2017 Issue No. 9
22 March 2017

Tax Alert — Canada

Building a Strong Middle Class: federal budget 2017-18

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

"Mr. Speaker, as Canadians come together to celebrate Canada 150, we proudly reflect on the generations that came before us. Generations that built a country on the belief that with hope and hard work, they could deliver a better future for themselves, and for their kids and grandkids.

"That optimism — and that confidence — helped define us as a country. Sharing those beliefs with others made Canada a beacon of diversity, openness and generosity around the world. Yet, over the last few decades, the middle class and those working hard to join it have fallen behind…

"But the good news is that Canadians — on their own accord — worked hard and persevered. We have always been resilient and innovative, able to adapt — and prosper — in the face of change.

"Knowing that, we put together a plan to ensure that, in a changing world, Canada's middle class and those working hard to join it can — and will — succeed.

Federal Finance Minister Bill Morneau
2017 federal budget speech

Tax policy and economic outlook

On 22 March 2017, federal Finance Minister Bill Morneau tabled his second budget. With a focus on economic growth, job creation and a strong middle class, the minister continued to build Canada's economy by seeking to attract investment in clean technologies, and by creating jobs and prosperity for the middle class.

Building a better working world

In his budget speech, Morneau stated, "[W]e've begun to see signs of confidence and optimism return to our middle class. Consumer spending is up since we introduced the Canada Child Benefit.

"In the last seven months, the Canadian economy has created a quarter million new jobs—the largest seven months of job gains Canada has seen in a decade. Unemployment has fallen in the time since we took office.

"These are good, early signs of a plan that is working. That's why we will continue to invest in our people, our communities, and our economy….

"[W]e know there is more work to do on behalf of middle class Canadians."

Surplus (deficit) and federal debt outlook

For a number of years, EY's federal budget Tax Alert has included projections of the federal surplus or deficit, the federal debt and a budgetary scorecard. The latest projections for fiscal 2017 and 2018 are improved from those expected a year ago.

Budgetary scorecard

In very general terms, the annual surplus (deficit) is the amount by which the government's revenue from all sources exceeds or is less than the aggregate of program expenses (including transfers to other governments) and the public debt charge.

Table A

Projections of federal budgetary surplus (deficit)
$billions

	Budget 2016 F2016-17	Nov. 2016 Update F2016-17	Spring 2017 Update F2016-17	Budget 2017 F2017-18
Revenue outlook				
Income taxes				
Personal	143.9	143.7	143.2	152.1
Corporate	36.9	41.4	42.5	43.6
Nonresident	6.3	6.3	6.6	6.9
Excise taxes				
GST	33.5	33.5	33.7	35.1
Customs	5.0	5.1	5.4	4.9
Other taxes/duties	11.1	11.6	11.6	11.7
EI premiums	22.4	22.3	22.3	21.2
Other revenues	27.7	27.1	26.7	29.1
	287.7	**291.1**	**292.1**	**304.7**
Program expenses outlook				
Major transfers to persons				
Elderly benefits	(48.4)	(48.4)	(48.3)	(51.1)
EI benefits	(21.1)	(21.0)	(21.0)	(22.0)
Children's benefits	(21.9)	(21.8)	(21.9)	(23.0)
Major transfers to other levels of gov't	(68.6)	(68.5)	(68.7)	(70.2)
Direct program expenses	(131.3)	(131.6)	(130.9)	(139.1)
Assessment of risk				(3.0)
	(291.4)	**(291.3)**	**(290.9)**	**(305.4)**
Public debt charges	(25.7)	(24.9)	(24.3)	(24.7)
Surplus (deficit) outlook	**(29.4)**	**(25.1)**	**(23.0)**	**(28.5)**

In Table A, we summarize the deficit projections for fiscal 2017 and 2018, including two updates to fiscal 2017 (the final fiscal 2017 accounts will be released in the fall 2017 economic update).

Fiscal 2017

The current update reflects an improved economic and fiscal outlook since Budget 2016. The Liberal government's projected fiscal deficit of $29.4 billion for 2016-17 has become a deficit of $23 billion. The main change in the forecast is attributed to the increase in corporate tax revenue and a reduction in public debt charges.

Fiscal 2018

The updated fiscal 2018 forecasted deficit is $28.5 billion, up from $ 27.8 billion. The 2018 forecast reflects a new risk contingency of $3 billion that offsets increased projected tax revenues.

The fiscal 2018 forecast takes into account a $200 million net impact of investments in Budget 2017. The fiscal 2018 forecasted deficit of $28.5 billion reflects an increase in revenue of $1.4 billion, offset by increases in program expenses of $1.1 billion.

Federal fiscal outlook

As set out in Table B, after accounting for economic and fiscal developments, the latest government projections call for budgetary deficits in fiscal 2016-17 through fiscal 2018-19 and in each subsequent year of the forecast period. These subsequent-year projections include a $3 billion contingency each year that offsets the projected increases in tax revenues. The deficits are larger than projected last year.

Measured in relation to the size of the economy, the federal debt is expected to remain at approximately the same level of GDP over the forecasted period.

Table B

Projections of federal surplus (deficit) and debt

	Surplus (deficit) outlook	Federal debt	
	$billion	$billion	% of GDP
2016-17	(23.0)	637.1	31.5
2017-18	(28.5)	665.5	31.6
2018-19	(27.4)	692.9	31.6
2019-20	(23.4)	716.3	31.5
2020-21	(21.7)	738.1	31.3
2021-22	(18.8)	756.9	30.9

Totals may not add due to rounding.

In October 2016, the International Monetary Fund estimated that Canada's total government net debt-to-GDP ratio was the lowest, by far, of any G7 country: Canada 26.9%, Germany 45.4%, UK 80.5%, US 82.2%, France 89.2%, Italy 113.8% and Japan 127.9%.

Budget 2017 measures

The government's projections of the net impact of the investments introduced in today's budget are relatively modest, being only $200 million.

Tax expenditure review

In Budget 2016, the government announced its intention to conduct a broad review of its tax expenditures with the stated objective of eliminating poorly targeted and inefficient tax measures, and identifying opportunities to reduce tax benefits benefiting the wealthiest Canadians.

As a result of this, and a number of statements the government has made since Budget 2016, many stakeholders expected Budget 2017 to include certain measures targeting tax planning using private corporations, limiting access by Canadian-controlled private corporations to the small-business tax rate, and increasing the capital gains inclusion rate. Currently, 50% of capital gains realized are taxable, and it was rumoured that Budget 2017 would increase this percentage to 66%, or even to the 75% inclusion rate that applied during the 1990s. Budget 2017 does not include these measures.

Tax planning using private companies

Budget 2017 does not include any specific measures that will impact the taxation of private companies and their shareholders. However, the Minister made it very clear in his speech to Parliament that this government, as first outlined in its election platform, remains committed to improving tax fairness by shutting down tax planning arrangements that solely benefit "wealthy" Canadians. The Department of Finance considers tax planning arrangements using private corporations to avoid paying the "fair share" of tax to be very high on its agenda for future tax changes.

Finance will be releasing a paper in the coming months setting out the nature of these issues in more detail, as well as proposed policy responses.

Examples of the offensive planning cited in the budget documents include income splitting arrangements through private companies to use the lower personal tax rates of other family members who are directly or indirectly shareholders of the company, earning investment income within a private corporation on undistributed business income that is not invested in the business and converting investment income to capital gains that are taxed at a lower effective rate.

At this point, we can only speculate about the specific planning arrangements that Finance considers offensive. Clearly, it must be more than conventional structures that rely on the system of corporate tax integration to ensure investment income earned directly or indirectly through a private corporation is taxed at approximately the same effective tax rate.

Billed-basis accounting

An unexpected legislative tax change deals with the perceived mismatching of revenue and costs primarily available to professional firms providing legal and accounting services. Current rules permit a deduction for expenses as incurred and the reporting of revenue only when amounts are billed to clients.

Budget 2017 includes measures that will phase out the deduction currently available for unbilled work in progress (WIP) over a two-year period. For tax years that commence on or after 22 March 2017, a deduction for WIP will be available for 50% of the lesser of cost and fair market value of unbilled WIP. In subsequent years, no deduction will be available for unbilled WIP. Consequently, as most practices have a calendar tax year, the 50% deduction will be available for 2018 and, starting in 2019, no WIP deduction will be permitted.

Meaning of factual control

The Income Tax Act contains two different definitions of control that apply for various purposes. Some provisions rely on *de jure* control while others rely on *de facto* control.

There is a substantial body of case law that provides clarity on how each should be interpreted. *De jure* generally entails the right to elect the majority of the board of directors of the corporation. *De facto* control is a much broader test that takes into consideration influence that, if exercised, would result in control in fact of the corporation.

De facto control generally applies for purposes of determining whether companies are associated and must share the benefit of the small-business deduction on the first $500,000 of annual business income and for the enhanced scientific research and experimental development tax credits available for Canadian-controlled private corporations.

The recent Federal Court of Appeal (FCA) decision in McGillivray Restaurant v The Queen restricted the scope of the *de facto* control test by restricting the influence to circumstances that include "a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability."

Budget 2017 introduces new legislation to remove the restriction established by the FCA. This new provision, which is effective for taxation years that begin on or after 22 March 2017, clarifies that, in determining whether factual control exists, factors may be considered that are not limited to the constraints established by the FCA but include all factors that are relevant in the circumstances.

Business income tax measures

Corporate tax rates

No changes are proposed to the corporate income tax rates or to the $500,000 small-business income limit of a Canadian-controlled private corporation (CCPC). The enacted Canadian federal corporate income tax rates are summarized in Table C.

Table C

Federal corporate income tax rates	
	2017
General corporate rate	15.0%
Small-business rate	10.5%

Accelerated capital cost allowance

Continuing with the theme of prior budgets, the Minister announced changes to capital cost allowance (CCA) rates:

Clean energy generation equipment: geothermal energy, Classes 43.1 and 43.2

- Eligible equipment expanded to include geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity
- Geothermal heating will be made an eligible thermal energy source for use in a district energy system
- Expenses incurred for the purpose of determining the extent and quality of a geothermal resource and the cost of all geothermal drilling, for both electricity and heating projects, will qualify as a Canadian renewable and conservation expense

The measures will apply in respect of property acquired for use on or after 22 March 2017 that has not been used or acquired for use before that date.

Mutual fund corporation reorganizations

Canadian mutual funds can be in the legal form of a trust or a corporation. The Income Tax Act contains special rules to facilitate the merger of mutual funds on a tax-deferred basis. However, the rules do not provide for a tax-deferred reorganization of mutual fund corporations into multiple mutual fund trusts.

Budget 2017 extends the mutual fund merger rules to facilitate the reorganization of certain mutual fund corporations with one or more mutual fund trusts on a tax-deferred basis.

This measure will apply to qualifying reorganizations that occur on or after 22 March 2017.

Segregated fund mergers

Segregated funds are life insurance policies that have characteristics that are similar to mutual fund trusts. To provide consistent treatment between mutual fund trusts and segregated funds, Budget 2017 proposes to allow tax-deferred mergers of segregated funds.

It is also proposed that, for non-capital losses that arise in taxation years that begin after 2017, a segregated fund be able to carry over those losses to offset taxable income for years that begin after 2017, subject to normal restrictions and limitations for the carryforward and carryback of non-capital losses. As is the case with the mutual fund merger rules, the use of these losses will be restricted in the case of a segregated fund merger.

To provide time for the life insurance industry to provide comments to these proposals, this measure will apply to mergers of segregated funds carried out after 2017, and to losses arising in taxation years beginning after 2017.

Timing of recognition of gains and losses on derivatives

Elective use of the mark-to-market method

There is uncertainty as to whether a taxpayer is able to apply a mark-to-market method for computing gains or losses from derivatives held on income account. To provide a clear framework for exercising the choice of using the mark-to-market method and to ensure that this choice does not lead to avoidance opportunities, Budget 2017 proposes to introduce an elective mark-to-market regime for derivatives held on income account. Specifically, an election will allow taxpayers to mark-to-market all of their eligible derivatives. Once made, the election will remain effective for all subsequent years unless revoked with the consent of the Minister of National Revenue.

An eligible derivative will be any derivative which includes a swap agreement, forward purchase or sale agreement, forward rate agreement, futures agreement, option agreement or similar agreement held on income account that meets certain conditions, including that the derivative is valued in accordance with accounting principles at its fair value in a taxpayer's audited financial statements or otherwise has a readily ascertainable fair market value. Once an election is made by a taxpayer, the taxpayer will be required to annually include in computing its income the increase or decrease in value of its eligible derivatives. This election will be available for taxation years that begin on or after 22 March 2017. Further, taxpayers that are not financial institutions and do not elect will not be permitted to apply a mark-to-market method for computing income (or loss) from derivatives.

Straddle transactions

In its simplest form, a "straddle" is a transaction in which a taxpayer concurrently enters into two or more positions – often derivative positions – that are expected to generate equal and offsetting gains and losses. Shortly before its taxation year end, the taxpayer disposes of the position with the accrued loss and realizes the loss. Shortly after the beginning of the following taxation year, the taxpayer disposes of the offsetting position with the accrued gain and realizes the gain. The taxpayer claims a deduction in respect of the realized loss against other income in the initial taxation year and defers the recognition of the offsetting gain until a future taxation year.

Budget 2017 proposes to introduce a specific anti-avoidance rule that targets straddle transactions. In particular, a stop-loss rule will effectively defer the realization of any loss on the disposition of a position to the extent of any unrealized gain on an offsetting position. A gain in respect of an offsetting position would generally be unrealized where the offsetting position has not been disposed of and is not subject to mark-to-market taxation.

For the purposes of the stop-loss rule, a position will generally be defined as including any interest in actively traded personal properties, as well as derivatives and certain debt obligations. An offsetting position with respect to a position held by a taxpayer will generally be a position that has the effect of eliminating all or substantially all of the taxpayer's risk of loss and opportunity for gain or profit in respect of the position.

The stop-loss rule will be subject to a number of exceptions. In particular, it will generally not apply to a position if:

- It is held by a financial institution, as defined for the purposes of the mark-to-market rules, or by a mutual fund trust or mutual fund corporation;
- It is part of certain types of hedging transactions entered into in the ordinary course of the taxpayer's business;
- The taxpayer continues to hold the offsetting position throughout a 30-day period that begins on the date of disposition of the position; or
- It is part of a transaction or a series of transactions none of the main purposes of which is to defer or avoid tax.

This measure will apply to any loss realized on a position entered into on or after 22 March 2017.

Canadian exploration expenses

Expenditures related to drilling or completing discovery wells will generally be classified as Canadian development expenses (CDEs) instead of Canadian exploration expenses (CEEs). The same will apply to expenditures related to building a temporary access road to these wells, or in preparing a site in respect of them. A discovery well is the first well in a previously unknown petroleum or natural gas reservoir.

Subject to transitional rules, this proposed measure will apply to expenses incurred after 2018.

Flow-through share rules — reclassification of renounced expenses

Eligible small oil and gas corporations will no longer be able to treat the first $1 million of CDE as CEE. Subject to transitional rules, this proposed measure will apply to expenses incurred after 2018.

Investment tax credit for child care spaces

Budget 2017 proposes elimination of the non-refundable tax credit to build or expand child care spaces in licensed child care facilities. This proposed measure will apply in respect of expenditures incurred on or after 22 March 2017.

Insurers of farming and fishing property

Budget 2017 proposes elimination of the tax exemption for insurers of farming and fishing property, effective for taxation years beginning after 2018.

International tax measures

While Canadian life insurers are taxable in Canada on Canadian-sourced businesses, income from a business carried through a foreign branch is generally exempt from Canadian income tax. In this respect, income from foreign branches of life insurers is treated in a somewhat similar manner to business income earned by a foreign affiliate of a corporate taxpayer.

Income earned by foreign affiliates is subject to robust anti-base erosion rules, specifically the foreign accrual property income (FAPI) regime. Under the FAPI regime, income earned by a foreign affiliate from the insurance of Canadian risks is specifically subject to tax in the hands of the Canadian taxpayer when it is earned unless certain *de minimis* conditions are satisfied. However, the FAPI regime does not apply in respect of income earned by a Canadian life insurer through a foreign branch.

Budget 2017 proposes amendments to ensure that Canadian life insurers are taxable in Canada with respect to income earned from "specified Canadian risks" through a "designated foreign insurance business." Similar to the rules in the FAPI regime, this will apply where 10% or more of the gross premium income (net of reinsurance ceded) earned by a foreign branch of a Canadian life insurer is premium income in respect of specified Canadian risks. For this purpose, specified Canadian risk has the same meaning as is assigned in the FAPI regime.

In addition, anti-avoidance rules are proposed that apply to so-called "insurance swap" arrangements. These rules are meant to be complementary to rules introduced to the FAPI regime in Budgets 2014 and 2015. In effect, these anti-avoidance rules are intended to ensure that income from Canadian risks cannot be "swapped out" with income from foreign risks in order to avoid Canadian tax.

Finally, if a life insurer has insured foreign risks through a foreign branch and it can reasonably be concluded that the foreign risks were insured by the insurer as part of a series of transactions one of the purposes of which was to avoid the main proposed rule, then the life insurer will be treated as if it had insured Canadian risks. A similar anti-avoidance rule is also added in respect of the FAPI regime.

These measures will apply to taxation years that begin on or after 22 March 2017.

Tax evasion, combating tax avoidance and BEPS

Budget 2017 promises to invest $523.9 million over five years to prevent tax evasion and improve tax compliance. The investment will be used to fund new initiatives and extend existing programs that ensure our tax system is fair and equitable for all Canadians. The measures in Budget 2017 will build on previous investments to support the Canada Revenue Agency (CRA) in its continued efforts to crack down on tax evasion and combat tax avoidance by:

- Increasing verification activities
- Hiring additional auditors and specialists with a focus on the underground economy
- Developing robust business intelligence infrastructure and risk assessment systems to target high-risk international tax and abusive tax avoidance cases
- Improving the quality of investigative work that targets criminal tax evaders

Budget 2017 accounts for the expected revenue impact of $2.5 billion over five years from measures that crack down on tax evasion and combat tax avoidance, resulting in a return on investment of five to one.

The government also remains firmly committed to protecting Canada's tax system and combatting international tax avoidance and evasion. Base erosion and profit shifting (BEPS) refers to international tax planning arrangements used by multinational enterprises to unfairly minimize their taxes. Legislation was enacted in December 2016 that requires large multinational enterprises to file country-by-country reports. This information will give tax authorities in each country a clearer picture of where the operations of the group in their particular jurisdiction fit into the group's global operations. This will enable them to better assess high-level avoidance risks such as the potential for mispricing of transactions between entities of the group in different jurisdictions.

Canada also participated in the development of a multilateral instrument to streamline the implementation of tax treaty-related BEPS recommendations, including those addressing treaty abuse. The multilateral instrument is a tax treaty that many countries could sign modifying certain provisions of existing bilateral tax treaties without the need for separate bilateral negotiations. The government is pursuing signature of the multilateral instrument and is undertaking the necessary domestic processes to do so.

The Government of Canada has also committed to the effective and timely resolution of tax treaty-related disputes by improving the mutual agreement procedure in Canada's tax treaties. The CRA has begun the spontaneous exchange with other tax administrations of tax rulings that could otherwise give rise to BEPS concerns. As part of the effort to counter harmful tax practices, this helps ensure that revenue authorities are not granting to taxpayers non-transparent "private" rulings that guarantee favourable tax treatment with respect to a transaction.

With respect to other BEPS recommendations:

- Canada has robust "controlled foreign corporation" rules in the form of foreign accrual property income regime, which helps prevent taxpayers from avoiding Canadian income tax by shifting income into foreign subsidiaries.
- Canada has implemented requirements for taxpayers, as well as promoters and advisors, to disclose specified tax avoidance transactions to the CRA.
- The CRA is applying revised international guidance on transfer pricing by multinational enterprises. These guidelines provide an improved interpretation of the requirement in the tax laws of Canada and most other countries that transactions between entities of a corporate group in different jurisdictions should be priced as if they were arm's-length transactions.

Tax relief for individuals and families

Personal income tax rates

There are no individual income tax rate or tax bracket changes in this budget. The brackets will continue to be indexed for inflation.

See Table D for the 2017 federal rates and the Appendix for the top combined marginal rates by province and territory.

Table D

Federal personal income tax rates	
	2017
Up to $45,916	15.0%
$45,917 to $91,831	20.5%
$91,832 to $142,353	26.0%
$142,354 to $202,800	29.0%
Over $202,800	33.0%

Budget 2017 includes the following tax credit proposals:

- **Tuition tax credit**: The budget extends the eligibility criteria for the tuition tax credit to amounts paid for tuition to a post-secondary institution in Canada for occupational skills courses that are not at the post-secondary level.

- **Public transit tax credit**: The public transit tax credit is eliminated effective 1 July 2017, such that public transit passes and electronic fare cards attributable to transit use after June 2017 will not be eligible for the credit.
- **Caregiver credits**: The budget proposes to replace the infirm dependant tax credit, the caregiver tax credit and the family caregiver tax credit with a new 15% non-refundable Canada caregiver credit for 2017 and subsequent years. Specifically, $6,883 may be claimed for the care of an infirm dependant relative (i.e., parent, grandparent, sibling, aunt, uncle, niece, nephew or an adult child) of the claimant, or of the claimant's spouse or common-law partner; and $2,150 for an infirm dependent spouse or common-law partner in respect of whom the individual claims the spouse or common-law partner amount, an infirm dependent for whom the eligible dependent credit is claimed, and an infirm child under 18 years of age at the end of the taxation year. The credit amount is reduced (dollar for dollar) when a dependent's net income exceeds $16,163. The credit amounts and the net income threshold will be indexed to inflation after 2017.
- **Disability tax credit**: The budget proposes to add nurse practitioners to the list of medical practitioners who are allowed to certify eligibility for the 15% non-refundable disability tax credit. Nurse practitioners are described in the budget as registered nurses with additional educational preparation and experience who are able to diagnose autonomously, order and interpret diagnostic tests, prescribe pharmaceuticals and perform specific procedures within their legislated scope of practice. This budget measure applies to disability tax credit certifications made on or after 22 March 2017.
- **Medical expense tax credit**: The list of expenses eligible for the medical expense tax credit will be clarified to ensure that individuals who incur costs related to the use of reproductive technologies (such as in-vitro fertilization), but do not have a medical infertility condition, are eligible to claim the credit. This measure generally applies for 2017 and subsequent years. However, an individual may elect in a year for this measure to apply for any of the immediately preceding 10 taxation years.
- **Mineral exploration**: As previously announced on 5 March 2017, the mineral exploration tax credit, equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors, will be extended to flow-through share agreements entered into on or before 31 March 2018. The credit was scheduled to expire on 31 March 2017.

Other personal measures

Anti-avoidance rules for registered plans

Budget 2017 proposes to extend the anti-avoidance rules that currently apply to tax-free savings accounts (TFSAs), registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) to registered education savings plans (RESPs) and registered disability savings plans (RDSPs). This includes the advantage tax rules, the prohibited investment rules and the non-qualified investment rules.

The measures will apply to transactions occurring and investments acquired after 22 March 2017. However, the advantage rules will not apply to swap transactions undertaken before July 2017, or that are undertaken any time before 2022 for the purpose of removing investments which would otherwise be considered a prohibited investment or an asset which gives rise to an advantage.

As well, a plan holder may elect by 1 April 2018 to pay regular personal income tax on the distribution of investment income instead of the advantage tax for an investment held on 22 March 2017.

Home relocation loans

Where an employer provides an individual with financial assistance in the form of a low- or no-interest loan, an imputed interest benefit must be included in the individual's employment income.

An employee who has received a home purchase loan that qualifies as a home relocation loan may be entitled to a deduction against the amount of any imputed interest benefit included in income. The value of the benefit arising from an eligible home relocation loan may be deducted from taxable income; however, the deductible amount is limited to the annual benefit that would arise from a loan of $25,000.

Budget 2017 proposes to eliminate this deduction for benefits arising after 2017. As a result, there will no longer be a deduction from taxable income for the interest benefit from home relocation loans.

Allowances for members of legislative assemblies and certain municipal officers

Certain officials receive non-accountable allowances for work expenses that are not taxable. These officials are elected members of provincial and territorial legislative assemblies and officers of incorporated municipalities; elected officers of municipal utilities boards, commissions, corporations or similar bodies; and members of public or separate school boards or similar bodies.

Budget 2017 proposes to include such non-accountable allowances in income.

Charities and non-profit organizations

Budget 2017 proposes the following measures relating to charities:

- **Gifts of medicine** — Elimination of the additional corporate deduction for gifts of medicine, effective for gifts made on or after 22 March 2017.

- **First-time donor's tax credit** — Confirmation that the first-time donor's tax credit will expire, as planned, after 2017.

- **Ecological gifts** — Four technical amendments are proposed:

  - **Transfer of ecological gifts** — The 50% Part XI.2 tax that applies where the use of ecologically sensitive land is changed, or the property is disposed of, without the consent of Environment and Climate Change Canada (ECCC), will be extended to situations where the land is transferred between organizations for consideration and the transferee changes the use of the property, or disposes of the land without the consent of the ECCC.

  - **Approval of recipients** — The requirement for the ECC to approve recipients of ecological gifts will be extended, on a gift-by-gift basis, to municipalities and municipal and public bodies performing a function of government.

  - **Private foundations** — Private foundations will no longer be permitted to receive ecological gifts.

  - **Personal servitudes** — The donation of personal servitudes will qualify as ecological gifts, provided certain conditions are met (e.g., the servitude must run for a least 100 years).

These measures will apply in respect of transactions or events that occur on or after 22 March 2017.

National carbon tax

Budget 2017 reaffirms the federal government's commitment to impose a national price on carbon pollution by 2018.

In 2016, the federal government committed to putting a national price on carbon emissions. Starting at $10/tonne in 2018 and increasing to $50/tonne by 2022, the federal legislation is a "backstop" — meaning that it will only apply in those provinces that have not otherwise adopted their own carbon pricing regime. The federal government further committed to transferring the funds raised in the province from the federal carbon pricing mechanism back to the provincial government.

In Budget 2017, the federal government committed to releasing a consultation paper in the coming months with technical details on its proposed carbon pricing backstop system.

At this point, two provinces — British Columbia and Alberta — have introduced a direct price on carbon pollution, and three have adopted a cap-and-trade system (Ontario, Quebec and Nova Scotia). This means that prior to 2018, the remaining provinces and territories will need to decide whether to introduce their own carbon pricing systems or rely on the "to be announced" federal pricing and collection mechanism.

One of the benefits for provinces of introducing their own carbon pricing systems is that the province also is able to define exemptions. For example, Alberta has substantially exempted its upstream oil and gas sector from its carbon levy until 2023; it's doubtful the federal government's backstop carbon pricing regime will include a similar exemption. Accordingly, stay tuned to whether the remaining provinces — particularly Saskatchewan and Manitoba — are willing to rely on the federal government to impose a price on carbon, or whether they'll move to implement their own to protect the competitiveness of their natural resource industries and agricultural sectors.

Key questions remain.

First, Budget 2017 did not reaffirm the price on carbon that the federal government is proposing. As of 1 January 2018, both Alberta and BC will be at $30/tonne, a federal price of $10/tonne in 2018 should be expected. However, neither Alberta nor BC has yet to commit to increasing their carbon pricing beyond the $30/tonne level, and with changes in climate change policy in the United States, it remains to be seen whether the federal government's backstop will impose a requirement to increase the provincial/territorial price beyond the $30/tonne level as the federal government originally announced.

Second, it's not yet clear whether the federal government's backstop will be in the form of a direct price on carbon (i.e., a tax or levy) or whether it will be a cap-and-trade system, although Budget 2017 does suggest it will be the former in that the budget documents refer to it as a "carbon pricing backstop mechanism."

Sales and excise tax measures

Ride-sharing services drivers must register and report GST/HST effective 1 July 2017

Taxi owners and drivers are required to charge and collect GST/HST on their fares regardless of the annual revenues they earn. To date, drivers for ride-sharing services were not required to be registered or report GST/HST on their fares if they earned less than $30,000/year.

Budget 2017 proposes to amend the definition of "taxi business" for GST/HST purposes effective 1 July 2017 and will require drivers offering ride-sharing services through electronic platforms or systems (i.e., an app) to also register for and to report GST/HST on their fares.

Elimination of nonresident GST/HST rebate for tour package accommodations

Budget 2017 proposes to repeal the GST/HST rebate available to nonresident individuals and tour operators in respect of the accommodation portion of eligible tour packages.

While generally repealed effective 23 March 2017, the rebate will continue to be available in respect of eligible tour packages supplied and paid for prior to 1 January 2018.

Opioid overdose drug GST/HST exemption

Naloxone is the drug used to treat opioid overdose. When Health Canada began allowing it to be dispensed without a prescription, the drug's historical GST/HST exemption was technically lost. To restore its GST/HST-free status, Budget 2017 proposes to include Naloxone on the list of GST/HST-free non-prescription drugs.

Confirmation of amendments to GST/HST drop-shipment rules, pension plan rules, and joint venture election

In July 2016, the Ministry of Finance released proposed amendments to the GST/HST drop-shipment rules and pension plan rules. The government also previously committed to expanding the availability of the GST/HST joint venture election. Budget 2017 reaffirmed the government's commitment to all of these measures. Read more in our Tax Alert 2016 Issue No. 38.

Customs measures

Budget 2017 includes proposals for legislative amendments to the General Preferential Tariff and Least Developed Country Tariff Rules of Origin Regulations. The proposed amendments will enable foreign manufacturers to use inputs from a broader scope of countries in the productions of T-shirts and pants that qualify for duty-free importation into Canada. Budget 2017 states that the regulatory amendments would be put forward in the coming weeks.

Budget 2017 includes proposals for a number of amendments to the Special Import Measures Act (SIMA) and related trade remedy regulations.

Budget 2017 proposes that SIMA be amended in order to include anti-avoidance rules whereby Canadian producers would be entitled to file complaints regarding trade and business practices intended to avoid trade remedy duties and whereby duties may be imposed on goods imported in connection with such practices.

In an effort to increase transparency of Canada's trade remedy system, Budget 2017 announced that interested parties will be allowed to file for scope rulings under which the CBSA would provide its position as to whether a specific product is subject to trade remedy measures. Interested parties should also be able to monitor and appeal enforcement decisions more easily. Budget 2017 also includes proposals for regulatory amendments to ensure that unions have the right to participate as interested parties in trade remedy proceedings.

Budget 2017 includes an engagement to amend SIMA in order to address circumstances where particular market situations in a domestic market have an impact on the evaluation of the price in this market of goods imported into Canada. In the context of SIMA investigations, the Minister proposed that CBSA investigators gain greater latitude in the evaluation and comparison of the goods' price in a domestic market and the price of the goods when they are exported to Canada.

In reaction to findings of the World Trade Organization (WTO) in December 2016 regarding exporters found to be dumping at de minimis levels, the Minister proposes to amend SIMA in order to bring Canada's trade remedy law in line with Canada's obligations under the WTO rules.

No notices of ways and means motions to amend SIMA and related legislation accompanied Budget 2017 and the effective date of the proposed amendments to SIMA and related legislation were not provided.

Excise duty measures

Although Budget 2017 includes no significant new excise duty proposals, the accompanying Notice of Ways and Means Motion to Amend the *Excise Act* and the *Excise Act, 2001* included the two tax measures, described below.

Tobacco tax

Budget 2017 proposes to eliminate the tobacco manufacturers' surtax of 10.5% applicable on profits under the Income Tax Act. In order to maintain an equivalent tax burden on tobacco manufacturers, Budget 2017 proposes to increase accordingly excise duty rates imposed under the Excise Act, 2001. The minister also proposed that inventories of cigarettes held by manufacturers, importers or wholesalers and retailers at the end of 22 March 2017 be subject to a tax of $0.00265 per cigarette. This tax, however, is not payable in situations where a separate retail establishment of a person holds inventory of 30,000 or fewer cigarettes. Taxpayers will have until 31 May 2017 to file returns and pay this inventory tax. These measures will be effective as of 23 March 2017.

There are corresponding proposals to amend the *Income Tax Act*, the *Excise Act* and the *Excise Act, 2001*.

Alcohol tax

Budget 2017 proposes to increase the excise duties on alcohol and corresponding rates imposed under the *Excise Act* and *Excise Act, 2001* by 2%. Budget 2017 also proposes that the rates be adjusted on 1 April of every year commencing in 2018 according to the Consumer Price Index. These amendments become effective on 23 March 2017.

Pending legislation

Bill C-4, *An Act to Amend the Canada Labour Code, the Parliamentary Employment and Staff Relations Act, the Public Service Labour Relations Act and the Income Tax Act*

Bill C-4 includes provisions to amend the *Income Tax Act* to remove the requirement that labour organizations and labour trusts annually provide the CRA with specific financial information for public disclosure. Such reporting requirement has never been implemented, as the CRA waived it for fiscal periods starting on 31 December 2015 and through 2016, as well as for fiscal periods starting in 2017.

Notice of Ways and Means Motion re principal residence exemption

This Notice of Ways and Means motion dated 3 October 2016 proposed changes to the principal residence exemption such as revising the calculation of the principal residence exemption for individuals who are nonresidents of Canada throughout the year of acquisition of the property as well as certain trusts that no longer qualify to designate a property as a principal residence after 2016. Additional amendments include an extended assessment period for taxpayers who do not report the disposition of property on their tax return for 2016 and later years. Read more in our Tax Alert 2016 No. 45.

Legislative proposals: Technical amendments re upstream loan rules, back-to-back loan rules, etc.

Draft legislation relating to technical amendments to the *Income Tax Act* and Income Tax Regulations was released 16 September 2016 with comments to be submitted by 15 November 2016. Many of the technical amendments included in this release respond to issues raised by taxpayers and their representatives, or are part of an ongoing effort by the Department of Finance to improve the accuracy and consistency of the income tax legislation and regulations. Read more in our Tax Alert 2016 No. 41.

2016 federal budget (tabled 22 March 2016)

Outstanding measures from the 2016 federal budget concerning new reporting requirements for corporate and partnership life insurance beneficiaries that are not policyholders, and the expansion of accelerated CCA Classes 43.1 and 43.2 for clean energy assets (generally applicable after 21 March 2016). Read more in our Tax Alert 2016 No. 14.

Webcast

22 March webcast: The evening following the finance minister's address, members of the EY tax team will record their analysis and insights on the tax measures in the 2017 budget. View our webcast at ey.com/ca/budget.

24 March webcast: Join us for a candid discussion of how the budget measures might impact Canadian private companies. The session will be hosted by David Steinberg, Co-leader of EY's Canadian Private Client Services practice, and EY Tax Partners John Sliskovic and Ryan Ball.

Learn more

For more information on the above measures or any other topics which may be of concern, please contact your EY or EY Law advisor.

And for up-to-date information on the federal, provincial and territorial budgets, visit ey.com/ca/budget.

Appendix

Maximum combined personal marginal income tax rates (as at 22 March 2017)

	Ordinary income			2017		
	2016	2017	Increase (decrease)	Eligible dividends	Ordinary dividends	Capital gains
	%	%	%	%	%	%
Federal only	33.00	33.00	0.00	24.81	26.30	16.50
BC	47.70	47.70	0.00	31.30	40.95	23.85
Alberta*	48.00	48.00	0.00	31.71	41.24	24.00
Saskatchewan**	48.00	48.00	0.00	30.33	39.91	24.00
Manitoba	50.40	50.40	0.00	37.78	45.74	25.20
Ontario	53.53	53.53	0.00	39.34	45.30	26.76
Quebec	53.31	53.31	0.00	39.83	43.84	26.65
NB	53.30	53.30	0.00	33.51	45.96	26.65
NS	54.00	54.00	0.00	41.58	46.97	27.00
PEI	51.37	51.37	0.00	34.22	43.87	25.69
NL	49.80	51.30	1.50	42.61	43.62	25.65
NWT	47.05	47.05	0.00	28.33	35.72	23.53
Nunavut	44.50	44.50	0.00	33.08	36.35	22.25
Yukon	48.00	48.00	0.00	24.81	40.17	24.00

**Alberta's 2017 budget proposed to introduce a change to the dividend tax credit rate for ordinary dividends for 2017 and subsequent years due to changes in the federal income tax components. However, no further details were provided. The rate above is the pre-budget rate. Income earned in a small business and flowed out to shareholders will continue to be taxed at a minimum rate of 10%, matching Alberta's lowest personal income tax rate.*

***Saskatchewan's 2017 budget changes to personal tax rates are not reflected in this table.*