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TaxNewsFlash Canada

2016 Federal Budget Highlights

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Finance Minister Bill Morneau delivered the government's 2016 federal budget today. The budget expects a deficit of $5.4 billion for fiscal 2015-2016 and forecasts a deficit of $29.4 billion for 2016-2017.

The major tax changes contained in the budget include the elimination of certain tax credits such as income splitting for couples with children, the Child Fitness Tax Credit, the Children's Art Credit and the Education Tax Credit and Textbook Tax Credit. As expected, a new Canada Child Benefit was introduced. There were no changes introduced to the capital gains inclusion rate or the stock options deduction.

The budget keeps the small business tax rate at 10.5% on the first $500,000 of business income. Furthermore, the budget precludes the multiplication of the small business deduction in certain partnership and corporate structures. As well, the budget repeals the eligible capital property regime, which will be replaced with a new capital cost allowance class. The use of life insurance policies to distribute amounts tax free to shareholders has also been tightened up.

The budget proposes new rules to limit cross-border paid-up capital (PUC) increases, extends the "back-to-back" loans rules, and proposes to implement country-by-country reporting. The budget has confirmed the new government's commitment to address treaty abuse and the BEPS minimum standard for the spontaneous exchange of certain tax rulings. Certain relieving changes were introduced to the *de minimus* financial institution rules for indirect tax purposes.

The budget announced $11.4 billion over five years to modernize public transit infrastructure, invest in green infrastructure and social infrastructure including affordable housing. The budget also notes that the government will invest $2 billion in a low carbon economy fund.

The tax highlights of the budget are as follows.

Personal Tax Changes

Income splitting credit

The budget proposes to eliminate the income splitting tax credit for couples with children under the age of 18 for the 2016 and subsequent taxation years. Pension income splitting will not be affected by this change.

This credit allows an eligible higher-income spouse or common-law partner to notionally transfer up to $50,000 of taxable income to their spouse or common-law partner to reduce the couple’s total income tax liability by up to $2,000.

Children’s Fitness and Arts Tax Credits

The budget proposes to phase out the Children’s Fitness and Arts Tax Credits by 2017. The Children’s Fitness Tax Credit provides a 15% refundable tax credit on up to $1,000 of eligible fitness expenses for children under 16 years of age at the beginning of the taxation year. The Children’s Arts Tax Credit provides a 15% non-refundable tax credit on up to $500 in eligible fees for programs of artistic, cultural, recreational and developmental activity for children under 16 years of age. For children eligible for the Disability Tax Credit, both credits are extended to children under 18 years of age and provide an additional $500 credit amount.

For 2016, the budget reduces the 2016 maximum eligible amounts to $500 (from $1,000) for the Children’s Fitness Tax Credit (which will remain refundable for 2016) and to $250 (from $500) for the Children’s Arts Tax Credit. The supplemental amounts for children eligible for the Disability Tax Credit will remain at $500 for 2016. Both credits will be eliminated for the 2017 and subsequent taxation years.

Education and Textbook Tax Credits

The budget eliminates the Education and Textbook Tax Credits, effective January 1, 2017. Individuals will still be able to claim tax credit amounts carried forward from years before 2017 in 2017 and subsequent years. This measure does not eliminate the tuition tax credit.

The budget notes that Finance will make changes to ensure that other income tax provisions that currently rely on eligibility for the education tax credit or use terms defined for the purpose of the education tax credit will be unaffected by this change (e.g., the tax exemption for scholarship, fellowship and bursary income).

Labour-Sponsored Venture Capital Corporation Tax Credit

The budget proposes to increase the federal Labour-Sponsored Venture Capital Corporation (LSVCC) tax credit to 15% (from 10%) for share purchases of provincially registered LSVCCs prescribed under the *Income Tax Act* for the 2016 and subsequent taxation years. An LSVCC is a form of mutual fund corporation, sponsored by an eligible labour body. LSVCCs are mandated to provide venture capital to small and medium-sized businesses.

In addition, the budget proposes to allow newly registered LSVCCs under existing provincial legislation to be eligible for prescription if the provincial legislation is currently prescribed for purposes of the federal LSVCC tax credit. New provincial regimes will be eligible for prescription under the *Income Tax Act* (the Act), provided the enabling provincial legislation is patterned on currently prescribed provincial legislation. For example, to be eligible, a new provincial regime would need to:

- Provide a provincial tax credit of at least 15% of an individual's net cost of shares purchased in an LSVCC
- Require that the LSVCC be sponsored by an eligible labour body
- Mandate that the LSVCC invest and maintain a minimum of 60% of its shareholder equity in eligible investments (generally investments in small and medium-sized enterprises).

Teacher and Early Childhood Educator School Supply Tax Credit

The budget proposes a 15% Teacher and Early Childhood Educator School Supply Tax Credit, effective beginning in the 2016 tax year. The refundable income tax credit will apply on up to $1,000 of eligible supplies (e.g., paper, glue and paint for art projects, games, puzzles, supplementary books). This measure will apply to supplies acquired on or after January 1, 2016.

To qualify, teachers must hold a teacher's certificate that is valid in the province or territory in which they are employed. Likewise, early childhood educators must hold a certificate or diploma in early childhood education recognized by the province or territory in which they are employed. Expenditures will be eligible for the teacher and early childhood educator school supply tax credit if they were made to purchase eligible supplies for use in a school or in a regulated child care facility for the purpose of teaching or otherwise enhancing students' learning in the classroom or learning environment.

For the cost of supplies to qualify for the credit, employers must certify that the supplies were purchased for the purpose of teaching or otherwise enhancing learning in a classroom or learning environment. Individuals making claims will be required to retain their receipts.

This tax credit will not be available for an amount already claimed under any other provision of the Act.

Ontario electricity support

The budget proposes to exempt amounts received under the Ontario Electricity Support Program (OESP) from income. The OESP is a Government of Ontario program that, effective January 1, 2016, provides assistance to low-income households in Ontario for the cost of electricity.

Mineral Exploration Tax Credit

The budget extends the 15% Mineral Exploration Tax Credit to flow-through share agreements entered into on or before March 31, 2017 (from March 31, 2016). This credit is intended to help junior mineral exploration companies raise capital by providing an incentive to individual investors in flow-through shares issued to finance “grassroots” mineral exploration.

Donation of private company shares or real estate

The budget states that the government will not proceed with the 2015 federal budget measure that proposed to provide an exemption from capital gains tax for certain dispositions of private corporation shares or real estate where cash proceeds from the disposition were to be donated to a registered charity or other qualified donee within 30 days.

Top marginal income tax rate – Further consequential amendments

The budget proposes amendments to reflect the new top 33% federal personal tax rate, further to the amendments made on December 7, 2015.

KPMG observations
In December 2015, the federal government announced two tax rate changes for individuals: a reduction in the federal tax rate for income between $45,283 and $90,563 to 20.5% (from 22%) and an increase of 4% in the tax rate for income over $200,000 to 33% (from 29%), starting January 1, 2016. The government also announced that the contribution limit for Tax-Free Savings Accounts will be reduced to $5,500 per year (from $10,000 per year), starting in 2016.

Further consequential amendments will:

- Provide a 33% charitable donation tax credit for donations over $200 to trusts that are subject to the top tax rate on all of their taxable income. This measure will apply to donations made after the 2015 taxation year
- Apply the 33% rate on excess employee profit sharing plan contributions
- Increase to 33% (from 28%) the tax rate on personal services business income earned by corporations. For corporations with taxation years that straddle 2015 and 2016, the rate increase will be prorated for the number of days in the taxation year that are after 2015
- Amend the definition of "relevant tax factor" in the foreign affiliate rules to reduce the relevant tax factor to 1.9 (from 2.2)
- Amend the capital gains refund mechanism for mutual fund trusts to reflect the 33% top rate in the formulas that are used to compute refundable tax
- Increase the Part XII.2 tax rate on the distributed income of certain trusts to 40% (from 36%)
- Amend the recovery tax rule that applies to qualified disability trusts to refer to the 33% top rate
- Extend the 33% charitable donation tax credit (which applies to donations made after 2015) to donations made by a graduated rate estate during the taxation year of the estate that straddles 2015 and 2016.

These amendments generally apply to the 2016 and subsequent taxation years.

Taxation of switch fund shares

The budget notes that many mutual fund corporations are organized as "switch funds". The budget proposes amendments so that an exchange of shares of a mutual fund corporation (or investment corporation) that results in the investor switching between funds will be considered to be a disposition at fair market value for tax purposes. This is to ensure the appropriate recognition of capital gains. Currently, this type of exchange of convertible corporate securities is deemed not to be a disposition for income tax purposes.

The measure will not apply to switches where the shares received in exchange differ only in respect of management fees or expenses to be borne by investors and otherwise derive their value from the same portfolio or fund within the mutual fund corporation (e.g., the switch is between different series of shares within the same class).

This measure will apply to dispositions of shares that occur after September 2016.

Sale of linked notes

The budget proposes amendments so that the return on a linked note retains the same character whether it is earned at maturity or reflected in a secondary market sale. In particular, a deeming rule will apply in certain cases, to treat any gain realized on the sale of a linked note as interest that accrued on the debt obligation for a period commencing before the time of the sale and ending at that time. When a linked note is denominated in a foreign currency, foreign currency fluctuations will be ignored for the purposes of calculating this gain. An exception will also be provided where a portion of the return on a linked note is based on a fixed rate of interest. In this case, any portion of the gain that is reasonably attributable to market interest rate fluctuations will be excluded.

This measure will apply to sales of linked notes that occur after September 2016.

Canada Child Benefit

The budget introduces a new Canada Child Benefit that provides monthly payments to eligible families, beginning in July 2016. The credit, which replaces the Canada Child Tax Benefit and the Universal Child Care Benefit, provides a maximum annual benefit of up to $6,400 per child under the age of 6 and up to $5,400 per child for those aged 6 through 17. The budget provides that families with less than $30,000 in net income will receive the maximum benefit. Entitlement to the Canada Child Benefit for the July 2016 to June 2017 benefit year will be based on adjusted family net income for the 2015 taxation year. The Canada Child Tax Benefit and the Universal Child Care Benefit will be eliminated for months after June 2016.

On the portion of adjusted family net income between $30,000 and $65,000, the benefit will be phased out at a rate of 7% for a one-child family, 13.5% for a two-child family, 19% for a three-child family and 23% for larger families. Where adjusted family net income exceeds $65,000, remaining benefits will be phased out at rates of 3.2% for a one-child family, 5.7% for a two-child family, 8% for a three-child family and 9.5% for larger families, on the portion of income above $65,000.

Amounts received under the new Canada Child Benefit will not be taxable and will not reduce benefits paid under the goods and services tax credit. These amounts will also not be included in income for the purposes of federal income-tested programs delivered outside of the income tax system, such as the Guaranteed Income Supplement, the Canada education savings grant, the Canada learning bond, the Canada disability savings bond and the Canada disability savings grant.

To be eligible for the Canada Child Benefit, an individual must be a resident of Canada for tax purposes and must reside with the qualified dependant and be the parent who primarily fulfils the responsibility for the care and upbringing of the qualified dependant, or be a shared custody parent.

The budget proposes to continue to provide the Child Disability Benefit, which provides an additional amount of up to $2,730 per eligible child. The phase-out of this additional amount generally aligns with the Canada Child Benefit.

The budget also proposes to ensure that all individuals who are Indians under the *Indian Act* and residents of Canada for tax purposes are eligible to receive the Canada Child Benefit where all other eligibility requirements are met.

In addition, a taxpayer can request a retroactive payment of the Canada Child Benefit, Canada Child Tax Benefit or the Universal Child Care Benefit for a month on or before the day that is 10 years after the beginning of that month, effective for requests made after June 2016.

For children under the care of a child protection agency, the budget proposes to increase the children's special allowance to the same level as is proposed under the Canada Child Benefit, effective July 1, 2016. The current allowance is equivalent to the maximum benefit under the existing Canada Child Tax Benefit and Universal Child Care Benefit system.

Guaranteed Income Supplement

The budget proposes to:

- Increase the Guaranteed Income Supplement top-up benefit by up to $947 annually for the most vulnerable single seniors starting in July 2016
- Decrease the age of eligibility for Old Age Security and Guaranteed Income Supplement benefits to 65 (from 67) and Allowance benefits to 60 from 62 over the 2023 to 2029 period
- Ensure couples who receive Guaranteed Income Supplement and Allowance benefits and have to live apart for reasons beyond their control (such as a requirement for long-term care) receive higher benefits based on their individual incomes.

The budget notes that, in the coming months, the government will launch consultations to give Canadians an opportunity to share their views on enhancing the Canada Pension Plan.

Northern residents deduction

The budget proposes to increase the maximum residency deduction for individuals who live in prescribed areas in northern Canada for at least six consecutive months beginning or ending in a taxation year. Under this increase, each member of a household may claim $11 per day (from $8.25) and, where no other member of the household claims the residency deduction, the budget proposes to increase the maximum residency deduction to $22 per day (from $16.50) for the 2016 taxation year. Residents of the Intermediate Zone will be entitled to deduct half of these increased amounts.

Small Business Tax Changes

Small business deduction

The budget proposes that the small business deduction rate will remain at 10.5%. (The rate was to decrease to 9% in 2019.) The gross-up rate on non-eligible dividends will be maintained at 17% and the dividend tax credit rate will be 21/29 of the gross-up amount.

The budget proposes a number of changes to preclude the multiplication of the small business deduction.

In general, where a Canadian controlled private corporation (CCPC) is a member of a partnership the CCPC is entitled to its pro-rata share of the $500,000 small business deduction based on its share of active business income allocated to it. Structures have been implemented where an individual owns a partnership interest. A CCPC is incorporated to provide services or property under contract to the partnership. A small business deduction is claimed in respect of the income earned thus providing an opportunity to double up on the small business deduction.

The budget proposes to eliminate this opportunity by deeming the CCPC to be a member of the partnership and its income is deemed to be partnership active business income. The specified partnership income of a deemed member of a partnership is initially deemed to be nil, however, an actual member of a partnership who does not deal at arm's length with a deemed member of a partnership will be able to assign its actual specified partnership income to the deemed partner.

An exception is provided where all or substantially all the income earned by the CCPC is earned from providing services to arm's length persons other than the partnership.

The budget proposes a similar change where a CCPC provides services or property to a private corporation, where the CCPC, one of its shareholders, or a person who does not deal at arm's length with such a shareholder has a direct or indirect interest in the private corporation. In this situation, the income earned by the CCPC will be ineligible for the small business deduction. The private corporation may assign a portion of its small business deduction to the CCPC equal to the least of:

- The CCPC's income from providing the services or property to the private corporation,
- The unused business limit of the private corporation, and

- The amount determined by the Minister of National Revenue to be reasonable in the circumstances.

As with partnerships, an exception is provided where all or substantially all the income earned by the CCPC is earned from providing services to arm's length persons other than the private corporation.

These proposals are effective for taxation years beginning on or after March 22, 2016, except that a person who is entitled to assign their small business deduction, can make an assignment in respect of a taxation year that begins before and ends after March 22, 2016 to a person where its year begins before and ends after March 22, 2016.

Under subsection 256(2) of the Act, two corporations which would otherwise not be associated, are deemed to be associated if each of the corporations is associated with the same third corporation. There is an exception to subsection 256(2) where the third corporation is not a CCPC or where the third corporation elects not to be a CCPC. In this situation, the third corporation cannot claim the small business deduction, but the other two corporations may claim a $500,000 small business deduction subject to their own taxable capital limit. The election under subsection 256(2) does not affect the associated corporation status for other rules in the Act. For example, subsection 129(6) deems investment income to be active income eligible for the small business deduction if the income is derived from active income of an associated corporation. CCPCs are using the subsection 256(2) election to multiply the small business deduction.

The budget proposes to amend the Act such that income derived from an associated corporation's active business income will be ineligible for the small business deduction where the third corporation is not a CCPC or an election is filed. In addition, the third corporation will be considered to be associated with the other two corporations for the purposes of the $15 million taxable capital threshold. These proposals are effective for taxation years beginning on or after March 22, 2016.

Active vs. investment business rules

The 2015 budget announced a review of the circumstances in which income from a business, the principal purpose of which is to earn income from property should qualify as active business income and therefore be eligible for the small business deduction. No modifications are proposed to these rules at this time.

Eligible capital property

The budget proposes to repeal the eligible capital property (ECP) regime, and replace it with a new capital cost allowance (CCA) class. New rules will provide for a transfer of taxpayers' existing cumulative eligible capital (CEC) pools to the new CCA class. The budget states that this proposal is not intended to affect the application of the GST/HST in this area.

KPMG observations

As a consequence of these changes, the disposition of assets in class 14.1 will give rise to recapture and capital gains. This change will result in a significant increase in income tax paid by many CCPCs in many circumstances. Currently, one half the gain on eligible capital property is subject to income tax as active business income. A taxable capital gain is subject to refundable income tax, increasing the immediate federal income tax rate by approximately 12%.

Eligible capital expenditures (ECE) (e.g., cost of goodwill, customer lists and licences, franchise rights and farm quotas of indefinite duration) that are currently added to CEC (at a 75% inclusion rate) will be included in new Class 14.1 at a 100% inclusion rate. The new class will have a 5% annual depreciation rate (instead of 7% of 75% of ECE). Existing CCA rules will generally apply, including rules relating to recapture, capital gains and depreciation, and the half-year rule.

There will be a separate new Class 14.1 for each CEC pool of a taxpayer.

Expenditures and receipts not related to "property" — New rules in new subsections 13(34) to (36) provide special rules for expenditures and receipts of a business that do not relate to "property" and that would adjust the CEC of the business under the ECP rules. Such an expenditure or receipt is accounted for by adjusting the capital cost of the goodwill of the business. New subsection 13(34) of the Act provides that every business is considered to have goodwill property associated with it, even if there has not been an expenditure to acquire goodwill. New subsections 13(34) and (35) provide that an expenditure that does not relate to property increases the capital cost of the goodwill of a business and thus, the UCC of the new CCA class. New subsections 13(34) and (36) provide that a receipt that does not relate to property reduces the capital cost of goodwill of a business, and thus the UCC of the new CCA class, by the lesser of the capital cost of the goodwill (which could be nil) and the amount of the receipt. If the amount of the receipt exceeds the capital cost of the goodwill, the excess will be a capital gain. Previously deducted depreciation is recaptured to the extent that the reduction of the capital cost of the goodwill results in a negative UCC balance.

Transitional rules — CEC pool balances will be calculated and transferred to the new CCA class as of January 1, 2017. The opening balance of the new CCA class will be equal to the balance at that time of the existing CEC pool. For the first ten years, the depreciation rate for the new CCA class will be 7% for expenditures incurred before January 1, 2017.

The budget provides a series of rules to establish the capital cost of each property in class 14.1 for the purpose of calculating the capital gain on the disposition of the property.

The budget states some receipts received after the time at which the new rules are implemented could relate to property acquired, or expenditures otherwise made, before that time. As such, certain qualifying receipts will reduce the balance of the new CCA class at a 75% rate. Receipts that qualify for the reduced rate will generally be receipts from the disposition of property the cost of which was included in the taxpayer's CEC and receipts that do not represent the proceeds of disposition of property. The total amount of such receipts for which only 75% of the receipt will reduce the new CCA class, will generally equal the amount that could have been received under the ECP regime before triggering an ECP gain. This rule is intended to ensure that receipts do not result in excess recapture when applied to reduce the balance of the new CCA class.

Other special rules — The budget states that to simplify the transition of these new rules for small businesses, it proposes to allow small initial balances to be eliminated quickly.

In particular, a taxpayer will be allowed to deduct as CCA, expenditures incurred before 2017, the greater of $500 per year and the amount otherwise deductible for that year. This measure will be provided for taxation years that end prior to 2027.

Small CEC balances arising from incorporation expenses will be eligible for a separate business deduction. In particular, the first $3,000 of these expenditures will be treated as a current expense rather than being added to the new CCA class.

The budget document contains more than 30 pages of explanatory notes explaining the new regime and also provides examples of how the measures, including transitional measures, will work.

These measures apply as of January 1, 2017.

Life insurance proceeds

The budget notes that life insurance proceeds received as a result of the death of an individual insured under a life insurance policy are generally not subject to income tax. In particular, a corporation may add the amount of the policy benefit it receives to its capital dividend account (CDA) and then pay tax-free capital dividends to shareholders. In the case of a partnership, the adjusted cost base (ACB) of a partner's interest in a partnership is increased to the extent of the partner's share of a policy benefit received by the partnership. A partner can generally withdraw funds from a partnership tax-free to the extent of the partner's ACB.

The budget proposes amendments to ensure that the CDA rules for private corporations and the ACB rules for partnership interests apply as intended. In particular, the proposal will provide that the "insurance benefit limit" (i.e., the portion of the policy benefit received by the corporation or partnership that is in excess of the policyholder's ACB of the policy) applies regardless of whether the corporation or partnership that receives the policy benefit is a policyholder of the policy.

The budget notes that taxpayers have structured their affairs so that the "insurance benefit limit" may not apply as intended, resulting in an artificial increase in a corporation's CDA balance, or increase in the ACB of a partner's interest in a partnership. As such, the government is challenging a number of these structures and is also proposing this new budget measure.

This measure will apply to policy benefits received as a result of a death that occurs on or after March 22, 2016.

Transfer of life insurance policies

The budget also notes similar concerns with the transfer of life insurance policies. The budget proposes amendments to ensure that amounts are not inappropriately received tax-free by a policyholder as a result of a disposition of an interest in a life insurance policy.

This amendment will apply to dispositions that occur on or after March 22, 2016.

The budget will also amend the CDA rules and the ACB rules for partnership interests, where an interest in a life insurance policy was disposed of before March 22, 2016 for consideration in excess of the proceeds of the disposition determined under the "policy transfer rule" (defined in the budget as a special rule that deems the policyholder's proceeds of disposition, and the acquiring person's cost, of the interest in a life insurance policy to be the amount that the policyholder would be entitled to receive if the policy were surrendered). Also, where an interest in a life insurance policy was disposed of before March 22, 2016 under the "policy transfer rule" to a corporation or a partnership as a contribution of capital, any increase in the paid-up capital (PUC) of a class of shares of the corporation, and the ACB of the shares or of an interest in the partnership, that may otherwise have been permitted will be limited to the amount of the proceeds of the disposition.

This measure will apply to policies under which policy benefits are received as a result of deaths that occur on or after March 22, 2016.

International Tax Changes

Cross-border PUC increases

Because the PUC of shares of a Canadian corporation can be distributed as a return of capital to a non-resident shareholder without attracting withholding tax, PUC is a valuable Canadian tax attribute. Current rules in the Act operate to ensure that cross-border PUC is not increased through certain non-arm's length transactions. Where a non-resident person (NR) disposes of shares of a Canadian corporation (Canco1, the subject corporation) to another Canadian corporation (Canco2, the purchaser corporation) that does not deal at arm's length with NR, the current tax rules deem any non-share consideration received by NR in excess of the PUC of the shares of Canco1 to be a deemed dividend subject to withholding tax. The rules also limit the PUC of the shares of Canco2 received as consideration by NR to the PUC of the shares of Canco1 immediately before the disposition.

There is currently an exception to the application of these rules where the non-resident is controlled by the purchaser corporation immediately before the disposition.

The case of *Collins and Aikman*, which was won by the taxpayer, was heard at the level of the Federal Court of Appeal in 2010. It dealt specifically with the creation of cross-border PUC and the application of these rules.

The budget introduces amendments to these rules that will apply to such dispositions that occur on or after March 22, 2016.

First, if NR receives no consideration from Canco2 for the disposition of the shares of Canco1, NR is deemed to receive non-share consideration equal to the fair market value of the shares of Canco1 that is in excess of the increase in value, because of the disposition, in the shares of Canco2.

In addition, the exception to the application of the rules is significantly tightened. As well as requiring NR to be controlled by the purchaser corporation immediately before the disposition, there is an additional requirement that must also be met. At the time of the disposition, or as part of a series of transactions that includes the disposition, a non-resident person cannot own, directly or indirectly, shares of the purchaser corporation, and cannot deal at arm's length with the purchaser corporation.

Extension of back-to-back loan rules

The 2014 federal budget introduced back-to-back loan rules that applied for purposes of both the thin capitalization and withholding tax provisions. Essentially, where an intermediary is interposed between a Canadian borrower and certain related foreign lenders such that the thin capitalization rules would not otherwise have applied, the back-to-back loan provisions deem the loan to exist between the Canadian borrower and the foreign lender, thus making the thin capitalization rules applicable to the loan. As well, related withholding tax provisions require the rate of such tax to be equal to the rate that would otherwise have applied to interest paid to the related foreign lender (assuming it is greater) rather than to the intermediary.

The budget introduces an extension of these rules such that they will also apply to back-to-back arrangements involving royalty payments. The rules will apply to royalty payments made after 2016.

Where a Canadian taxpayer makes a royalty payment to a person resident in a treaty country (the intermediary) under the terms of a lease, license or similar agreement, and the intermediary has an obligation to pay an amount to another non-resident under the terms of a lease, license or similar agreement, and the payments are established in reference to each other or are interconnected in some way, the withholding tax rules currently in existence in respect of interest payments will also apply to the royalty payments. The rate of such tax will now equal the rate that would otherwise have applied to royalties paid to the non-resident (assuming it is greater) rather than to the intermediary.

Character substitution rules

The withholding tax provisions will also apply in cases where payments that are economically similar to interest and royalties are made as part of a back-to-back arrangement. Where there has been the substitution of an economically similar arrangement between the intermediary and the non-resident, the rules will also apply. These rules will also apply to payments made after 2016.

Back-to-back shareholder loan rules

Currently, the shareholder benefit rules generally apply where a Canadian corporation makes a loan to a shareholder or another related party, and the loan remains outstanding for more than a year after the end of the year in which it was made. If the loan is made to a non-resident, it is deemed to be a dividend subject to withholding tax.

Similar to the back-to-back loan rules outlined above, the budget introduces back-to-back rules that will apply where an intermediary is interposed between the Canadian corporation and the shareholder or other related party. The Canadian corporation will be deemed to have made the loan directly to the shareholder rather than to the intermediary, such that the shareholder benefit provisions will apply in respect of the loan. These rules will apply to such loan arrangements in place on March 22, 2016.

Debt parking to avoid foreign exchange

A taxpayer may realize a gain or a loss on the repayment of a debt denominated in a foreign currency as a result of the fluctuation of the foreign currency relative to the Canadian dollar. A specific rule for computing foreign exchange capital gains and losses on a debt deems a gain made or loss sustained on a foreign currency debt that is on capital account to be a capital gain or loss from the disposition of the foreign currency. For purposes of this rule, a gain or loss is generally considered to have been made or sustained only when it is realized, such as when the debt is settled or extinguished.

Debt parking transactions — To avoid realizing a foreign exchange gain on the repayment of a foreign currency debt, some taxpayers have entered into debt-parking transactions. In a typical debt-parking transaction, instead of directly repaying a debt with an accrued foreign exchange gain, the debtor would arrange for a person with which it does not deal at arm’s length to acquire the debt from the initial creditor for a purchase price equal to its principal amount. The debt would effectively be repaid from the initial creditor’s perspective. From the debtor’s perspective, the transfer of the debt by the initial creditor to the non-arm's length person would generally avoid settling or extinguishing the debt. The non-arm's length person, as the new creditor, would then let the debt remain outstanding to avoid the debtor realizing a foreign exchange gain.

The debt-parking rules were introduced to address the use of this technique to avoid the application of the debt forgiveness rules. Where the debt-parking rules apply to a debt, it is deemed to have been repaid for an amount equal to its cost to the new creditor. Any difference between this amount and the principal amount of the debt is treated as a forgiven amount, which is first applied to reduce the tax attributes of the debtor; one-half of any residual amount is then generally included in the debtor's income.

While the debt-parking rules would deem the foreign currency debt to have been settled at the time of the acquisition by the new creditor, any foreign exchange gain realized on the debt would not be taken into account in determining the forgiven amount of the debtor. As a result, the foreign exchange gain would neither reduce the tax attributes, nor be included in the income, of the debtor.

Budget 2016 proposes to introduce rules so that any accrued foreign exchange gains on a foreign currency debt will be realized when the debt becomes a parked obligation. The debtor will be deemed to have made the gain, if any, that it otherwise would have made if it had paid an amount (expressed in the currency in which the debt is denominated) in satisfaction of the principal amount of the debt equal to:

- Where the debt becomes a parked obligation as a result of its acquisition by the current holder, the amount for which the debt was acquired; and
- In other cases, the fair market value of the debt.

For this purpose, a foreign currency debt will become a parked obligation at any particular time where:

- At that time, the current holder of the debt does not deal at arm's length with the debtor or, where the debtor is a corporation, has a significant interest in the corporation; and
- At any previous time, a person who held the debt dealt at arm's length with the debtor and, where the debtor is a corporation, did not have a significant interest in the corporation.

In general, a person will have a significant interest in a corporation if the person (and non-arm's length persons) owns shares of the corporation to which 25 percent or more of the votes or value are attributable.

Rules similar to those contained in the debt forgiveness rules will be introduced to determine whether a creditor is related to, and therefore not dealing at arm's length with, a debtor where trusts and partnerships are involved. Each partnership and trust will be treated as a corporation having a single class of capital stock of 100 voting shares. The members of the partnership, or the beneficiaries under the trust, will be treated as owning such shares in accordance with their proportionate interests in the partnership or trust. The proportionate interest of a partner or a beneficiary will be based on the fair market value of the partner's or beneficiary's interest in the partnership or trust.

Exceptions will be provided so that a foreign currency debt will not become a parked obligation in the context of certain bona fide commercial transactions. In particular, a foreign currency debt will not be a parked obligation if the debt is acquired by the current holder as part of a transaction or series of transactions that results in the acquisition of a significant interest in, or control of, the debtor by the current holder (or a person related to the current holder) unless one of the main purposes of the transaction or series of transactions was to avoid a foreign exchange gain. In addition, a change of status between the debtor and the current holder (i.e., from dealing at arm's length to not dealing at non-arm's length or, where the debtor is a corporation, from the current holder not having a significant interest in the debtor to having one) will not cause the debt to become a parked obligation unless one of the main purposes of the transaction or series of transactions that gave rise to the change of status was to avoid a foreign exchange gain.

The budget says related rules will provide relief to financially distressed debtors. This relief will be similar to the deductions currently available to debtors with respect to amounts included in income because of the application of the debt forgiveness rules. For instance, where a debtor is a corporation resident in Canada, a rule will ensure that the combined federal/provincial taxes payable on a deemed foreign exchange capital gain will not result in the corporation's liabilities exceeding the fair market value of its assets.

This measure will apply to a foreign currency debt that meets the conditions to become a parked obligation on or after March 22, 2016. There will be an exception where the meeting of these conditions occurs before 2017 and results from a written agreement entered into before March 22, 2016.

Multiple intermediary structures

The budget also clarifies that the current back-to-back loan rules, as well as the proposed royalty and shareholder loan rules, will also apply to situations where there is more than one intermediary in the structure. These rules will apply to interest and royalty payments made after 2016, and to shareholder debts as of January 1, 2017.

Treaty abuse

The OECD Action Plan on Base Erosion and Profit Shifting (BEPS), introduced in 2013, set 15 specific action points aimed at international tax planning carried on by global corporate groups. On October 5, 2015, the OECD published guidance on domestic legislative and administrative changes to address all 15 of the Plan's action points.

Action 6 identified treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concerns. Treaty shopping occurs, for example, where a third country resident creates an intermediary holding company in a treaty country for purposes of channeling income and gains sourced in Canada through the company to access benefits granted under a tax treaty that would not otherwise have been available to them.

OECD minimum standard for treaty abuse — The OECD recommends a minimum standard of protection against treaty shopping that countries should agree to include in their treaties. The minimum standard requires countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. In addition, the treaty abuse minimum standard requires countries to implement this common intention by adopting a principal purpose test or a limitation-on-benefits rule in their tax treaties.

Principal purpose test — The principal purpose test is a general anti-abuse rule that uses the criterion of whether one of the principal purposes of an arrangement or transaction was to obtain treaty benefits in a way that is not in accordance with the object and purpose of the relevant treaty provisions. Canada has several treaties that have adopted a limited principal purpose test.

Limitation-on-benefits rule — The limitation-on-benefits rule is a more mechanical and specific anti-abuse rule that requires satisfaction of a series of tests in order to qualify for treaty benefits. Canada currently has one treaty that has adopted a limitation on-benefits approach.

Canada's tax treaties going forward — The budget confirms Canada's commitment to address treaty abuse in accordance with the OECD's minimum standard. Going forward, Canada will consider either the principal purposes test or the limitation-on-benefits approach, depending on the particular circumstances and discussions with Canada's tax treaty partners.

The budget states that amendments to Canada's tax treaties to include a treaty anti-abuse rule could be achieved through bilateral negotiations, the multilateral instrument that will be developed in 2016 under the OECD's BEPS Action 15, or a combination of the two. The multilateral instrument is a tax treaty that many countries could sign modifying certain provisions of existing bilateral tax treaties and is intended to streamline the implementation of treaty-related BEPS recommendations. Canada is actively participating in international work to develop the multilateral instrument.

Exchange of tax rulings

The OECD's BEPS project developed a framework for the spontaneous exchange of certain tax rulings that could give rise to BEPS concerns. The framework covers six categories of rulings: (i) rulings related to preferential regimes; (ii) cross-border unilateral advance pricing arrangements; (iii) rulings giving a downward adjustment to profits; (iv) permanent establishment rulings; (v) conduit rulings; and (vi) any other type of ruling agreed to in the future.

The budget confirms Canada's intention to implement the OECD's minimum standard for the spontaneous exchange of certain tax rulings under the BEPS project. The budget says that the Canada Revenue Agency will commence exchanging tax rulings in 2016 with other jurisdictions that have committed to the minimum standard.

The budget says that Canada's agreements under its established exchange of information program include provisions to restrict the use of the exchanged information, typically limiting its use to the enforcement of tax laws and to ensure the confidentiality of the information. The budget states that any information exchanged with respect to the targeted tax rulings will be subject to the confidentiality provisions in the relevant agreement and therefore be protected in the same manner as taxpayer information.

Automatic exchange of information

The OECD recently developed the "Standard for Automatic Exchange of Financial Account Information in Tax Matters", which calls for an annual automatic exchange of financial account information between governments.

To make the exchange of information possible, financial institutions, as broadly defined under domestic and international law, must report information according to common reporting standards on accounts held by non-resident individuals and entities such as certain corporations, trusts and foundations.

Countries around the world have begun enacting legislation to implement these common reporting standards in their jurisdictions. In Canada, the CRA signed the international Multilateral Competent Authority Agreement in June 2015 to activate the automatic exchange of financial information between tax jurisdictions beginning in 2018.

The budget confirms Canada's intention to implement the common reporting standard starting on July 1, 2017, allowing for the first exchanges of information with other countries in 2018. Legislative proposals will be issued for public comment in the near future.

Transfer Pricing Changes

Country-by-country reporting

The recommendations arising from the OECD's BEPS project include changes to the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations to incorporate new standards for transfer pricing documentation. These common standards are intended to help align transfer pricing documentation across jurisdictions. The recommendations include a minimum standard for country-by-country reporting.

Where a jurisdiction receives a country-by-country report from a member of a Multinational Enterprise (MNE), that jurisdiction will automatically exchange the report with other jurisdictions in which the MNE operates, provided that, in each case, the other jurisdiction has implemented country-by-country reporting, the two jurisdictions have a legal framework in place for automatic exchange of information (e.g., under a bilateral tax treaty or the multilateral Convention on Mutual Administrative Assistance in Tax Matters), and they have entered into a competent authority agreement relating to country-by-country reporting.

If the jurisdiction where a subsidiary resides cannot obtain the country-by-country report from the parent's jurisdiction through automatic exchange of information, then in certain cases the tax administration of the subsidiary's jurisdiction may require the subsidiary to file the country-by-country report. An MNE may avoid having this filing requirement imposed on multiple subsidiaries in multiple jurisdictions by designating one of its subsidiaries to be a "surrogate" for filing purposes. As a result of this designation, provided that the surrogate is located in a jurisdiction which has implemented country-by country reporting, the surrogate would file the country-by-country report on behalf of the MNE as a whole.

The budget proposes to implement country-by-country reporting in Canada. This measure will apply only to MNEs with total annual consolidated group revenue of €750 million or more. Where such an MNE has an ultimate parent entity that is resident in Canada (or a Canadian resident subsidiary in the circumstances set out above), it will be required to file a country-by-country report with the Canada Revenue Agency within one year of the end of the fiscal year to which the report relates.

First exchanges between jurisdictions of country-by-country reports are expected to occur by June 2018. Before any exchange with another jurisdiction, the Canada Revenue Agency will formalize an exchange arrangement with the other jurisdiction and will ensure that it has appropriate safeguards in place to protect the confidentiality of the reports.

The budget says that draft legislative proposals will be released for comment in the coming months.

Consistent with the BEPS project recommendations released in autumn 2015, country-by-country reporting will be required for taxation years that begin after 2015.

Transfer pricing guidance

The recommendations arising from the BEPS project include revisions to the Transfer Pricing Guidelines. These revisions provide an improved interpretation of the arm's length principle, and are intended to better ensure alignment of the profits of MNEs with the economic activities generating those profits. The budget says that the clarifications provided in the revisions generally support the Canada Revenue Agency's current interpretation and application of the arm's length principle, as reflected in its audit and assessing practices. These revisions are thus being applied by the Canada Revenue Agency as they are consistent with current practices.

In two areas, however, where the revisions to the Transfer Pricing Guidelines are not yet complete, the budget says that the Canada Revenue Agency will not be adjusting its administrative practices at this time. The BEPS project participants are still engaged in follow-up work on the development of a threshold for the proposed simplified approach to low value-adding services. Work is also continuing to clarify the definition of risk-free and risk-adjusted returns for minimally functional entities (often referred to as "cash boxes"). The budget says that Canada will decide on a course of action with regards to these measures after the outstanding work is complete.

Business Tax Changes

Accelerated CCA for clean energy equipment

Classes 43.1 and 43.2 provide accelerated CCA rates (30% and 50% respectively on a declining balance basis) for investments in specified clean energy generation and conservation equipment. The assets in these classes include eligible equipment that generates or conserves energy by using a renewable energy source, using a fuel from waste or making efficient use of fossil fuels.

Electric vehicle charging stations — Electric vehicle charging stations are generally included in Class 8 which provides a CCA rate of 20% on a declining balance basis. The budget proposes to expand Classes 43.1 and 43.2 to include electric vehicle charging stations based on whether they meet certain power thresholds. Class 43.1 will include those charging stations set up to supply more than 10 kilowatts but less than 90 kilowatts of continuous power. Class 43.2 will include electric vehicle charging stations set up to supply at least 90 kilowatts of continuous power.

Eligible equipment will include certain equipment downstream of an electricity meter owned by an electric utility and used for billing purposes or owned by the taxpayer to measure electricity generated by the taxpayer. To be eligible, more than 75% of the annual electricity consumed in connection with the equipment must be used to charge electric vehicles. Eligible equipment includes charging stations, transformers, distribution and control panels, circuit breakers, conduits, wiring and related electrical energy storage equipment.

These measures will apply to property acquired for use on or after March 22, 2016 that has not been used or acquired for use before March 22, 2016.

Electrical energy storage property — Eligibility of electrical energy storage equipment for inclusion in Classes 43.1 and 43.2 currently depends on the technology being used to generate electricity. Storage equipment which does not qualify for inclusion in these classes is generally included in Class 8.

The budget proposes to clarify and expand the range of electrical energy storage property that is eligible for Class 43.1 or Class 43.2 to include a broad range of short and long-term storage equipment, on the basis that it is ancillary to eligible generation equipment. If the storage equipment is part of an electricity generation system that is eligible for Class 43.2, it will be included in Class 43.2. If the storage equipment is part of an electricity generation system that is eligible for Class 43.1, it will be included in Class 43.1.

The budget also proposes to allow stand-alone electrical energy storage property to be included in Class 43.1 provided that the round trip efficiency of the equipment is greater than 50%. However, a fuel cell which uses hydrogen produced by electrolysis equipment will remain eligible for Class 43.2 regardless of its round trip efficiency provided all or substantially all of the electricity used to power the electrolysis process is generated from specified renewable sources. The eligible generation sources will be expanded to include electricity generated by the other renewable energy sources currently included in Class 43.2—geothermal, waves, tides and the kinetic energy of flowing water.

Eligible electrical energy storage property will include equipment such as batteries, flywheels, compressed air energy storage and ancillary equipment and structures. It will not include pumped hydroelectric storage, hydroelectric dams and reservoirs or a fuel cell system where the hydrogen is produced via steam reformation of methane. Certain uses of electrical energy storage equipment will also be excluded from eligibility: back up electricity generation; motive uses (e.g., in battery electric vehicles or fuel cell electric vehicles); and mobile uses (e.g., consumer batteries).

These measures will apply to property acquired for use on or after March 22, 2016 that has not been used or acquired for use before March 22, 2016.

Emissions trading regimes

Under emissions trading regimes, regulated emitters are obligated to deliver emissions allowances to governments. The required allowances are determined by reference to the amount of emissions of a regulated substance, such as greenhouse gases, that are produced. These allowances may be purchased by emitters in the market or at auction and are earned in relation to emissions reduction activities or provided by the government at a reduced price or cost.

The tax treatment of transactions under emissions trading regimes is currently determined under general tax principles. Currently, for a regulated emitter, emissions allowances are generally treated as an eligible capital property (entitled to an annual deduction of 7% in respect of 75% of the cost of the allowance, on a declining balance basis), however the budget proposes to replace the eligible capital property regime with a new class of depreciable property (see above). Further, where an emissions allowance is provided by a government for no consideration, there is no tax rule to adjust the cost amount of the emissions allowance to reflect the allowance's inclusion in the taxpayer's income. This would result in taxpayers being subject to double tax on the disposition of the emissions allowance.

The budget proposes to introduce specific rules to clarify the tax treatment of emissions allowances and to eliminate the double taxation of certain free allowances. Specifically, these rules will provide that emissions allowances be treated as inventory for all taxpayers. However, the "lower of cost or market" method for the valuation of inventory will not be available for emission allowances because of the potential volatility of their value.

The budget also proposes that where a regulated emitter receives a free allowance, there will be no income inclusion on receipt of the allowance.

In addition, the budget proposes that the deduction in respect of an accrued emissions obligation will be limited to the extent that the obligation exceeds the cost of any emissions allowances that the taxpayer has acquired and that can be used to settle the obligation. Each year the taxpayer claims a deduction for an emissions obligation, the taxpayer will quantify its deduction based on the cost of emission allowances that it has acquired and which can be used to settle its emissions obligation, plus the fair market value of any emissions allowances that it still needs to obtain to fully satisfy its obligation. If a deduction is claimed in respect of an emissions obligation that accrues in one year (for example, 2017) and that will be satisfied in a future year (for example, 2018), the amount of this deduction will be brought back into income in the subsequent year (2018) and the taxpayer will be required to evaluate the deductible obligation again each year, until it is ultimately satisfied.

If a taxpayer disposes of an emissions allowance otherwise than in satisfaction of an obligation under the emissions allowance regime, any proceeds received in excess of the taxpayer's cost, if any, for the allowance will be included in computing income.

This measure will apply to emissions allowances acquired in taxation years beginning after 2016. It will also apply on an elective basis in respect of emissions allowances acquired in taxation years ending after 2012.

Valuation for derivatives

The budget proposes amendments to the valuation of derivatives because of a Tax Court of Canada decision that held a derivative that provides rights to a taxpayer and that is held on income account would be considered inventory property. The budget proposes to exclude derivatives from the application of the inventory valuation rules while maintaining the status of such property as inventory. A related rule will be introduced to ensure that taxpayers are not able to value derivatives using the lower of cost and market method under the general principles for the computation of profit for tax purposes.

This measure will apply to derivatives entered into on or after March 22, 2016.

CCA for liquefied natural gas

The budget states that it intends to maintain the current accelerated CCA for certain liquefied natural gas (LNG) facilities and will allow it to expire as scheduled. That is, for assets acquired before 2025, an effective CCA rate of 30% is available for eligible liquefaction equipment and a 10% CCA rate is available for related buildings.

Indirect Tax and Customs Changes

Medical and assistive devices

The budget proposes to add insulin pens, insulin pen needles and intermittent urinary catheters to the list of zero-rated medical devices zero-rated under the Goods and Services Tax/Harmonized Sales Tax (GST/HST) rules. As a result, suppliers will not charge purchasers GST/HST on these medical devices and are entitled to claim input tax credits to recover the GST/HST paid on inputs related to these supplies. For insulin pens and insulin pen needles, this measure will apply to supplies made after March 22, 2016 and to supplies made on or before this date, unless the supplier charged, collected or remitted GST/HST in respect of the supply. For intermittent urinary catheters, this measure will apply to supplies made after March 22, 2016.

Cosmetic procedures

The budget proposes to clarify that the GST/HST generally applies to supplies of purely cosmetic procedures provided by all suppliers, including registered charities (e.g., liposuction, hair replacement procedures, hair removal, botulinum toxin injections, teeth whitening). To be exempt, a cosmetic procedure must be required for medical or reconstructive purposes (e.g., as surgery to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease). Cosmetic procedures paid for by a provincial health insurance plan will continue to be exempt. This measure will apply to supplies made after March 22, 2016.

Call centre services

The budget proposes to modify the zero-rating rules for certain exported supplies of call centre services. Specifically, the supply of a service of rendering technical or customer support to individuals by means of telecommunications (e.g., by telephone, email or web chat) will generally be zero-rated for GST/HST purposes if the service is supplied to a non-resident person that is not registered for GST/HST purposes and it can reasonably be expected, at the time the supply is made, that the technical or customer support is to be rendered primarily to individuals who are outside Canada at the time the support is rendered to those individuals. This measure will apply to supplies made after March 22, 2016 and to supplies made on or before March 22, 2016 in cases where the supplier did not, on or before that day, charge, collect or remit an amount as or on account of tax under Part IX of the *Excise Tax Act* for the supply.

Reporting of grandparented housing sales

The budget proposes to simplify special requirements for builders to report grandparented housing sales where the purchaser was not entitled to a GST New Housing Rebate or a GST New Residential Rental under transitional rules.

Under the transitional rules that applied when a province either joined the harmonized value-added tax system since 2010 or increased its HST rate, certain sales of newly constructed or substantially renovated homes were grandparented for HST purposes. This meant that the housing sale was not subject to the provincial component of the HST or the increased HST rate. A housing sale was generally grandparented if the agreement of purchase and sale was entered into in writing on or before the date the transitional rules were announced and ownership and possession of the housing was transferred on or after the date on which the HST, or the increased HST rate, came into effect.

The budget proposes to limit the reporting requirement to those grandparented housing sales for which the consideration is equal to or greater than $450,000, and to allow builders to correct past misreporting and avoid penalties by allowing them to elect to report all past grandparented housing sales for which the consideration was equal to or greater than $450,000. This measure will apply for any reporting period of a person that ends after March 22, 2016. In addition, where builders make this election, the measure will also apply to any supply of grandparented housing for which the federal component of the HST became payable on or after July 1, 2010. Builders can generally make the election between May 1, 2016 and December 31, 2016.

Donations to charities

The budget proposes a rule that provides that, when a charity supplies property or services in exchange for a donation, and when an income tax receipt may be issued for a portion of the donation, only the value of the property or services supplied will be subject to GST/HST. This rule will apply to supplies that are not already exempt from GST/HST, and is intended to ensure that the portion of the donation that exceeds the value of the property or services supplied is not subject to the GST/HST. This measure will apply to supplies made after March 22, 2016.

In addition, where a charity did not collect GST/HST on the full value of donations made in exchange for an inducement, for supplies made between December 21, 2002 (when the income tax split-receipting rules came into effect) and March 22, 2016, the budget provides that, if GST/HST was charged on only the value of the inducement, consistent with the income tax split-receipting rules, or if the value of the inducement was less than $500, the donors' and charities' GST/HST obligations will effectively be satisfied, and no further GST/HST is owed. In other cases, the charity will be required to remit GST/HST on the value of the inducement only (i.e., the relieving split-receipting rules will apply).

De minimis financial institutions

A person that earns more than $1 million in interest income in respect of bank deposits in a taxation year will be considered to be a financial institution for GST/HST purposes for its following year.

The budget proposes that interest earned in respect of demand deposits, as well as term deposits and guaranteed income certificates with an original due date to maturity not exceeding 364 days, not be included in determining whether the $1 million threshold is reached.

This measure will apply to taxation years of a person beginning on or after March 22, 2016 and to the fiscal year of a person that begins before March 22, 2016 and ends on or after that day.

Application of GST/HST to cross-border reinsurance

The budget proposes to clarify that two specific components of imported reinsurance services, ceding commissions and the margin for risk transfer (a newly defined term), do not form part of the tax base that is subject to the self-assessment provisions contained in the GST/HST imported supply rules for financial institutions and sets out the specific conditions applicable to this measure.

This measure will generally apply as of the introduction of the special GST/HST imported supply rules for financial institutions.

GST closely related test

To ensure that the closely related test for the closely related group election applies only to situations where nearly complete voting control exists, the budget proposes to require that in addition to meeting the current rules for the closely related test, a corporation or partnership must also hold and control 90 percent or more of the votes in respect of every corporate matter of the subsidiary corporation (with limited exceptions) in order to be closely related.

This measure will generally apply as of the day that is one year after March 22, 2016. This measure will apply as of March 23, 2016 for the purposes of determining whether the conditions of the closely related test are met in respect of elections under section 150 and section 156 of the Excise Tax Act that are filed after March 22, 2016 and that are to be effective as of the day that is after March 22, 2016.

Restricting the relief of excise tax on diesel and aviation fuel

The budget proposes to restrict the relief for certain diesel and aviation fuel delivered or imported after June 2016.

Tariffs

The budget announces that the government will eliminate tariffs on about a dozen manufacturing inputs and intends to launch public consultations on eliminating tariffs on food manufacturing ingredients other than supply managed products.

Administrative Changes and Dispute Resolution

CRA service improvements

The budget proposes additional funding to the CRA to:

- Enhance CRA telephone services, including introducing a dedicated telephone support line for tax service providers as a pilot project
- Make the CRA's written correspondence more straightforward and easy to read by revamping the structure, design and format of its correspondence
- Clarify the rules governing the political activities of charities by having Finance and the CRA engage in discussions and an online consultation with charities and stakeholder groups
- Increase the CRA's capacity to resolve taxpayer objections and provide more timely resolutions
- Expand the CRA's local community organization volunteer program to help eligible Canadians with modest incomes complete their tax returns and notify lower-income non-filers about their eligibility for tax credits.

The budget says that these proposed enhancements are intended to increase compliance and fairness, which will allow the CRA to direct its efforts towards cracking down on tax evasion and aggressive tax avoidance.

The budget also proposes additional funding for the CRA to improve its ability to collect outstanding tax debts.

Other Changes

Aboriginal tax policy

The budget confirms the government's willingness to discuss and put into effect direct taxation arrangements with interested Aboriginal governments. The government will also continue to facilitate direct taxation arrangements between interested provinces or territories and Aboriginal governments.

Identify and address tax planning

The budget announces that the government will undertake a review of the tax system in the coming year in an effort to eliminate poorly targeted and inefficient tax measures.

We can help

Your KPMG adviser can help you assess the effect of the tax changes in this year's federal budget on your personal finances or business affairs, and point out ways to take advantage of their benefits or ease their impact. We can also keep you abreast of the progress of these proposals as they make their way into law.
