MONTHLY NEWSLETTER

Summary of the 2015 Federal Budget

JACOB MILOSEK, CPA, CA
JENNIFER DAWE, CPA, CA

JUNE 2015

Our goal is to provide updates on topical tax issues. Information contained in the newsletters is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients. We would be pleased to discuss any questions that you, the reader, might have in greater detail.

On 21 April 2015, federal Finance Minister Joe Oliver tabled his first budget. Although there were no major income tax changes, a number of small amendments were made which will benefit individuals and small business owners. The remainder of this newsletter summarizes what we believe are the most important changes for our clients going forward.

PERSONAL INCOME TAX CHANGES

1) Tax-Free Savings Accounts:

   As recently speculated in the media, the Tax-Free Savings Account (TFSA) annual contribution limit will increase from $5,500 to $10,000 per taxpayer for 2015 and subsequent calendar years, and will no longer be indexed to inflation. For couples, this allows for up to $20,000 to be invested each year and sheltered from income tax. For most Canadian families, this represents all or a significant portion of their annual savings.

2) Lifetime Capital Gains Exemption:

   An increase to $1 million was proposed to the capital gains exemption (CGE) for dispositions of farm property or fishing property after April 20, 2015. The 2015 CGE for capital gains realized on the disposition of qualified small business corporation shares is $813,600, which is indexed for inflation. These exemptions offer significant tax savings where all of the required conditions are met.

3) Donation of Private Corporation Shares and Real Estate:

   Prior to the 2015 budget, only the donation of public securities provided for a capital gains exemption. The taxpayer making the donation receives the benefit of a donation tax credit based on the fair market value of the securities donated but are not required to report any accrued gains on the securities. The rules did not previously exist for the donation of private corporation shares or real estate as the fair market value of such assets is not easily determinable. The budget has introduced an exemption in respect of arm's-length dispositions of private corporation shares or real estate, where cash proceeds from

the disposition are donated within 30 days of the sale of such assets. The requirement of an arm's-length sale resolves the valuation issue that previously existed. These new rules are applicable to donations made in respect of dispositions occurring after 2016.

4) Registered Retirement Income Funds:

At age 71, individuals are required to convert their Registered Retirement Savings Plans (RRSPs) into Registered Retirement Income Funds (RRIFs). Each year, taxpayers are required to make a minimum withdrawal from their RRIF, which is included in their taxable income for that taxation year. Effective for 2015 and subsequent taxation years, the factors used to calculate the annual minimum amount required to be withdrawn from a RRIF will be reduced. The new minimum withdrawal factors will be based on a 5% nominal rate of return and a 2% indexing factor (for inflation). The reduced factors will permit individuals to keep more money in their RRIF for a longer period of time. This is a welcome change for many seniors given the general trend of longer life expectancies and the need to retain funds for the future.

As a transitional measure, individuals who at any time in 2015 withdraw more than the reduced 2015 minimum amount will be permitted to recontribute the excess (up to the amount of the proposed reduction in the minimum amount for 2015) to their RRIF. The excess must be recontributed by 29 February 2016, and will be deductible for the 2015 taxation year.

CORPORATE INCOME TAX CHANGES

1) Small-Business Tax Rate:

The small-business deduction currently reduces the federal income tax rate from 15% to 11% on the first $500,000 per year of qualifying active business income of a Canadian-controlled private corporation. The 11% rate will be reduced by 0.5% per year for the next four years, commencing January 1, 2016. By January 1, 2019, the effective federal rate will be 9%. No changes are proposed to the general corporate income tax rate.

In conjunction with this reduction in the small-business tax rate, the personal gross-up factor and dividend tax credit (DTC) for non-eligible dividends will be adjusted to result in a phased-in increase in personal tax on all non-eligible dividends paid out over the next four years. The result will be an increase to the effective personal income tax rates on non-eligible dividends to account for the lower small-business tax rate described above. These changes increase the incentive to defer personal tax by retaining funds within a corporation for use in business operations or for investment purposes.

2) Accelerated Capital Cost Allowance:

The temporary Class 29 pool for manufacturing and processing machinery and equipment (with a 50% straight-line capital cost allowance (CCA) rate) that is applicable for acquisitions prior to 2016 has been replaced with a new CCA Class 53 (with a 50% declining-balance CCA rate) for eligible assets acquired after 2015 and before 2026. The half-year rule will apply to the taxation year when the asset is first available for use.

3) Consultation on Eligible Capital Property:

   The government is still considering submissions from various stakeholders on its announcement in 2014 to repeal the eligible capital property regime and replace it with a new capital cost allowance class. The 2015 budget indicated that it was the intention of the government to release detailed draft legislative proposals for stakeholder comment before introducing a bill. We anticipate these proposals to be released later this year.

<u>OTHER INCOME TAX CHANGES</u>

1) Penalties for Repeated Failure to Report Income:

   Taxpayers that fail to report all of their income on their income tax return are subject to penalties. Previously, taxpayers could be subject to a failure to report income penalty of 10% federally and 10% provincially of unreported income for a taxation year if they fail to report an amount of income in a taxation year, as well as in any of the three preceding taxation years. There is no minimum threshold on the magnitude of the unreported income in previous years, so a very small account can subject taxpayers to these punitive rules.

   In addition, a gross negligence penalty may apply if the taxpayer knew, or under circumstances amounting to gross negligence, ought to have known that an amount of income should have been reported. This penalty is generally equal to 50% of the understatement of tax payable (or overstatement of tax credits) related to the omission.

   In many cases, and particularly for lower-income individuals, the penalty for repeated failure to report income is disproportionate to the actual associated tax liability, and in some cases exceeds the gross negligence penalty.

   The failure to report income penalty will now apply only if in a taxation year the taxpayer fails to report at least $500 of income in the year and any of the three preceding years. Further, the amount of the penalty will be the lesser of:

   i. 10% of the amount of unreported income
   ii. An amount equal to 50% of the difference between the understatement of tax related to the omission and the amount of any tax paid in respect of the unreported amount (tax withheld at source by an employer for example)

   The new provisions are much fairer for taxpayers as they introduce a minimum threshold of unreported income and provide a cap to the amount of the penalty based on the actual resultant income tax results from the unreported income. No changes are proposed to the gross negligence penalty.

2) Reporting Requirements for Foreign Investment Assets:

   A Canadian-resident individual, corporation or trust that, at any time in a taxation year, owns 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 (CRA). Specified foreign property generally includes funds and investments held outside

Canada, but excludes property used exclusively in carrying on an active business, property that is for personal use and property held in registered plans.

The CRA introduced a revised Form T1135 in 2013, which requires more detailed information on each specified property. This new level of reporting has resulted in a significant compliance burden for some taxpayers.

To reduce the compliance burden, Form T1135 will be simplified in 2015. Under a revised form being developed, 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 the assets under a new simplified reporting system. The current 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.

CONCLUSION

The changes outlined above are all favourable for taxpayers as they offer tax savings, remedy inequities that previously existed in tax legislation (including certain penalty provisions), and simplify certain reporting requirements. Should you have any questions or concerns about how these changes may impact you, please do not hesitate to contact us.