Canadian Federal **2015-16 Budget**

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The Federal Post-Recession Recovery

- **Black ink!** After narrowing a record $55.6 billion shortfall in fiscal 2009-10 (FY10) to an estimated $2.0 billion gap (-0.1% of GDP) for fiscal 2014-15 (FY15), surpluses are projected for the next half decade, rising from a forecast $1.4 billion and $1.7 billion in FY16 and FY17, respectively, to almost $5 billion by FY20 (+0.2% of GDP).

- **Importantly,** the projected surpluses accelerate the downward trend in Ottawa's accumulated deficit relative to GDP that began in FY14. As targeted by Ottawa, the accumulated deficit, after averaging just over 33% of GDP from FY10 to FY13, is expected to fall below 28% of GDP by March 28, less than the March 2009 pre-recession low of 28.2%. By March 2020, the accumulated deficit is expected to fall to 25.5% of GDP, well ahead of the government's goal of 25% by March 2022.

- **The federal government's deficit reduction** is integral in the IMF estimates that Canada's net debt across all levels of government is the lowest among the G7 relative to GDP and will turn lower in 2016. The IMF expects Canada's gross debt relative to GDP to drop from its 87.9% peak in 2012 to 85% by 2016.

- **As promised,** the federal deficit elimination was accomplished without tax rate hikes or slowing the scheduled growth in major transfers to individuals and other levels of government. Unwinding the stimulus package kick-started a drop in direct program expenditure totalling almost $7 billion from FY11 to FY14, representing an average annual 4½% decrease on a real per capita basis.

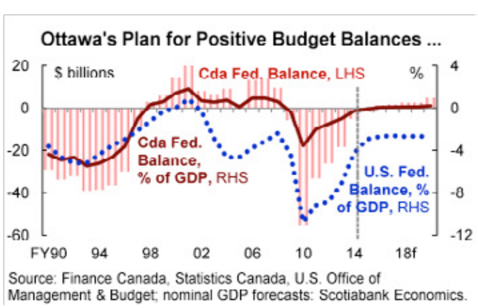
- **Balancing the books in FY16** relies upon major savings on the debt service, positive net revenues in the Employment Insurance program and asset sales. After FY16, maintaining surpluses is assisted by nominal GDP growth surpassing 4% each year but, with the ongoing need for careful fiscal management, a number of new initiatives are delayed or phased in.

- **This *Budget* completes many of the government's outstanding commitments,** and steps forward on several emerging priorities, when affordable, such as transit. The hefty family and small business tax relief package averaging $5 billion annually as of FY16 remains the centrepiece of the government's post-deficit initiatives.

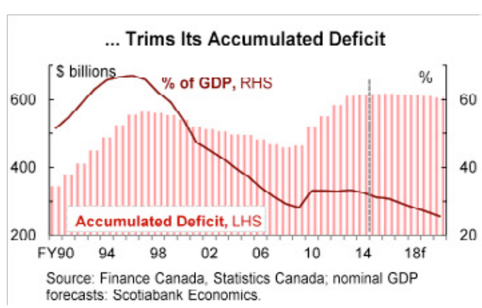
- **Financial requirements for FY16** are expected to be just $14 billion. Recognizing the government's moderate financing requirements over the next half decade, the 3-year budget auction is eliminated, as announced on March 30 (see *Fiscal Pulse: Canada's Federal Debt Management Strategy, Fiscal 2015-16*).

- **The FY16 balanced budget forecast** was well known in the market, minimizing the Budget's immediate impact. Achieving the forecast surpluses over the next few years will be broadly supportive, recognizing the benefits in competitiveness and flexibility that they offer to Canada's small open economy.

The Fiscal Pulse Federal Budget and Debt Management reports are at: http://www.scotiabank.com/ca/en/0,,3112,00.html



Source: Finance Canada, Statistics Canada, U.S. Office of Management & Budget; nominal GDP forecasts: Scotiabank Economics.



Source: Finance Canada, Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

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BUDGET 2015

It's All About Balance

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The federal government today tabled its Economic Action Plan 2015 – a balanced budget for the first time since fiscal 2008. The government promised to balance the budget, and Budget 2015 announces that the deficit has been reduced from $55.6 billion at the height of the global and economic financial crisis to a projected surplus of $1.4 billion for 2015-16.

From Thirty Thousand Feet

Given that Budget 2015 is a pre-election budget, it's not surprising that it was generally a good-news budget for Canadians. Finance Minister Joe Oliver presented a budget that focuses on four key priorities:

1. Balancing the budget: The projected surplus in 2015-16 is $1.4 billion, and is expected to rise to $1.7 billion in 2016-17, $2.6 billion in each of 2017-18 and 2018-19, and $4.8 billion in 2019-20.
2. Supporting jobs and growth: The government is taking steps to promote job-creation, making new investments in infrastructure, and training a highly skilled workforce that responds to the needs of employers.
3. Helping families and communities prosper: Budget 2015 provides tax relief to families, seniors, and individuals. More on those tax measures in a moment.
4. Ensuring the security of Canadians: Measures are being taken to further support the Canadian Armed Forces and protect Canadians from the threat of terrorism at home and abroad.

While the tax measures in Budget 2015 are largely welcome and good for taxpayers, some of the measures will not come into effect until 2016 or later years – not surprising, perhaps, given the pending election this fall. There were also no changes or clarifications announced to the estate and trust rules that many had hoped for.

As for Canada's debt: Our federal debt currently stands at $616 billion, with a debt-to-GDP ratio of 31.2 per cent. Our government has announced its commitment to bring the debt-to-GDP ratio down to 25.0 per cent by 2021. It is expected that our total federal debt will be reduced slightly over the next few years to $605.2 billion by 2020.

Personal Tax Measures

The following are the key personal tax measures proposed in Budget 2015:

Tax-Free Savings Account (TFSA)

The TFSA was originally introduced in 2009 with an annual contribution limit of $5,000 per individual. On January 1, 2013, the TFSA account was indexed to inflation and the annual contribution limit was increased to $5,500. Budget 2015 proposes to increase the annual contribution limit to $10,000 and will be applicable to 2015 and subsequent years. The TFSA annual contribution limit will no longer be indexed to inflation going forward.

Home Accessibility Tax Credit

Budget 2015 proposes to introduce a new Home Accessibility Tax Credit. The proposed non-refundable credit will provide tax relief of 15 per cent on up to $10,000 of eligible expenditures per calendar year, per qualifying individual and up to a maximum of $10,000 per eligible dwelling.

Qualifying Individuals
Seniors who are 65 years of age or older and persons with disabilities who are eligible for the disability tax credit will be considered qualifying individuals for the purposes of claiming the Home Accessibility Tax Credit. Those who are related to, and are caregivers for, qualifying individuals may be able to claim the new tax credit. These related persons are called "eligible individuals" and include those who have claimed the spouse or common law partner amount, eligible dependant amount, caregiver amount or infirm dependant amount for the qualifying individual in the taxation year.

Eligible Expenditures
Expenditures are eligible for the Home Accessibility Tax Credit provided that they are incurred in relation to a renovation to:

1. Allow a qualifying individual to gain access or to be more mobile/functional within the dwelling; or
2. Reduce the risk of harm to the qualifying individual within the dwelling or in gaining access to the dwelling.

The improvements must be of an enduring nature and be integral to the eligible dwelling. Examples of eligible expenditures include expenditures relating to wheelchair ramps, walk-in bathtubs, wheel-in showers and grab bars. Eligible expenditures will include the cost of labour and professional services, building materials, fixtures, equipment rentals and permits.

The following are examples of other expenditures that will not be eligible for the Home Accessibility Tax Credit:

- expenditures made with the primary intent of improving or maintaining the value of a dwelling;
- the cost of annual routine repairs and maintenance;
- expenditures for household appliances and devices, such as electronics;
- payments for services such as outdoor maintenance and gardening,
- housekeeping or security; and
- costs of financing a renovation (e.g., mortgage interest costs).

The Home Accessibility Tax Credit will not be reduced by any other tax credits or grants. For example, in the case of an individual who claims an eligible expenditure that also qualifies for the Medical Expense Tax Credit, the individual will be permitted to claim both tax credits for the same expenditure.

Minimum Withdrawal Factors for Registered Retirement Income Funds (RRIFs)

A Registered Retirement Savings Plan (RRSP) must be converted to a Registered Retirement Income Fund (RRIF) by the end of the year in which the RRSP holder attains the age of 71. Contributions to a RRIF are not permitted and a minimum amount must be withdrawn annually beginning the year after it is established (i.e. no later than the year in which the RRIF holder attains 72 years of age) The required minimum withdrawal amounts are determined based on minimum withdrawal factors. Budget 2015 proposes to adjust the RRIF minimum withdrawal factors as follows:

Existing and New RRIF Factors

Age (at start of year)	Existing Factor %	New Factor %
71	7.38	5.28
72	7.48	5.40
73	7.59	5.53
74	7.71	5.67
75	7.85	5.82
76	7.99	5.98
77	8.15	6.17
78	8.33	6.36
79	8.53	6.58
80	8.75	6.82
81	8.99	7.08
82	9.27	7.38
83	9.58	7.71
84	9.93	8.08
85	10.33	8.51
86	10.79	8.99
87	11.33	9.55
88	11.96	10.21
89	12.71	10.99
90	13.62	11.92
91	14.73	13.06
92	16.12	14.49
93	17.92	16.34
94	20.00	18.79
95 & Over	20.00	20.00

The new RRIF factors will permit holders to preserve more of their savings in order to provide income during retirement while continuing to ensure that tax deferral is provided on their RRIF. The new RRIF factors will apply for the 2015 and subsequent taxation years. To provide flexibility, RRIF holders who at any time in 2015 withdraw more than the reduced 2015 minimum amount will be permitted to re-contribute the excess (up to the amount of the reduction in the minimum withdrawal amount provided by this measure) to their RRIFs. Re-contributions will be permitted until February 29, 2016 and will be deductible for the 2015 taxation year.

Lifetime Capital Gains Exemption for Qualified Farm or Fishing Property

Budget 2015 proposes to increase the Lifetime Capital Gains Exemption to apply to up to $1 million of capital gains realized by an individual on the disposition of qualified farm or fishing property. This measure will apply to dispositions of qualified farm or fishing property that occur on or after Budget Day.

Registered Disability Savings Plan – Legal Representation

Budget 2012 introduced a temporary measure to allow a qualifying family member (i.e. a beneficiary's parent, spouse or common-law partner) to become the plan holder of a Registered Disability Savings Plan (RDSP) for an adult individual who may lack the capacity to enter into a contract. Budget 2012 indicated that this measure would apply until the end of 2016. Budget 2015 proposes to extend the temporary measure introduced in Budget 2012 to apply to the end of 2018.

Repeated Failure to Report Income Penalty

Budget 2015 proposes to amend the repeated failure to report income penalty to apply in a taxation year only if a taxpayer fails to report at least $500 of income in the year and in any of the three preceding taxation years.

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The amount of the penalty will equal the lesser of:

1. 10 per cent of the amount of unreported income; and

2. an amount equal to 50 per cent of the difference between the understatement of tax (or the overstatement of tax credits) related to the omission and the amount of any tax paid in respect of the unreported amount

This measure will apply to the 2015 and subsequent taxation years.

Transfer of Education Credits – Effect on the Family Tax Cut

Budget 2015 proposes to revise the calculation of the Family Tax Cut for the 2014 and subsequent taxation years to ensure that couples claiming the Family Tax Cut and transferring education-related credits between themselves receive the appropriate value of the Family Tax Cut. After the enacting legislation receives Royal Assent, the Canada Revenue Agency will automatically reassess affected taxpayers for the 2014 taxation year to ensure that they receive any additional benefits to which they are entitled under the Family Tax Cut.

Business Tax Measures

Small Business Rate

The small business deduction currently reduces to 11 per cent the federal corporate income tax rate applying to the first $500,000 per year of qualifying active business income of a Canadian-controlled private corporation (CCPC). To further reduce taxes paid by small businesses, Budget 2015 proposes a two percentage-point decrease in the 11-per-cent small business tax rate. The reduction will be implemented as follows:

- effective January 1, 2016, the rate will be reduced to 10.5 per cent;

- effective January 1, 2017, the rate will be reduced to 10 per cent;

- effective January 1, 2018, the rate will be reduced to 9.5 per cent; and

- effective January 1, 2019, the rate will be reduced to 9 per cent.

The reduction in the small business rate will be pro-rated for corporations with taxation years that do not coincide with the calendar year. In conjunction with the proposed reduction in the small business tax rate, Budget 2015 also proposes to adjust the gross-up factor and DTC rate applicable to non-eligible dividends to ensure that tax integration properly applies.

Manufacturing and Processing Machinery and Equipment: Accelerated Capital Cost Allowance

Budget 2015 proposes to provide an accelerated CCA rate of 50 per cent on a declining-balance basis for machinery and equipment acquired by a taxpayer after 2015 and before 2026 primarily for use in Canada for the manufacturing and processing of goods for sale or lease. Eligible assets are those that would currently be included in Class 29. These assets will be included in new CCA Class 53.

Quarterly Remitter Category for New Employers

Employers are required to remit source deductions to the Government in respect of employees' income tax, as well as the employer and employee portions of Canada Pension Plan contributions and Employment Insurance premiums. New employers must currently remit on a monthly basis for at least one year, after which time they may be eligible to apply for quarterly remitting if they have an average monthly withholding amount of less than $3,000 and have demonstrated a perfect compliance record over the preceding 12 months. To reduce the tax compliance burden, Budget 2015 proposes to decrease the required frequency of remittances for the smallest new employers by allowing eligible employers to immediately remit on a quarterly basis.

Synthetic Equity Arrangements

Our tax law generally allows a corporation to claim a deduction for taxable dividends received, so that inter-corporate dividends are generally not taxed. Certain corporations that own Canadian shares have taken advantage of these rules to gain an unintended tax break. Specifically, some corporations have eliminated the risks (and rewards) of owning shares by entering into derivative contracts with financial institutions. These corporations would receive the dividends on the shares, claim a deduction under our tax law for the dividends, then pay the dividends to the financial institution and claim an additional tax deduction for the payment to the institution. Budget 2015 modifies the rules to disallow the deduction for taxable dividends received when these "synthetic equity arrangements" exist.

Tax Avoidance of Corporate Capital Gains (Section 55)

The Income Tax Act contains an anti-avoidance rule that generally taxes as capital gains certain otherwise tax-free inter-corporate dividends. This rule typically applies where a dividend is paid by a subsidiary, tax-free, up to a parent company, thereby reducing the assets of the subsidiary corporation. This will reduce the value of the subsidiary corporation, so that when the parent company disposes of the shares of the subsidiary, any capital gain on the disposition is reduced.

As a result of a recent court decision, Budget 2015 proposes an amendment to ensure that the anti-avoidance rule applies where one of the purposes of a dividend is to effect a significant reduction in the fair market value of any share or a significant increase in the total cost of properties of the recipient of the dividend. Related rules are also proposed to ensure this amendment is not circumvented.

Budget 2015 also proposes an amendment to ensure that any dividend to which the anti-avoidance rule applies is to be treated as a gain from the disposition of capital property. This measure will apply to dividends received by a corporation on or after Budget Day.

Charitable Measures

Donations Involving Private Corporation Shares or Real Estate

Donations to registered Canadian charities and other qualified donees are eligible for a charitable donation tax credit (if the donor is an individual) or deduction (if the donor is a corporation). In addition, donations of publicly listed securities to qualified donees are exempt from capital gains tax. Donations of ecologically sensitive land and certified cultural property to certain qualified donees are also exempt from capital gains tax. In contrast, taxable capital gains can arise on donations of private corporation shares or other types of real estate.

To increase support for charities, Budget 2015 proposes to provide an exemption from capital gains tax in respect of certain dispositions of private corporation shares and real estate. The exemption will be available where:

1. cash proceeds from the disposition of the private corporation shares or real estate are donated to a qualified donee within 30 days after the disposition; and

2. the private corporation shares or real estate are sold to a purchaser that is dealing at arm's length with both the donor and the qualified donee to which cash proceeds are donated.

This measure will apply to donations made in respect of dispositions occurring after 2016.

Gifts to Foreign Charitable Foundations

Canadian registered charities are "qualified donees" under the Income Tax Act and donations made to them by Canadian taxpayers are eligible for the charitable donation tax credit or deduction. In addition, Canadian registered charities are permitted to make gifts to other qualified donees. Budget 2015 proposes to amend the Income Tax Act to allow foreign charitable foundations to be registered as qualified donees if they receive a gift from the Canadian

Government and if they are pursuing activities related to disaster relief or urgent humanitarian aid or are carrying on activities in the national interest of Canada. The Minister of National Revenue may, in consultation with the Minister of Finance, grant qualified donee status to a foreign charitable foundation that meets these conditions.

International Tax Measures

Withholding for Non-Resident Employers

Canada generally taxes the employment income of non-residents that is earned in Canada. However, a resident of a country that has a tax treaty with Canada is generally exempt from Canadian tax on employment income from a non-resident employer if certain conditions are met. An employer (including a non-resident employer) is generally required to withhold amounts on account of the income tax liability of an employee working in Canada, even if the employee is a non-resident who is expected to be exempt from Canadian tax because of a tax treaty. Budget 2015 proposes to provide an exception to the withholding requirements for payments by qualifying non-resident employers to qualifying non-resident employees.

Streamlining Reporting Requirements for Foreign Assets

The Canada Revenue Agency introduced a revised Form T1135 in 2013. The revised form requires taxpayers to provide very detailed information regarding each specified foreign property when the aggregate cost of the foreign property is over $100,000. Stakeholders have commented that this approach has resulted in a compliance burden for some taxpayers that may be disproportionate to the amount of their foreign investments.

To reduce the compliance burden on taxpayers Budget 2015 proposes to simplify the foreign asset reporting system for taxation years beginning after 2014. Under the revised form (currently being developed by the Canada Revenue Agency), if the total cost of a taxpayer's specified foreign property is less than $250,000 throughout the year (but more than $100,000 at any point in the year), the taxpayer will be able to report these assets under a new simplified foreign asset reporting system.

Update on the Automatic Exchange of Information for Tax Purposes

In November 2014, Canada and the other G-20 countries endorsed a new common reporting standard for automatic information exchange and committed to a first exchange of information by 2017 or 2018. Canada proposes to implement the common reporting standard starting on July 1, 2017, allowing a first exchange of information in 2018. As of the implementation date, financial institutions will be expected to have procedures in place to identify accounts held by residents of any country other than Canada and to report the required information to the Canada Revenue Agency.

Other Changes

- Enhancing access to post-secondary education by expanding the eligibility for Low- and Middle-Income Canada Student Grants to students in short-duration programs.
- Making the Canada Student Loans Program work for families by reducing the expected parental contribution under the needs assessment process.
- Extending Employment Insurance Compassionate Care Benefits from six weeks to six months to better support Canadians caring for gravely ill and dying family members.
- Reducing Employment Insurance premiums from $1.88 in 2016 to $1.49 in 2017, a reduction of 21 per cent; average savings for a $50,000 earner will be approximately $200 annually.
- Measures to make the new Family Caregiver Relief Benefit and Critical Injury Benefit, announced on March 17, 2015 and March 30, 2015, non-taxable to Veterans.