31, 2014. The credit will continue to be available for flow-through share arrangements entered into on or before March 31, 2015.

GST/HST credit administration

The budget proposes to allow the Canada Revenue Agency (CRA) to automatically determine if an individual is eligible for the GST/HST credit, rather than requiring the individual to check a box on their personal income tax return. In the case of eligible couples, the credit will be paid to the spouse or common-law partner whose tax return is assessed first. This change will apply beginning with the 2014 personal income tax return.

Amateur athlete trusts

The budget proposes to allow income contributed to an amateur athlete trust to qualify as earned income for purposes of determining the Registered Retirement Savings Plan (RRSP) contribution limit of the trust's beneficiary. This measure will apply to trust contributions made after 2013.

In addition, individuals who contributed to these trusts before 2014 will be allowed to make an election to have income that was contributed to the trust in 2011, 2012 and 2013 qualify as earned income for RRSP purposes. The individual's RRSP limit will be re-determined for each of those years and the amount will be added to their 2014 RRSP contribution room. In order to take advantage of this provision, the individual will have to file an election in writing with CRA on or before March 2, 2015.

Registered pension plan transfer limits

The 2011 budget introduced special rules that did not reduce the transferable pension amount in cases where the individual's estimated pension benefit was reduced due to underfunding of a registered pension plan (RPP) that was being wound up by an insolvent employer.

This budget proposes to extend this rule to additional circumstances, particularly:

- if the plan is an RPP other than an individual pension plan and the reduction in benefits is approved pursuant to the applicable pension benefits standards legislation; or
- if the plan is an individual pension plan, the commutation payment to the plan member is the last payment from the plan, as it is being wound up.

This measure will apply to commutation payments made after 2012.

CORPORATE TAX MATTERS

Corporate income tax rates

There were no changes proposed to any corporate income tax rates. The table below shows federal tax rates and the small business limit for 2014.

Category	2014 tax rates
General rate	15%
Manufacturing & processing rate	15%
Small business rate	11%
Small business limit	$500,000

Remittance thresholds for employer source deductions

In order to reduce the tax compliance burden for small business, the budget proposes to reduce the required frequency of remitting source deductions for amounts withheld after 2014.

For employers required to remit up to two times per month, the budget increases the threshold level for average monthly withholdings from $15,000 to $25,000.

For employers required to remit up to four times per month, the budget increases the threshold level for average monthly withholdings from $50,000 to $100,000.

Eligible capital property

The budget proposes to consult with stakeholders with respect to a proposal to repeal the existing eligible capital property system and replace it with a new capital cost allowance (CCA) class, in order to simplify the rules for businesses. Detailed draft legislation will be released for comment in the near future, with implementation timing determined after the consultation period.

The proposal replaces the current 7% rate on 75% of qualifying expenditures with a CCA class that has a 5% rate on 100% of qualifying expenditures. The simplification objective is met in that all current CCA rules would apply, including those relating to recapture, capital gains, depreciation and the half-year rule. Transitional rules would apply for the first 10 years in respect of expenditures incurred before the implementation of the new rules.

Various other tax measures

The budget proposes various other measures that are applicable to specific industry sectors, large business enterprises, and international transactions. These proposed measures include:

- accelerated CCA provisions for clean energy generation;

- amending the existing anti-avoidance rule in the foreign accrual property income (FAPI) regime related to captive insurers;
- adding new conditions to the FAPI regime with respect to qualifying for the regulated foreign financial institution exception;
- addressing “back to back” loan arrangements by adding specific anti-avoidance rules in respect of withholding tax on interest payments, and by amending the existing anti-avoidance provision in the thin capitalization rules;
- consultation on tax planning by multi-national enterprises;
- consultation on treaty shopping;
- an update on the automatic exchange of information for tax purposes, including the recent information sharing agreement between the CRA and the Internal Revenue Service (IRS) with respect to the U.S. Foreign Account Tax Compliance Act (FATCA) regime; and
- an update on tax treaties and tax information exchange agreements. Canada now has 92 tax treaties in force, three tax treaties signed but not yet in force, and eight tax treaties and protocols under negotiation.

OTHER PROPOSALS

Charities and non-profit organizations

The budget proposes several new measures within the charity and non-profit sectors. They are as follows:

Donations by an estate – When an individual makes a donation in his or her will, the donation is treated as having been made by the individual immediately before the individual’s death, for income tax purposes. Similar provisions apply where an individual designates an RRSP, a Registered Retirement Income Fund (RRIF), a Tax Free Savings Account (TFSA), or a life insurance policy to a qualified donee. Under these circumstances the charitable donation tax credit is only available to offset the individual’s income tax. Conversely, a donation made by the individual’s estate may only be used to offset the estate’s tax payable.

Effective for deaths after 2015, the budget proposes to increase flexibility to allocate the donation in the most favorable manner by no longer deeming that donations by will and direct designations were made by the individual. The new rules deem those donations and designations to have been made by the estate at the time the property is transferred to the charity. For donations made in the first 36 months following the individual’s death, the executor/trustee will have the ability to allocate the 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.

An estate will continue to be able to claim the charitable donation tax credit for other donations in the year in which the donation is made or in any of the five following years.

Donations of ecologically sensitive land – applicable to donations made on or after February 11, 2014, the budget proposes to extend the carry-forward period from five years to 10 years.

Donations of certified cultural property – applicable to donations made as part of a tax shelter gifting arrangement on or after February 11, 2014, the budget proposes to remove the exception from the rule that deems the value of the gift to be no greater than its cost to the donor. Other donations of certified cultural property will not be affected by this measure.

Donations from state supporters of terrorism – applicable to donations accepted on or after February 11, 2014 from a foreign state listed as a supporter of terrorism for purposes of the State Immunity Act, the budget proposes to allow the Minister of Revenue to refuse to register the charity or to revoke its registration.

Consultations on non-profit organizations (NPOs) – the budget announces the Government's intention to review whether the tax exemption for NPOs remains properly targeted and whether sufficient transparency and accountability provisions are in place. This review will not extend to registered charities or registered Canadian amateur athletic associations.

Tobacco tax

The budget increases the excise duty on tobacco effective after midnight February 11, 2014. The rates will increase as follows:

- on cigarettes, from $17.00 to $21.03 per carton of 200 cigarettes;
- on tobacco sticks, from $17.00 to $21.03 per carton of 200 tobacco sticks; and
- on fine-cut tobacco, from $21.25 to $26.29 per 200 grams of tobacco.

For cigars, there will be an increase in the excise duty from $18.50 to $22.89 per 1,000 cigars, and an increase in the additional duty per cigar to the greater of 8.226 cents per cigar and 82% of the sale price or duty-paid value.

The budget also proposes to increase the excise duty on "duty-free" tobacco products including those brought into Canada by returning travelers. The rates will increase as follows:

- on cigarettes, from $15.00 to $21.03 per carton of 200 cigarettes;
- on tobacco sticks, from $15.00 to $21.03 per carton of 200 tobacco sticks; and
- on fine-cut tobacco, from $18.74 to $26.29 per 200 grams of tobacco.

The excise duty rates will be indexed to the consumer price index and will automatically be adjusted every five years. The first inflationary adjustment will be effective December 1, 2019.

To ensure consistent application of the rate increase, it is proposed that inventories held on budget day be subject to a per cigarette tax of 2.015 cents. In order to simplify compliance, this inventory tax will not apply to taxpayers holding less than 150 cartons of cigarettes or to cigarettes held in vending machines. Taxpayers have until April 30, 2014 to file returns and pay the tax. An inventory tax will apply at the time of each inflationary adjustment noted above.

Sales and excise tax measures

The budget proposes several measures dealing with GST and HST, including:

- improving the application of the GST/HST to the health care sector specifically with respect to an exemption for designing training for individuals with a disorder or disability, an exemption for services provided by acupuncturists and naturopathic doctors, and zero-rating of eyewear specially designed to electronically enhance the vision of individuals with vision impairment;
- changes to the GST/HST group relief election for closely-related persons to subject the group members to joint and several liability with respect to any GST/HST liability that may arise in relation to supplies made between them on or after January 1, 2015;
- new measures for joint ventures to simplify the application of GST/HST under the joint venture election; and
- new measures that allow CRA to assign a GST/HST number to a person who fails to comply with a requirement to register.

WE CAN HELP

Your Assante advisor can help you assess the impact of these proposals on your personal finances or business affairs, and show you ways to take advantage of their benefits or ease their impact. The resources available to you and your advisor include United Financial's Wealth Planning Group, a multi-disciplinary team of accountants, lawyers and financial planners.

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