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Tax Tips & Traps
2014

On February 11, 2014 the Honourable Jim Flaherty, Minister of Finance, presented Canada's Economic Action Plan 2014 to the House of Commons.

The Government's fiscal positions include deficits in the years 2013/2014 ($16.6 billion), 2014/2015 ($2.9 billion), and surpluses in 2015/2016 ($6.4 billion), 2016/2017 ($8.1 billion), 2017/2018 ($8.1 billion), and 2018/2019 ($10.3 billion).

The Federal Government notes:

- New measures are proposed to improve competition in the telecommunications market by capping wholesale domestic wireless roaming rates.
- $305 million will be invested over five years to extend and enhance broadband Internet service for Canadians in rural and northern communities.
- Legislation is to be introduced prohibiting unjustified cross-border price discrimination to reduce the gap between consumer prices in Canada and the United States.
- $200 million over five years will be directed to establish a National Disaster Mitigation Program.
- An additional $500 million over two years will be provided to the Automotive Innovation Fund to support significant new strategic research and development projects.
- The Canada Apprentice Loan will be created by expanding the Canada Student Loans Program to help apprentices registered in Red Seal trades with the cost of training.
- $391 million over five years will be provided to the Parks Canada Agency to make improvements to highways, bridges and dams located in national parks and along historic canals.
- $390 million over five years will be provided to strengthen Canada's food safety system.

	Actual	Projection (in billions of $)					
	2012 - 13	2013 - 14	2014 - 15	2015 - 16	2016 - 17	2017 - 18	2018 - 19
Budgetary revenues	256.6	264.0	276.3	293.3	306.8	317.7	332.4
Program expenses	246.4	251.2	250.2	256.9	266.5	275.2	286.3
Public debt charges	29.2	29.3	29.0	30.0	32.1	34.4	35.8
Total expenses	275.6	280.5	279.2	286.9	298.7	309.7	322.1
Budgetary Balance	(18.9)	(16.6)	(2.9)	6.4	8.1	8.1	10.3

Note: Totals may not add due to rounding.

TAX HIGHLIGHTS

A. Personal Income Tax
B. Business Income Tax
C. International Tax
D. Sales and Excise Tax
E. Previously Announced Measures
F. CRA Service

A. Personal Income Tax

Adoption Expense Tax Credit
Budget 2014 proposes to increase the maximum amount of eligible expenses to $15,000 per child for 2014. This maximum amount will be indexed to inflation for taxation years after 2014.

Medical Expense Tax Credit (METC)
Budget 2014 proposes that amounts paid in some scenarios for the design of an individualized therapy plan be eligible for the METC if the cost of the therapy itself would be eligible for the METC.

Federal Budget Commentary 2014

Expenses for service animals specially trained to assist an individual in managing their severe diabetes will also be added to the list of expenditures eligible for the METC.

This will apply to expenses incurred after 2013.

Search and Rescue Volunteers Tax Credit
Budget 2014 proposes a Search and Rescue Volunteers Tax Credit (SRVTC) to allow eligible ground, air and marine search and rescue volunteers to claim a 15-per-cent non-refundable tax credit based on an amount of $3,000.

An eligible individual must perform at least 200 hours of volunteer search and rescue services in a taxation year, for one or more ground, air or marine search and rescue organizations.

Individuals will only be able to claim either the Volunteer Firefighters Tax Credit or the SRVTC.

This will apply to the 2014 and subsequent taxation years.

Extension of the Mineral Exploration Tax Credit for Flow-Through Share Investors
Budget 2014 proposes to extend eligibility for the Mineral Exploration Tax Credit for one year, to flow-through share agreements entered into on or before March 31, 2015.

Farming and Fishing Businesses
To simplify the tax rules relating to the intergenerational rollover and the Lifetime Capital Gains Exemption, Budget 2014 proposes to extend eligibility for the rollover and the exemption to property of an individual used principally in a combination of farming and fishing.

Tax Deferral for Farmers
Farmers who dispose of breeding livestock due to drought, flood or excess moisture conditions existing in prescribed regions in a given year are permitted to defer up to 90 per cent of the sale proceeds from inclusion in their taxable income until the year following the sale, or a later year if the conditions persist.

Budget 2014 proposes to extend this tax deferral to bees, and to all types of horses that are over 12 months of age, that are kept for breeding.

Amateur Athlete Trusts
Budget 2014 proposes to allow income that is contributed to an amateur athlete trust to qualify as earned income for the purpose of determining the RRSP contribution limit of the trust's beneficiary.

This will apply in respect of contributions made to amateur athlete trusts after 2013. In addition, individuals who contributed to an amateur athlete trust before 2014 will be permitted to make an election to have income that was contributed to the trust in 2011, 2012 and 2013 also qualify as earned income.

An individual will be required to make the election in writing and submit it to the Canada Revenue Agency on or before March 2, 2015.

GST/HST Credit Administration
Budget 2014 proposes to eliminate the need for an individual to apply for the GST/HST Credit and to allow the Canada Revenue Agency to automatically determine if an individual is eligible to receive the GST/HST Credit. In the case of eligible couples, the GST/HST Credit will be paid to the spouse or common-law partner whose tax return is assessed first.

This will apply in respect of income tax returns for the 2014 and subsequent taxation years.

Tax on Split Income (Kiddie Tax)
The tax on split income does not currently apply to situations where a minor is allocated income from a partnership or trust that is derived from business or rental activities conducted with third parties. For example, an adult might provide services to clients of a partnership of which the adult's minor child is a member (either directly or through a trust of which the child is a beneficiary). The child is allocated a share of the partnership's income – income that was earned as a result of the services provided by the adult.

Similarly, income allocated to a minor beneficiary of a Trust from business or rental income will be subject to the kiddie tax.

It is proposed that the definition "split income" in the Income Tax Act be modified to include income that is, directly or indirectly, paid or allocated to a minor from a trust or partnership, if:

- the income is derived from a source that is a business or a rental property; and
- a person related to the minor
  - is actively engaged on a regular basis in the activities of the trust or partnership to earn income from any business or rental property, or
  - has, in the case of a partnership, an interest in the partnership (whether held directly or through another partnership).

This will apply to the 2014 and subsequent taxation years.

Graduated Rate Taxation of Trusts and Estates
Budget 2014 proposes to generally proceed with the measures described in the consultation paper released June 3, 2013. It contained measures that would apply flat top-rate tax to estates for taxation years that end more than 36 months after the death of the relevant individual and to all grandfathered inter vivos trusts and trusts created by will.

In addition to the original proposal, graduated rates will continue to be provided in respect of such trusts having as their beneficiaries individuals who are eligible for the federal Disability Tax Credit.

Also under this proposal, testamentary trusts (other than estates for their first 36 months) and grandfathered inter vivos trusts will not benefit from special treatment under a number of related tax rules, in particular:

- an exemption from the income tax installment rules;
- an exemption from the requirement that trusts have a calendar taxation year and fiscal periods that end in the calendar year in which the period began;
- the basic exemption in computing alternative minimum tax;
- preferential treatment under Part XII.2 of the Income Tax Act;
- classification as a personal trust without regard to the circumstances in which beneficial interests in the trust have been acquired;
- the ability to make investment tax credits available to a trust's beneficiaries; and
- a number of tax administration rules that otherwise apply only to ordinary individuals.

This will apply to the 2016 and subsequent taxation years.

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

Non-Resident Trusts
Budget 2014 proposes to eliminate the 60-month exemption from the deemed residence rules, eliminating a common planning tool for immigrants.

This will generally apply to Trust taxation years ending on or after Budget Day. However, limited grandfathering will apply for taxation years ended in 2014 where no contributions are made to the Trust between Budget Day and December 31, 2014.

Donations of Ecologically Sensitive Land
Budget 2014 proposes to extend to ten years the carry-forward period for donations of ecologically sensitive land, or easements, covenants and servitudes on such land.

This will apply to donations made on or after Budget Day.

Estate Donations
Budget 2014 proposes to provide more flexibility in the tax treatment of charitable donations made in the context of a death that occurs after 2015. Donations made by will and designation donations will no longer be deemed to be made by an individual immediately before the individual's death. Instead, these donations will be deemed to have been made by the estate, at the time at which the property that is the subject of the donation is transferred to a qualified donee.

This means that the trustee of the individual's estate will have the flexibility to allocate the available donation among any of: the taxation year of the estate in which the donation is made; an earlier taxation year of the estate; the deceased's personal tax return for the year of death or the year preceding death. Donations must be made from the Estate to the charity within 36 months after the date of death.

This will apply to the 2016 and subsequent taxation years.

Donations of Certified Cultural Property
Budget 2014 proposes that the value of a gift of certified cultural property acquired as part of a tax shelter gifting arrangement be deemed no greater than its cost to the donor. Other donations of certified cultural property will not be affected by this measure.

This will apply to donations made on or after Budget Day.

State Supporters of Terrorism
Budget 2014 proposes that where a charity (or a Canadian amateur athletic association) accepts a donation from a foreign state listed as a supporter of terrorism for purposes of the State Immunity Act, or from an agency of such a state, the Minister of National Revenue may refuse to register the charity (or amateur athletic association) or may revoke its registration.

This will apply to donations accepted on or after Budget Day.

Consultation on Non-Profit Organizations
Budget 2014 announces the Government's intention to review whether the income tax exemption for NPOs remains properly targeted and whether sufficient transparency and accountability provisions are in place. This review will not extend to registered charities or registered Canadian amateur athletic associations.

B. Business Income Tax

Remittance Thresholds for Employer Source Deductions
Budget 2014 proposes to:

- increase the threshold level of average monthly withholdings at which employers are required to remit up to two times per month to $25,000 from $15,000; and
- increase the threshold level of average monthly withholdings at which employers are required to remit up to four times per month to $100,000 from $50,000.

This will apply in respect of amounts to be withheld after 2014.

Water-Current Energy Equipment/Gasification Equipment
Budget 2014 proposes to expand Class 43.2 (50% declining-balance) to include water-current energy equipment and equipment used to gasify eligible waste fuel for use in a broader range of applications.

This will apply to property acquired on or after Budget Day that has not been used or acquired for use before that date.

Consultation on Eligible Capital Property (ECP)
Budget 2014 announces a public consultation on a proposal to repeal the ECP regime, replace it with a new CCA class available to businesses and transfer taxpayers' existing Cumulative Eligible Cost (CEC) pools to the new CCA class. The timing of the implementation of this proposal will be determined following the consultation.

Proposed Rules
Expenditures that are currently added to CEC (at a 75-per-cent inclusion rate) would be included in the new CCA class at a 100-per-cent inclusion rate. The new class would have a 5-per-cent annual depreciation rate. The existing CCA rules would generally apply, including rules relating to recapture, capital gains and depreciation (e.g., the "half-year rule").

Special rules
Special rules would apply in respect of goodwill and in respect of expenditures and receipts that do not relate to a specific property of the business. Such expenditures and receipts would be accounted for by adjusting the capital cost of the goodwill of the business.

Every business would be considered to have goodwill associated with it, even if there had not been an expenditure to acquire goodwill. An expenditure that did not relate to property would increase the capital cost of the goodwill of the business and, consequently, the balance of the new CCA class.

A receipt that did not relate to a specific property would reduce the capital cost of the goodwill of the business and, consequently, the balance 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 exceeded the capital cost of the goodwill, the excess would be a capital gain. Previously deducted CCA would be recaptured to the extent that the amount of the receipt exceeds the balance of the new CCA class.

C. International Tax

Captive Insurance
Budget 2014 proposes to amend the existing anti-avoidance rule in the Foreign Accrual Property Income (FAPI) regime relating to the insurance of Canadian risks.

Budget 2014 proposes to add new conditions for qualifying under the regulated foreign financial institution exception.

Thin Capitalization
Budget 2014 proposes the addition of a specific anti-avoidance provision to treat certain back-to-back loans as loans from specified non-residents for purposes of the thin capitalization rules. Specifically, a back-to-back loan arrangement will exist where, as a result of a transaction or series of transactions, the following conditions are met:

- a taxpayer has an outstanding interest-bearing obligation owing to a lender (the intermediary); and
- the intermediary or any person that does not deal at arm's length with the intermediary
    - is pledged a property by a non-resident person as security in respect of the obligation (a guarantee, in and of itself, will not be considered a pledge of property),
    - is indebted to a non-resident person under a debt for which recourse is limited, or
    - receives a loan from a non-resident person on condition that a loan be made to the taxpayer.

In addition, Part XIII withholding tax will also apply in respect of a back-to-back loan arrangement to the extent that it would otherwise be avoided by virtue of the arrangement.

Consultation on Tax Planning by Multinational Enterprises
The Government invites input on questions such as:
What are the impacts of international tax planning by multinational enterprises (MNEs) on other participants in the Canadian economy?

The Government invites comments within 120 days after Budget Day.

Consultation on Treaty Shopping
The Government invites comments from interested parties on a proposed rule to prevent treaty shopping. The rule would use a general approach focused on avoidance transactions.

FATCA: Automatic Exchange of Information with the U.S.
In 2010, the U.S. enacted provisions known as the Foreign Account Tax Compliance Act (FATCA). FATCA would require non-U.S. financial institutions to identify accounts held by U.S. persons, which include U.S. citizens living abroad, and report to the U.S. Internal Revenue Service (IRS) information in respect of these accounts.

The Government of Canada successfully negotiated an intergovernmental agreement with the U.S. which contains significant exemptions and other relief. Under the approach in the Canada-U.S. agreement, which was signed on February 5, 2014, Canadian financial institutions will report to the Canada Revenue Agency (CRA) information in respect of U.S. persons that will be transmitted by the CRA to the IRS under the Canada-U.S. tax treaty and be subject to its confidentiality safeguards.

A variety of registered accounts (including Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Education Savings Plans, Registered Disability Savings Plans, and Tax-Free Savings Accounts) and smaller deposit-taking institutions, such as credit unions, with assets of less than $175 million will be exempt from reporting.

Meanwhile, the CRA will receive information from the U.S. in respect of Canadian resident taxpayers that hold accounts at U.S. financial institutions, which will assist Canadian tax authorities in administering and enforcing compliance with Canadian tax laws.

While the Canada-U.S. tax treaty contains a provision that allows a country to collect the taxes imposed by the other country, the CRA will not collect the U.S. tax liability of a Canadian citizen if the individual was a Canadian citizen at the time the liability arose (whether or not the individual was also a U.S. citizen at that time).

This new reporting regime will come into effect starting in July 2014, with Canada and the U.S. beginning to receive enhanced tax information from each other in 2015. A number of other countries have negotiated or are negotiating similar agreements with the U.S.

D. Sales and Excise Tax

Improving the Application of the GST/HST to the Health Care Sector

Budget 2014 proposes to expand the exemption for training that is specially designed to assist individuals with a disorder or disability to also exempt the services of designing such training under certain conditions.

The professional services of acupuncturists and naturopathic doctors are now regulated as a health profession in at least five provinces. Accordingly, Budget 2014 proposes that acupuncturists and naturopathic doctors be added to the list of health care practitioners whose professional services rendered to individuals are exempt from the GST/HST.

This will apply to supplies made after Budget Day.

Budget 2014 proposes to add eyewear specially designed to treat or correct a defect of vision by electronic means, if supplied on the written order of a physician or optometrist for use by a consumer named in the order, to the list of GST/HST zero-rated medical and assistive devices.

This will apply to supplies made after Budget Day.

GST/HST Election for Closely Related Persons

Budget 2014 proposes to extend, effective January 1, 2015, the availability of the group relief to new members that have not yet acquired any property, provided that the new members continue as going concerns engaged exclusively in commercial activities.

It is also proposed that a filing requirement in relation to the group relief election be introduced. Effective January 1, 2015, parties to a new election will be required to file that election in a prescribed manner with the Canada Revenue Agency.

Joint Ventures

The joint venture election simplifies GST/HST accounting obligations by allowing the joint venture participants to elect one person to be responsible for accounting for the GST/HST on the supplies, acquisitions and importations that are made in the course of their joint venture activities.

The Government intends to propose new joint venture election measures, as well as complementary anti-avoidance measures, that will allow the participants in a joint venture to make the joint venture election as long as the activities of the joint venture are exclusively commercial and the participants are engaged exclusively in commercial activities.

Strengthening Compliance with GST/HST Registration

Budget 2014 proposes that the Minister of National Revenue be given the discretionary authority to register and assign a GST/HST registration number where a person fails to comply with the requirement to register, even after having been notified of the requirement to register by the CRA.

This will apply on Royal Assent to the enacting legislation.

Standardizing Sanctions Related to False Statements in Excise Tax Returns

Budget 2014 proposes to add a new administrative monetary penalty, and to amend the existing criminal offence, for the making of false statements or omissions in an excise tax return and related offences under the non-GST/HST portion of the Excise Tax Act.

Specifically, the new administrative monetary penalty will be the greater of $250 and 25 per cent of the tax avoided. For the revised criminal offence: the fine will range from 50 to 200 per cent of the tax evaded, along with a potential maximum two year term of imprisonment.

This will apply to excise tax returns filed after the day of Royal Assent to the enacting legislation.

Tobacco Products

The Budget increases the excise tax on tobacco products. The lower rates applicable to “duty-free” tobacco are being eliminated. In future, tobacco taxes will be indexed to the Consumer Price Index, with the first rate adjustment effective December 1, 2019, and further adjustments every five years thereafter.

Finally, an excise tax will apply to tobacco inventories on hand at the end of Budget Day, equal to the amount of the increase in the tobacco tax from the pre-Budget rates. This tax will be due April 30, 2014. Taxpayers whose inventory is no greater than 30,000 cigarettes (150 cartons), and cigarettes held in vending machines, will be exempt from this inventory tax.

A similar tax will apply to the future CPI adjustments.

E. Previously Announced Measures

Budget 2014 announced the continued development of the Canada Job Grant. The Federal government will be covering the required provincial contribution.

The Canada Job Grant could provide up to $15,000 per person for training costs, including tuition and training materials.

Budget 2014 confirms the Government's intention to proceed with the following:

- Proposed changes to automobile expense deduction limits and the prescribed rates for the automobile operating expense benefit for 2012 announced on December 29, 2011, and for 2013 announced on December 28, 2012 (a December 30, 2013 news release announced there would be no changes for 2014);
- Legislative proposals released on November 27, 2012 relating to income tax rules applicable to Canadian banks with foreign affiliates;
- Legislative proposals released on July 12, 2013 relating to income tax and excise duties and sales tax technical amendments;
- Legislative proposals released on August 16, 2013 relating to the foreign affiliate dumping rules;
- Legislative proposals released on August 23, 2013 relating to changes to the life insurance policyholder exemption test;
- Modifications to the Customs Tariff to implement the Notice of Ways and Means Motion tabled by the Government in Parliament on November 22, 2013, which clarified the tariff classification of certain imported food products;
- Legislative proposals released on November 27, 2013 relating to the tax rules governing Labour-Sponsored Venture Capital Corporations;
- Legislative proposals released on January 9, 2014 to require that international electronic funds transfers of $10,000 or more be reported to the Canada Revenue Agency;
- Legislative proposals released on January 17, 2014 clarifying GST/HST rules to prevent input tax credit claims that exceed tax actually paid; and
- Legislative proposals released on January 24, 2014 relating to the provision of a GST/HST exemption for hospital parking for patients and visitors.

F. CRA Service

The CRA has noted the following changes to its service:

- **Submitting Documents Electronically—** In April 2014 the electronic filing service will be expanded to allow the filing of amended T2 corporate returns, and in October 2014 businesses will be able to update their banking and direct deposit information online.
- **Authorized Representatives**—In April 2014 representatives will be able to transmit an electronic authorization request to the CRA.
- **Electronic Pre-Authorized Debit Service for Business**—In October 2014, business owners registered with My Business Account will have the option for paying their taxes online. In addition, the CRA will be providing businesses with a detailed payment history for all of their accounts.
- **Business Number**—The CRA will be improving the online business registration service by removing some restrictions, enhancing authentication and improving the registration process.
- **Liaison Officer Initiative**—This recently announced pilot project will be focused on improving compliance by providing small and medium-sized enterprises with the information and the support they need, when they most need it. This will help small businesses avoid costly and time-consuming interactions with the CRA—such as requests for additional information, reviews, audits, and reassessments.
- **Registration of Tax Preparers Program—**On January 17, 2014, the Minister of National Revenue launched consultations on a proposal to register tax preparers as part of a CRA initiative to improve voluntary compliance among small and medium-sized businesses.