March 23, 2016

UPDATE

Budget Briefing 2016

Budget 2016 focuses on growth, not austerity. It includes measures that will grow the economy for the benefit of every Canadian.

In an environment of sustained economic weakness and low interest rates, fiscal policy is the right policy lever to use to support long term growth…

Investment is needed and the time to invest is now. Smart investments can strengthen and expand the middle class, reduce inequality among Canadians and position Canada for sustained economic growth in the years to come.

"Growing the Middle Class," 2016 Federal Budget tabled in the House of Commons by the Honourable Bill Morneau, Minister of Finance

The Honourable Bill Morneau, Minister of Finance, tabled the Liberal government's first budget on March 22, 2016 (Budget 2016).

As expected, Budget 2016 includes the revamped Canada Child Benefit, one of the Liberals' key election promises, calling it "the most significant social policy innovation in a generation." It also includes significant spending promises on infrastructure ($120 billion over the next 10 years), with an immediate $11.9 billion investment in public transit, water and wastewater systems, and affordable housing, among others.

OSLER

Budget 2016 projects deficits of $29.4 billion for 2016/17, $29 billion in 2017/18, $22.8 billion in 2018/19, $17.7 billion in 2019/20 and $14.3 billion in 2020/21. However, Budget 2016 predicts that the federal debt-to-GDP ratio will decline beginning in 2017/18.

Budget 2016 does not propose any changes to the favourable tax treatment afforded stock option benefits – another Liberal election promise – and it is not clear whether the government intends to pursue such changes. With respect to the taxation of small businesses, Budget 2016 proposes to "defer" future rate reductions (freezing the rate at 10.5%) and to close down some loopholes, but does not otherwise propose any further restrictions. Again, it is not clear whether the government intends to consider this further. Another rumoured change, to the capital gains inclusion rate, is also notably absent from Budget 2016.

In addition to the specific measures summarized below, Budget 2016 indicates that the government will undertake a review of the tax system with a view to eliminating poorly targeted and inefficient tax measures.

In this Budget Briefing 2016, we summarize the more significant tax proposals included in Budget 2016.

BUSINESS INCOME TAX MEASURES

General Corporate Tax Rate

Budget 2016 does not propose to change the general corporate income tax rate, which remains at 15% at the federal level for 2016.

Small Business Taxation

A "Canadian-controlled private corporation" (CCPC) is a Canadian-incorporated, private corporation that is, throughout the year, not controlled, directly or indirectly, by one or more non-residents of Canada or public corporations (or any combination thereof). A corporation that qualifies as a CCPC for purposes of the *Income Tax Act* (Canada) (ITA) also qualifies for a number of tax benefits, including access to the small business tax rate on the first $500,000 of active business income.

Small Business Tax Rate

Budget 2016 proposes that the small business tax rate remain at 10.5% for 2016 and future years. This reverses the Conservative government's prior commitment to reduce the small business tax rate to 9% by 2019. Budget 2016 refers to this as a "deferral" of the rate reductions.

Multiplication of the Small Business Deduction

The small business deduction rules in the ITA reduce the federal corporate income tax rate applicable to the first $500,000 of qualifying active business income of a CCPC to 10.5%. The rules require an allocation of the annual eligible income limit of $500,000 among associated corporations. Similarly, where a business is carried on through a partnership, the members of the partnership share one $500,000 limit in respect of that business.

Budget 2016 proposes rules intended to limit the small business deduction in cases where certain partnership and corporate structures are used to inappropriately multiply access to the small business deduction.

Partnerships

Budget 2016 identifies structures that circumvent the application of the specified partnership income rules by having corporations, which are owned by partnership members and qualify as CCPCs, provide services or property to the partnership (without such corporations actually being or becoming members of the partnership). In so doing, such CCPCs may, respectively, claim the small business deduction, without having to allocate the $500,000 limit amongst all of the partners to the partnership (or other CCPCs owned by members of the partnership that provide services or property to the partnership).

Budget 2016 proposes to extend the specified partnership income rules to partnership structures in which a CCPC provides services or property to a partnership where the CCPC, or a shareholder of the CCPC, is a member of the partnership, or does not deal at arm's length with a member of the partnership. The rules do not apply to a CCPC that earns all or substantially all of its active business income from providing services or property to arm's-length persons other than the partnership.

Where the rules apply, the CCPC will then be deemed to be a member of the partnership and the income from the services or property provided to the partnership will be treated as active business income from the partnership. In calculating the CCPC's small business deduction, the CCPC will have to calculate its specified partnership income (SPI) limit which will initially be deemed to be *nil*; however, an actual member of the partnership who does not deal at arm's length with the CCPC will be entitled to assign any portion of the actual member's SPI limit (in that regard, an individual member of the partnership will be treated as if they were a corporation for purposes of determining the assignable SPI limit). The intended result is that members of the partnership and CCPCs providing services or property to the partnership (where the shareholders are members of the partnership) will share one $500,000 small business deduction limit.

The proposals include an anti-avoidance provision applicable to tiered partnership and corporate structures intended to circumvent the application of the foregoing measures.

This measure will apply to taxation years that begin on or after March 22, 2016. However, a private corporation will be entitled to assign all or a portion of its unused SPI limit in respect of its taxation year that begins before and ends on or after March 22, 2016.

Corporations

The same types of tax planning described above with respect to partnerships could also be effected by using a corporate vehicle. Such multiplication of the small business deduction could occur where a CCPC earns active business income from providing services or property to a private corporation while one of its shareholders, or a person who does not deal at arm's length with such shareholder, has an interest in the private corporation.

Budget 2016 proposes to address such structures by treating income from providing services or property to a private corporation as ineligible for the small business deduction. This ineligibility will not apply if all or substantially all of the CCPC's business income for the year is earned from providing services or property to arm's-length persons other than the private corporation. A private corporation that is a CCPC will be entitled to assign any portion of its unused business limit to one or more CCPCs that are ineligible for the small business deduction under these proposals.

This measure will apply to taxation years that begin on or after March 22, 2016. However, a private corporation will be entitled to assign all or a portion of its unused business limit in respect of its taxation year that begins before and ends on or after March 22, 2016.

Avoidance of the Business Limit and the Taxable Capital Limit

The ITA contains a provision whereby two corporations that would not otherwise be associated will be treated as associated if each of the corporations is associated with a third corporation. Such corporations would then have to allocate one $500,000 limit amongst all of them. However, the ITA provides for an exception to the rule if that third corporation is not a CCPC, or elects not to be associated with the other two corporations for purposes of determining their entitlement to the small business deduction. As a result, the two corporations, which would otherwise not be associated, may each claim a $500,000 small business deduction.

The ITA also contains a rule that treats a CCPC's investment income as active business income eligible for the small business deduction if that income is derived from the active business of an associated corporation. The exception noted above does not apply in this context. As a result, the two corporations mentioned above could each treat their investment income as active business income because the third corporation is associated with both corporations for purposes of this rule.

Budget 2016 identifies that CCPCs are misusing the election not to be treated as associated. The government is currently challenging such situations under existing specific and general anti-avoidance rules where the small business deduction is being claimed on investment income that is treated as active business income. Budget 2016 notes that any such challenge could be time-consuming and costly, and therefore, the government is introducing specific legislation to address such situations. Budget 2016 proposes to ensure that investment income derived from an associated corporation's active business will be ineligible for the small business deduction and be taxed at the general rate where the exception to the deemed associated corporation rule applies. The third corporation will continue to be associated with each of the other two corporations for the purpose of applying the $15 million taxable capital limit.

This measure will apply to taxation years beginning on or after March 22, 2016.

Consultation on Active Versus Investment Business

Budget 2015 announced a review of the circumstances in which a business, the principal purpose of which is to earn income from property, should qualify as earning active business income and therefore be potentially eligible for the small business deduction. Budget 2016 announces that the government's review is complete and it is not proposing any modification to these rules.

Repeal of Eligible Capital Property Regime

Budget 2016 proposes to repeal the rules in the ITA applicable to the treatment of eligible capital property (ECP) and replace those rules with a new class of depreciable property in respect of which capital cost allowance (CCA) may be claimed.

The current ECP regime applies to eligible capital expenditures (ECE) and eligible capital receipts. An ECE is generally a capital expenditure made for the purpose of earning income from business that is not deductible in computing income, and that is not made to acquire a depreciable property in respect of which CCA may be claimed. ECEs include the cost of goodwill on the purchase of a business, as well as other expenditures to acquire certain intangible rights such as customer lists. Under the current rules, 75% of an ECE is added to the cumulative eligible capital (CEC) pool and is deductible at an annual rate of 7% on a declining-balance basis.

An eligible capital receipt is generally a capital receipt for an intangible that is not included in income or in the proceeds of disposition of a capital property. Under the current rules, 75% of an eligible capital receipt is first applied to reduce the CEC pool and then results in the recapture of previously-deducted CEC. Any excess ECP gain is included in income from the business at a 50% inclusion rate, similar to capital gains.

Budget 2016 proposes to repeal the current ECP regime, which is described as having become increasingly complicated, and replace it with a new class of depreciable property for CCA purposes (Class 14.1). Expenditures that are currently added to CEC at a 75% inclusion rate will be included in Class 14.1 at a 100% inclusion rate. The existing CCA rules, such as those relating to recapture, capital gains and depreciation, will generally apply to Class 14.1, which will have a 5% annual depreciation rate on a declining-balance basis.

There will be a separate Class 14.1 pool for each business of a taxpayer, which will generally include existing ECP in respect of the business as of December 31, 2016, property that is acquired after 2016 meeting certain conditions (generally, identifiable intangible property that would receive ECP treatment under the current ECP regime) and "goodwill."

Because goodwill is not considered to be property under existing rules, Budget 2016 proposes new rules that will deem the goodwill of a business to be property, and that will deem each business to have a "single goodwill property." Generally, outlays or expenses made or incurred in respect of a business that would be eligible capital expenditures under the current ECP regime, and that do not form part of the cost of an identifiable property, will increase the capital cost of the goodwill and consequently, the balance of Class 14.1. Amounts that would be eligible capital receipts under the current regime, and that do not reduce the cost of an identifiable property or contribute to a gain or loss from the disposition of an identifiable property, will (to the extent they exceed any outlays or expenses made or incurred for the purpose of obtaining the receipts) reduce the capital cost of the goodwill in respect of the business and the balance of Class 14.1.

Budget 2016 proposes that the repeal of the ECP regime and the introduction of the new regime for Class 14.1 property will be effective January 1, 2017. CEC pool balances will be transferred to the new CCA class as of that date, and the depreciation rate applicable to expenditures incurred before that date will be 7% for the first ten years. Budget 2016 includes detailed transition rules intended to ensure that receipts received after January 1, 2017 that relate to expenditures incurred before that date do not result in excess recapture.

Budget 2016 also includes special measures targeted to small businesses to simplify the transition to the new CCA regime for ECP. First, until 2027, taxpayers will be permitted as an annual CCA deduction, in respect of expenditures incurred before 2017, the greater of $500 and the amount otherwise deductible. Second, the first $3,000 of incorporation expenses will be permitted as a current deduction rather than included in Class 14.1 and depreciated over time.

Taxation of Switch Fund Shares

"Switch fund" mutual fund corporations have been available to Canadian retail investors for many years. They offer convenient exposure to different types of assets in different funds, with each fund structured as a separate class of shares of a single mutual fund corporation. Investors in switch funds are able to "switch" their exposure among funds by exchanging shares of one class of the mutual fund corporation for shares of another class. Subject to certain exceptions, any gain on such a share exchange is currently tax-deferred.

Budget 2016 proposes to amend the ITA to cause an exchange of shares of a mutual fund corporation or investment corporation that results in the investor "switching between funds" to be a taxable disposition at fair market value. Budget 2016 states that the measure will not apply where the shares received in exchange differ only in respect of management fees or expenses borne by investors and otherwise derive their value from the same portfolio or fund.

In effect, this measure would align the treatment of an investor in a mutual fund corporation with the current treatment of investors in a mutual fund trust. Investors in mutual fund trusts are generally permitted to redesignate their investment between trust unit classes of the same fund without triggering a disposition of their units, provided the only distinction between unit classes relates to fees or expenses. Budget 2016 proposes to apply this measure to dispositions of shares occurring after September 2016. No draft legislation to implement this measure is included in the Budget materials.

Sales of Linked Notes

Linked notes are generally issued by financial institutions, and provide investors with a return linked to the performance of a particular reference asset or index.

Existing rules in the ITA deem interest to accrue on "prescribed debt obligations," which include certain linked notes on which the maximum amount of interest that could be payable on the note is determinable. A separate existing rule requires interest that has accrued on a debt obligation prior to its sale, and that is not payable until after such sale, to be included in the income of the vendor (and to allow such interest to be deducted in computing the income of the purchaser). Where a linked note is sold prior to the time at which the return on the note is determinable, investors may take the position that no amount in respect of the return on the note is accrued interest on the date of sale for purposes of this rule. Accordingly, on a sale or other transfer of a linked note prior to such time, an investor holding a linked note as capital property may in some circumstances report a capital gain or loss on the disposition of the note.

Budget 2016 proposes amendments to treat any gain realized by a taxpayer on a sale or transfer of a debt obligation (that is at any time a debt obligation, in respect of which the amount of interest to be paid in respect of any taxation year is, under the terms and conditions of the obligation, dependent on a contingency existing after the year) as interest that accrued on the obligation prior to the time of the transfer and that is not payable until after that time. The taxpayer's gain would be computed for this purpose without regard to fluctuations in the currency in which the debt is denominated, or to an increase in the value of fixed rate interest payments to be received under the debt obligation because of a decrease in market interest rates, since the date of issuance of the obligation.

Budget 2016 proposes to apply this measure to sales of linked notes occurring after September 2016.

Valuation of Derivatives

Budget 2016 proposes new rules for the valuation of derivatives held on income account that are not mark-to-market property or property of a business that is an adventure or concern in the nature of trade. Budget 2016 suggests this proposal responds to a Tax Court of Canada decision (presumably the decision in *Kruger Incorporated v. The Queen*, 2015 TCC 119) with a view to protecting the Canadian tax base from the application of traditional inventory valuation rules to derivatives, which have "potentially higher volatility and longer holding periods, as compared to conventional inventory." The extent to which this approach holds true over the vast breadth of the derivatives market remains unclear. Nonetheless, the proposal would deem a swap agreement, a forward purchase or sale agreement, a forward rate agreement, a futures agreement, an option agreement or any similar agreement not to be inventory of a taxpayer for purposes of the inventory valuation rules. In addition, Budget 2016 would preclude a taxpayer from realizing any reduction in the value of a derivative by using the lower of cost and market method through the addition of a new prohibition against deductibility in subsection 18(1) of the ITA.

These proposals would apply to derivative agreements that are entered into on or after March 22, 2016.

Debt Parking to Avoid Foreign Exchange Gains

The "debt parking" rules in the ITA apply to prevent debtors from avoiding the adverse application of the debt forgiveness rules by arranging for the transfer of a debt obligation to a non-arm's length person who has no intention of taking steps to collect on the debt. Where applicable, the rules deem the "parked debt" to have been repaid for an amount equal to its cost to the new holder, with any difference between such amount and the original principal amount being treated as a forgiven amount to which the debt forgiveness rules apply.

Budget 2016 proposes to extend the "debt parking" rules in the ITA to debt parking transactions entered into to avoid the realization of foreign exchange gains by the debtor of a foreign-currency denominated debt. The new rule will deem the debtor to realize any accrued foreign exchange gain when the debt becomes a "parked obligation." The debtor will then be deemed to have made the foreign exchange gain, if any, that it would have otherwise 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 issued; and
- in other cases, the fair market value of the debt.

A debt becomes a parked obligation where 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 (being shares to which 25% or more of the votes or value are attributable) and at any previous time the debt was not held by any such person.

Exceptions will be provided for certain *bona fide* commercial transactions, where the main purpose of a transaction or series (or of a change in status of a holder of debt) was not to avoid a foreign exchange gain. Related rules will also provide relief for financially distressed debtors with respect to taxes payable on any deemed foreign exchange capital gain, similar to the existing rules that currently provide relief to debtors with respect to a deemed income inclusion under the debt forgiveness rules.

Draft legislation for the new rules was not provided in the Budget 2016 materials.

The new debt parking rules for foreign-currency denominated debts will be effective for debts becoming a parked obligation on or after March 22, 2016 (except – for debts becoming a parked obligation before 2017 – if the status results from a written agreement entered into before March 22, 2016).

Accelerated CCA Expanded to Include Electric Vehicle Charging and Electrical Energy Storage

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

Budget 2016 proposes to expand the types of equipment eligible for accelerated CCA under Class 43.1 and Class 43.2 to include electric vehicle charging and electrical energy storage.

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

Tax Treatment of Transactions under Emission Allowance Regimes

The ITA currently does not have specific rules to address the tax treatment of transactions under carbon emission trading regimes or the tax treatment of emission allowances provided to certain emitters by a provincial government for no consideration. Under general principles, the receipt of the free emissions allowance may be taxable to the recipient as government assistance, without a corresponding cost adjustment to reflect this income inclusion. This would result in double taxation to the taxpayer on the disposition of the emissions allowance. Furthermore, if the taxpayer is required to include the benefit of the free emissions allowance in its income in the year of receipt, but not entitled to a deduction for emissions incurred until a subsequent year (i.e., the year the regulated substance is emitted or the year the taxpayer becomes liable to remit allowances), this can give rise to cash flow concerns for the taxpayer.

Budget 2016 proposes new rules to address these concerns. Under the new rules, emission allowances will be treated as inventory for all taxpayers; however, the "lower of cost and market" method for the valuation of inventory cannot be used to value emissions allowances. If the recipient of a free emissions allowance is a regulated emitter, there will be no income inclusion on receipt of the allowance.

Taxpayers will be entitled to a deduction for accrued emissions obligations to the extent that the obligation exceeds the cost of any emissions allowances that the taxpayer has acquired and that can be used to offset the obligation. Each year following, and until the emissions obligation is satisfied, the taxpayer is required to include the amount of the prior year's deduction in income and must evaluate the emissions obligation to determine if a further deduction is available in that year.

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 for the allowance will be included in computing income.

These measures 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.

No Intention to Extend Accelerated Capital Cost Allowance for Liquefied Natural Gas Facilities

An accelerated CCA is currently available for certain liquefied natural gas (LNG) facilities. For assets acquired after February 19, 2015 and before 2025, an effective CCA rate of 30% is available for eligible liquefaction equipment and 10% for buildings that are part of facilities used to liquefy natural gas. Budget 2016 indicates that, consistent with its G20 commitment to eliminate fossil fuel subsidies over the medium term, Canada intends to maintain the current accelerated CCA treatment for LNG facilities, but will allow it to expire as scheduled without extension.

Life Insurance Policies

Budget 2016 proposes various measures to address certain income tax results, described as being "inappropriate," "artificial," or "unintended," that may arise from corporate or partnership distributions involving life insurance proceeds, or from transfers of life insurance policies.

First, Budget 2016 proposes measures stated to be required to ensure that an appropriate amount in respect of the policy benefit received by a private corporation or partnership on the death of an individual insured under a life insurance policy is added to the corporation's capital dividend account or to the adjusted cost base of the partners' partnership interests. These changes are aimed at certain planning techniques that are said to result in unintended increases in the tax-free portion of life insurance policy benefits received by the corporation or partnership. These changes apply to policy benefits received as a result of a death that occurs on or after March 22, 2016.

Second, Budget 2016 proposes changes to the "policy transfer rule" that applies where a policyholder disposes of an interest in a life insurance policy to a non-arm's-length person. Budget 2016 indicates that these changes are meant to ensure that certain amounts in respect of a policy benefit are not afforded tax-free treatment more than once. The changes mean that the consideration received by the transferor policyholder in excess of the surrender value of the interest in the life insurance policy is included in the policyholder's proceeds of disposition (and the transferee's cost) of the interest. This ensures that the excess is not withdrawn from the corporation without being accounted for by the transferor as part of the proceeds of disposition of the interest and then distributed by the corporation a second time as a distribution of the tax-free portion of the life insurance policy benefits. Similar results may also occur in the partnership context. This measure will apply to dispositions of an interest in a life insurance policy that occur on or after March 22, 2016.

Other measures ensure appropriate adjustments to the capital dividend account for private corporations and the adjusted cost base rules for partnerships in respect of policy benefits are received as a result of deaths that occur on or after March 22, 2016, where the old policy transfer rule applied in respect of the acquisition of the interest in the policy.

INTERNATIONAL TAX MEASURES

Base Erosion and Profit Shifting

Budget 2016 recognizes "the importance of protecting the integrity of the Canadian tax base and ensuring that everyone pays their fair share of tax", and notes that Canada has been actively engaged with the efforts of the G20 and the Organisation for Economic Co-operation and Development (OECD) to address base erosion and profit shifting (BEPS). BEPS generally refers to shifting taxable profits away from the jurisdiction in which underlying economic activity has taken place. Aspects of the BEPS project are discussed in detail in numerous earlier Osler Updates:

- International Tax Reform 2015-BEPS Final Reports, October 6, 2015.
- Treaty Shopping - OECD Releases Revised Discussion Draft on BEPS Action 6, May 25, 2015
- OECD Releases Proposed Changes to Permanent Establishment Rules, May 20, 2015
- OECD Discussion Draft Considers Controlled Foreign Corporation Rules, April 6, 2015
- OECD Considers Availability of Tax Treaty Benefits for Investment Funds, Pension Funds and Private Equity Funds, November 24, 2014
- OECD Releases 2014 BEPS Deliverables, September 16, 2014
- OECD Releases Discussion Draft on Tax Challenges of the Digital Economy, March 25, 2014
- OECD Proposes Revisions to Tax Treaties to Prevent 'Treaty Abuse', March 17, 2014
- Canada Considers a New Anti-Treaty-Shopping Rule, August 14, 2013
- OECD/G20 International Tax Reform: Potential Impact on Canadian Companies, July 19, 2013

Budget 2016 confirms the government's intention to move forward with a number of initiatives to address BEPS, including requiring country-by-country reporting for large multinational enterprises, applying revised international guidance on transfer pricing, participating in work to develop a multilateral instrument to streamline the implementation of treaty-related BEPS measures, and undertaking spontaneous exchange with other tax administrations of tax rulings that could potentially give rise to BEPS concerns. Each of these is discussed below.

Budget 2016 notes that the government is continuing to examine the recommendations pertaining to the other aspects of BEPS, and will continue to work with the international community to ensure a coherent and consistent response.

Country-by-Country Reporting

The recommendations arising from the BEPS project include issuing revised standards for transfer pricing documentation, including a common template for country-by-country reporting of income, taxes paid, and certain measures of economic activity by certain large multinational enterprises (MNEs). These revised standards are discussed in Osler Updates dated October 6, 2015 and September 16, 2014.

Budget 2016 states that the government will implement country-by-country reporting for MNEs with total annual consolidated group revenue of €750 million or more. Consistent with the BEPS recommendations, Budget 2016 proposes that country-by-country reporting will be required for taxation years that begin after 2015, with the first such reports due within one year of the end of the fiscal year to which the reports relate (i.e., by December 31, 2017 for MNEs with a calendar fiscal year), and the first government-to-government exchanges expected to occur by June 2018.

In general terms, the country-by-country report is a document that a MNE would be required to file in the jurisdiction in which the ultimate parent of the MNE is located and that would be automatically exchanged with each country in which the MNE operates, provided that certain conditions are met (namely, the other country has implemented country-by-country reporting, the two countries have a legal framework for the automatic exchange of information, and they have entered into a competent authority agreement relating to country-by-country reporting). The country-by-country report includes information with respect to the MNE's revenue, profit, tax paid, stated capital, accumulated earnings, number of employees, assets, and activities.

In some circumstances where the parent jurisdiction of a MNE has not implemented country-by-country reporting, the BEPS recommendations call for local filing in each country in which the MNE operates. For Canadian-headquartered MNEs, Canada's implementation of the regime before the international deadline for filing information for 2016 would therefore likely come as a welcome relief. By contrast, implementation of country-by-country reporting by the U.S. is expected to be delayed, with the result that U.S.-headquartered MNEs may face the prospect of local filing of information without the confidentiality protection that would be afforded by competent authority agreements between those local jurisdictions and the U.S.

No draft legislation is included in Budget 2016, which says that proposals will be released for comment in the coming months. The 2015 BEPS final report on transfer pricing documentation included, as part of its implementation package, model legislation for countries to implement country-by-country reporting under their domestic rules.

It appears that significant controversy continues with respect to the potential impact of country-by-country reporting and its dissemination around the world. The U.K. continues to suggest that it may seek to require public disclosure of country-by-country reporting items, while U.S. officials have asserted that the U.S. may refuse to exchange country-by-country reports with countries that make such reports public. Some commentators suggest that MNEs should assume that their country-by-country reports will become publicly available. Others are not satisfied that the report will be used, as intended, by tax authorities in all countries as a risk assessment tool, expressing concern that it may lead to automatic adjustments when certain parameters are breached.

Revised Guidance on Transfer Pricing

The arm's length principle is the term used to describe the principle, set out in Article 9 of the OECD Model Tax Convention and Canada's bilateral tax treaties and reflected in the transfer pricing rules of the ITA, that the prices (transfer prices) at which members of a MNE transact should reflect those that would be agreed by parties dealing at arm's length. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) provide detailed guidance on the application of the arm's length principle.

The recommendations arising from the BEPS project include significant revisions to the OECD Guidelines, particularly with respect to the treatment of intangibles and the allocation of risk and capital. Although these revisions are described by the OECD as "clarifying" in nature, many commentators have expressed the view that they represent a marked departure from the arm's length principle as it has been understood and interpreted by taxpayers and the courts. Some have questioned whether such wholesale revisions could affect the interpretation and application of the arm's length principle in Canada without legislative amendment.

Budget 2016 asserts that the Canada Revenue Agency (CRA) is currently applying the revised international guidance on transfer pricing by MNEs arising from the BEPS project. Describing such guidance as providing an "improved interpretation of the arm's length principle", Budget 2016 states that the revisions generally support the CRA's "current interpretation and application of the arm's length principle, as reflected in its audit and assessing practices."

Based on these statements, it appears that the true impact of the BEPS revisions to the OECD Guidelines will not be known until the CRA's audit and assessing practices are adjudicated by the courts. In this regard, the courts have expressed reluctance thus far to treat the OECD Guidelines as "controlling as if they were a Canadian statute" (*Canada v. GlaxoSmithKline Inc.*, 2012 SCC 52), noting that they are "written not only by persons who are not legislators, but in fact are the tax collection authorities of the world" (*McKesson Canada Corporation v. The Queen*, 2013 TCC 404).

Budget 2016 also notes that follow-up work continues in respect of certain aspects of the OECD Guidelines in respect of which the BEPS project is not yet complete. These include a proposed simplified approach to the transfer pricing of low value-adding services, as well as clarifying the definitions of risk-free and risk-adjusted returns for minimally functional entities (cash boxes). Budget 2016 states that Canada's course of action with respect to these measures will be decided once the work is complete.

Spontaneous Exchange of Tax Rulings

Budget 2016 confirms the government's intention to implement the BEPS minimum standard for the spontaneous exchange of certain categories of taxpayer-specific rulings and to commence the exchange of the tax rulings in 2016. Any information exchanged will be subject to confidentiality provisions and protected in the same manner as taxpayer information that is currently exchanged under an exchange of information program established by the CRA in accordance with Canada's tax treaties, tax information exchange agreements and the multilateral *Convention on Mutual Administrative Assistance in Tax Matters*.

Treaty Abuse

The minimum standard for preventing treaty abuse adopted by the OECD in the final BEPS recommendations 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, countries must also adopt either a general anti-abuse rule (based on a principal purpose test) or a specific anti-abuse rule (based on a limitation on benefits test). Budget 2016 confirms the government's commitment to address treaty abuse in accordance with the minimum standard; however, the implementation of that approach will depend on particular circumstances and discussions with Canada's tax treaty partners. Amendments to Canada's tax treaties to include a treaty anti-abuse rule could be achieved through bilateral negotiations, the multilateral instrument being developed by the OECD, or a combination of the two.

Extension of the Back-to-Back Loan Rules

The 2014 federal budget introduced certain back-to-back loan rules in the context of non-resident withholding tax applicable to interest payments. These rules effectively constitute an anti-conduit rule targeted at payments of interest on an obligation owing by a Canadian debtor to a non-resident intermediary creditor, where the intermediary has a corresponding and sufficiently connected obligation to pay an amount to another non-resident person, and where the rate of withholding under Part XIII of the ITA would have been higher if the interest had been paid directly by the Canadian debtor to the other person on account of an obligation owing to such person, and not to the intermediary.

Budget 2016 proposes a number of measures to extend the application of these rules.

Specifically:

- extension of the rules to back-to-back royalty arrangements;
- enactment of "character substitution rules" aimed at the avoidance of the back-to-back loan and royalty rules through the use of "economically similar arrangements";
- application of the back-to-back loan rules to the shareholder loan rules in subsection 15(2) of the ITA; and
- enactment of rules aimed at multi-intermediary structures for both the Part XIII and the shareholder loan back-to-back rules.

Back-to-Back Rules for Rents, Royalties and Similar Payments

The statutory rate of withholding on the payment of rents, royalties or similar payments (referred to collectively as "royalties") made by a resident of Canada to a non-resident is 25%. This rate is often reduced by tax treaty. Budget 2016 proposes a back-to-back rule aimed at preventing treaty shopping transactions under which an intermediary located in a favourable treaty country is interposed between the Canadian-resident payer and the ultimate recipient of the payment.

Budget 2016 indicates that a back-to-back arrangement will be considered to exist where:

- a Canadian resident makes a royalty payment in respect of a particular lease, licence or similar arrangement (the "Canadian leg") to a person resident in a tax treaty country (the "intermediary");
- the intermediary (or a non-arm's-length person in respect of the intermediary) has an obligation to pay an amount to another non-resident person and such payment is in respect of a lease, licence or similar agreement, or is in respect of an assignment or instalment sale (the "second leg"); and
- one of the following conditions is met:
  - the amount that the intermediary pays under the second leg is established by reference to the royalty under the Canadian leg or by reference to the value of, or return from, or any similar criteria in respect of property that is the subject of the Canadian leg; or
  - on an assessment of the facts and circumstances, it can be reasonably concluded that the Canadian leg was entered into or stayed in effect because the second leg was, or was anticipated to be, entered into.
    - With respect to this causal connection test, Budget 2016 indicates that the fact that the Canadian leg and the second leg are in respect of the same property would "generally not be considered sufficient on its own to support the conclusion that this condition has been met."

The back-to-back rule would only apply if the withholding tax rate on the Canadian leg is lower than it would have been if the payment thereunder had been made directly to the recipient under the second leg. Where applicable, the new back-to-back rules will cause a deemed payment to have been made by the Canadian resident payor under the Canadian leg directly to the ultimate non-resident recipient under the second leg, and an amount equal to the withholding tax otherwise avoided as a result of a the back-to-back arrangement will be payable thereon.

The new back-to-back rules will apply to royalty payments made after 2016.

Character Substitution Rules

Generally speaking, the back-to-back rules apply where the character of the payment between the Canadian resident and the intermediary under the "Canadian leg" matches the character of the payment between the intermediary and another non-resident under the "second leg." Budget 2016 observes that arrangements between the intermediary and the other non-resident may substitute payments that have a different character but that are economically similar to the payments on the Canadian leg. Budget 2016 proposes rules to prevent avoidance of the back-to-back rules through the use of such arrangements.

Budget 2016 refers specifically to back-to-back arrangements where:

- interest is paid on the Canadian leg and royalties are paid on the second leg;
- royalties are paid on the Canadian leg and interest is paid on the second leg; and
- interest or royalties are paid on the Canadian leg and the second leg involves a shareholding in the intermediary and there are obligations to pay dividends or to redeem or cancel the shares.

The proposed character substitution rules will apply where there is a sufficient connection between the payment on the Canadian leg and the arrangement under the second leg. Budget 2016 indicates that the existence of such a connection "will be determined by applying tests similar to those used for back-to-back loans and back-to-back royalty arrangements, but adapted to reflect the particular circumstances of the arrangements."

The character substitution rules will apply to interest and royalty payments made after 2016.

Back-to-Back Shareholder Loan Rules

The shareholder loan rules are aimed at preventing corporate profits from being effectively distributed to shareholders in the form of a loan. The rules generally apply where an individual or a non-resident person is a shareholder of a Canadian-resident corporation (or is connected to a shareholder) and receives a loan from or otherwise becomes indebted to the corporation. A person is connected with a shareholder of a particular corporation if the person does not deal at arm's length with the shareholder or is affiliated with the shareholder, but excludes a foreign affiliate of the particular corporation or of a Canadian resident that does not deal at arm's length with the particular corporation.

Very generally, if the loan remains outstanding beyond the end of the taxation year after the taxation year in which the loan was incurred, the amount is included in the shareholder's income or – if the shareholder is non-resident – is treated as a deemed dividend subject to withholding tax. As an alternative, and on an elective basis, where the creditor is controlled by a non-resident, the loan may be treated as a "pertinent loan or indebtedness" in respect of which interest at least equal to a prescribed rate of interest must be included in the creditor's income.

Budget 2016 notes that there is an incentive to avoid the application of the shareholder loan rules through the interposition of an intermediary that is not a shareholder nor connected to a shareholder. As a result, Budget 2016 proposes back-to-back loan rules – similar to the rules in the withholding tax context – to address avoidance of the shareholder loan rules.

Under the proposed rules, a back-to-back shareholder loan arrangement will exist where:

- An intermediary that is not connected with a shareholder of a particular Canadian-resident corporation is owed a "shareholder debt" by the shareholder or by a person connected with the shareholder;
- Either
  - > The intermediary owes an "intermediary debt" to the particular corporation and either
    - – Recourse on the intermediary debt is limited to amounts recovered on the shareholder debt, or
    - – It may reasonably be concluded that the shareholder debt became owing or was permitted to remain outstanding because the intermediary debt was or was anticipated to be entered into; or
  - > The intermediary has a "specified right" in respect of property granted by the particular corporation that is required under the shareholder debt, or (it can reasonably be concluded) because of which the shareholder debt became owing or was permitted to remain outstanding. The meaning of specified right will be the same as under the existing back-to-back loan rules, and so will not include a mere security interest in property.

Where applicable, the back-to-back loan rules will deem the shareholder to owe an amount directly to the Canadian-resident corporation, equal to the lesser of (a) the amount of the shareholder debt and (b) the amount of the intermediary debt plus the fair market value of over which the intermediary was granted a specified right.

Budget 2016 provides that the new rule will apply to back-to-back shareholder loan arrangements "as of" March 22, 2016. For arrangements that are in place on March 22, 2016, the deemed indebtedness between the shareholder and the Canadian-resident corporation will be deemed to have become owing on March 22, 2016.

Multiple-Intermediary Structures

Budget 2016 indicates that there will be a "clarification" of the application of the back-to-back rules to arrangements involving multiple intermediaries.

In the withholding tax context, the stated objective of these rules is to ensure that an appropriate withholding tax rate applies on payments to the "ultimate non-resident recipient in a chain of connected arrangements." The precise circumstances under which arrangements are considered connected remain to be clarified.

A multiple intermediary rule in the shareholder loan context is also proposed.

The multiple intermediary rule will apply to payments made after 2016 and to shareholder loans as of January 1, 2017.

Conclusion

Budget 2016 evidences the government's intention to proceed with targeted domestic anti-treaty shopping measures, notwithstanding Canada's stated commitment to the OECD's BEPS project, which advocated for the adoption of treaty shopping measures in tax treaties, and Canada's participation in the negotiation of the multilateral instrument (which is intended to address treaty abuse).

Budget 2016 does not contain draft legislative proposals relating to these measures, which are yet to come. The proposed measures are extremely complex, and developing legislation that both captures targeted arrangements while excluding genuine commercial transactions without any treaty shopping element may prove challenging. It is hoped that the government will provide adequate opportunity for the tax community to review and comment on draft legislation before it is enacted.

Cross-Border Surplus Stripping

"Paid-up capital" or PUC is a valuable cross-border tax attribute, since a Canadian-resident corporation can make a distribution as a return of capital free of non-resident withholding tax.

The ITA contains rules that are aimed at preventing cross-border PUC from being artificially increased, or from "stripping" value out of Canada in excess of cross-border PUC. Specifically, the rules apply if a non-resident person transfers shares of a Canadian-resident corporation (the subject corporation) to another Canadian-resident corporation (the purchaser corporation) with which the non-resident person does not deal at arm's length, and the subject corporation and purchaser corporation are connected immediately after the disposition. In that case, any non-share consideration received by the non-resident corporation in excess of the PUC of the transferred shares is deemed to be a dividend paid by the purchaser corporation to the non-resident. The deemed dividend will be subject to Canadian withholding tax. There may also be a suppression of the PUC of any shares of the purchaser corporation issued to the non-resident, so that the cross-border PUC after the transaction does not exceed the cross-border PUC prior to the transaction less any non-share consideration.

These rules are subject to a specific exception that applies where the non-resident vendor corporation is controlled by the Canadian-resident purchaser corporation immediately prior to the disposition. As Budget 2016 notes, this exception applies where the non-resident corporation is "sandwiched" between the two Canadian-resident corporations and the non-resident disposes of shares of the lower-tier Canadian-resident corporation to its Canadian-resident shareholder in order to eliminate the sandwich.

Budget 2016 notes that this exception has been the subject of misuse whereby a sandwich structure has been created as part of a series of transactions designed to result in the artificial increase of cross-border PUC.

As a result, for dispositions occurring on or after March 22, 2016, the exception will not apply if a non-resident person both owns (directly or indirectly) shares of the purchaser corporation and does not deal at arm's length with the purchaser corporation. By enacting this change, the Department of Finance has seemed to accept the CRA's interpretation that the exception was only meant to apply where the ultimate parent corporation of the relevant corporate group is resident in Canada (or the group was otherwise not controlled by a non-resident).

In addition, the surplus stripping rule is amended to clarify that if no consideration is received from a non-resident person for the disposition of the subject shares, then the non-resident is deemed to receive non-share consideration from the purchaser corporation determined by reference to the fair market value of the subject corporation shares. This provision could be relevant in situations where, for example, the subject shares are transferred to the purchaser corporation as a return of capital. This change applies to dispositions occurring on or after March 22, 2016.

PERSONAL INCOME TAX MEASURES

Top Marginal Income Tax Rate – Consequential Amendments

In 2015, consistent with its election platform, the government introduced a new top marginal tax rate of 33%, applicable to individual taxable income over $200,000, effective for 2016 and later taxation years. The legislation effecting the rate change, which has received second reading in the House of Commons, also included a number of consequential amendments to rules that either rely on the top personal income tax rate or use formulas that reflect that rate.

Budget 2016 proposes a number of further amendments to reflect the new top marginal income tax rate for individuals, including:

- amending the definition of "relevant tax factor" in the foreign affiliate rules to reduce the relevant tax factor for individuals from the current 2.2 to 1.9;
- amending the capital gains refund mechanism for mutual fund trusts to reflect the new 33% rate in the formulas that are used in computing refundable tax;
- increasing the Part XII.2 tax rate on the distributed income of certain trusts from 36% to 40%;
- increasing from 28% to 33% the tax rate on personal services business income earned by corporations;
- providing a 33% charitable donation tax credit (on donations over $200) to trusts that are subject to the 33% rate on all of their taxable income;
- applying the new 33% rate on excess employee profit sharing plan contributions; and
- amending the recovery tax rule for qualified disability trusts to refer to the new 33% rate.

These amendments will generally apply to 2016 and later taxation years. The charitable donation tax credit measure will be limited to donations made after 2015, while the rate increase on personal services business income will be prorated for taxation years beginning in 2015 and ending in 2016.

Canada Child Benefit

Budget 2016 proposes to implement one of the Liberals' key election promises by consolidating the Canada Child Tax Benefit and the Universal Child Care Benefit into a single, non-taxable benefit entitled the "Canada Child Benefit." This new regime will provide a maximum annual benefit of $6,400 per child under the age of six and $5,400 per child aged six through 17. The maximum amount of the benefit would be increased by up to $2,730 per child where that child is eligible for the disability tax credit. The amount of the benefit is proposed to be reduced by prescribed percentages of household income above $30,000. The Canada Child Benefit would be paid in monthly instalments commencing in July.

Elimination of the Income Splitting Tax Credit

Budget 2016 proposes to eliminate the income splitting tax credit for couples with at least one child under the age of 18 for 2016 and subsequent taxation years. Pension income splitting is not affected.

Mineral Exploration Tax Credit for Flow-Through Share Investors

Budget 2016 extends the 15% mineral tax exploration credit for investors in flow-through shares for an additional year, until March 31, 2017.

Increase to Northern Residents Deduction

Budget 2016 proposes substantial increases to the northern residency deductions for residents in both the Northern Zone and the Intermediate Zone. The maximum for those in the Northern Zone is proposed to be increased from $8.25 to $11 per day where multiple household members claim the deduction, and from $16.50 to $22 per day where no other member of the household claims the residency deduction for the 2016 taxation year. The proposed maximums for those in the Intermediate Zone would be increased to $6.50 per day and $11 per day, respectively.

Tax Credits for Provincially Registered Labour-Sponsored Venture Capital Corporations (LSVCC) Tax Credits

Budget 2016 proposes to restore the federal LSVCC tax credit to 15% for share purchases of provincially registered LSVCCs prescribed under the ITA for 2016 and subsequent taxation years. Newly registered LSVCCs under existing provincial legislation would be eligible for prescription if the provincial legislation is currently prescribed for purposes of the federal LSVCC tax credit. New provincial regimes would be eligible for prescription under the ITA, provided that the enabling provincial legislation is patterned on currently prescribed provincial legislation. Note, however, that the prohibition on new federal LSVCC registrations and the current transition rules for federally registered LSVCCs would be maintained.

Creation of Teacher and Early Childhood Educator School Supply Tax Credit

Budget 2016 proposes to introduce a refundable tax credit for "eligible educators" to provide tax recognition of the costs that these educators incur. The amount of the credit would be 15% of the amount paid for "eligible supplies" of up to a maximum of $1,000.

Exclusion of Ontario Electricity Support Program Income

Budget 2016 proposes to exempt from income amounts received under the Ontario Electricity Support Program, so that the amounts received under these programs do not affect income-tested federal or provincial/territorial benefits.

Elimination of Education and Textbook Tax Credits

Budget 2016 proposes to eliminate the education and textbook tax credits, while leaving the tuition tax credit in place. Other income tax provisions that rely on eligibility for the education tax credit would be unaffected by the elimination of the credit effective January 1, 2017.

Phase Out of Children's Fitness and Arts Tax Credits

Budget 2016 proposes to phase out the children's fitness and arts tax credits by reducing the maximum amount of the fitness credit from $1,000 to $500, and reducing the maximum amount of the arts tax credit from $500 to $250. The supplemental amounts for children eligible for the disability tax credit will remain at $500 for 2016. Both credits would be completely eliminated for 2017 and subsequent taxation years.

CHARITIES

Capital Gains Exemption for Sale of Private Corporation Shares and Real Estate

Budget 2016 announces that the government will not proceed with the 2015 budget proposal that would have exempted from tax certain capital gains from the disposition of private corporation shares or real estate, provided that the cash proceeds were donated to a registered charity within 30 days.

ADMINISTRATIVE MEASURES

Additional Funding for CRA

Budget 2016 proposes to invest additional funds for the CRA for the purposes of improving service levels, cracking down on tax evasion, combatting tax avoidance and enhancing tax collections. In particular, over the next five years, Budget 2016 proposes to invest:

- $185.5 million for the CRA to address the government's commitment to "service excellence," including enhanced telephone services, a revamp of written correspondence and timely resolution of objections.
- $444.4 million to be used towards hiring additional auditors and specialists; developing robust business intelligence infrastructure; increasing verification activities; and improving the quality of investigative work that targets criminal behaviour. These measures are expected to bring in additional federal revenues of $2.6 billion over five years.
- $351.6 million to improve CRA's ability to collect outstanding debts. It is anticipated that this proposal will lead to the collection of an additional $7.4 billion in tax debt over five years.

GST/HST AND EXCISE MEASURES

Closely Related Test

Under sections 150 and 156 of the *Excise Tax Act*, members of a group of closely related corporations or partnerships can make an election under which they are not required to charge GST/HST on certain intragroup supplies that would otherwise be subject to GST/HST.

Budget 2016 proposes to add the requirement that, in order to fit within these rules, a parent corporation or partnership of a subsidiary corporation must hold and control at least 90% of the votes in respect of every corporate matter of the subsidiary corporation (with limited exceptions) in order to be considered to be closely related.

This measure will apply generally as of March 22, 2017, and will also apply effective March 23, 2016, for determining whether the closely related test is met in respect of elections under sections 150 and 156 of the *Excise Tax Act* that are filed, and take effect, after March 22, 2016.

Application of GST/HST to Cross-Border Reinsurance

The GST/HST imported supply rules for financial institutions require a financial institution, including an insurer, with a presence outside Canada (e.g., a branch or subsidiary) to pay GST/HST, on a self-assessment basis, on certain expenses incurred outside Canada that relate to its Canadian activities. Considerable uncertainty has existed with respect to the application of these rules to reinsurance premiums paid by a primary insurer to a reinsurer. In response to industry concerns, in January 2015, the CRA issued GST/HST Notice No. 287, setting out its administrative positions and the Department of Finance's policy intentions regarding the application of these imported supply rules. Budget 2016 follows up on that Notice by proposing amendments in this area.
In particular, Budget 2016 proposes to clarify that two specific components of the premium for imported reinsurance services, ceding commissions and the margin for risk transfer, do not form part of the amount that is subject to self-assessment. The budget also proposes amendments to set out specific conditions under which the special rules for insurers do not impose GST/HST on reinsurance premiums charged by a reinsurer to a primary insurer.

This measure will apply as of the introduction of the special GST/HST imported supply rules for financial institutions (i.e., in respect of any specified year of a financial institution that ends after November 16, 2005). Further, this measure will allow a financial institution to request a reassessment by the CRA of the amount of GST/HST owing by the financial institution under the special GST/HST imported supply rules (as well as any related penalties or interest) for a past specified year, but solely for purposes of taking into account the effect of this measure. A financial institution will have until the day that is one year after the day that these amendments receive Royal Assent to request such a reassessment.

De Minimis *Financial Institutions*

Financial institutions are subject to special GST/HST rules that, among other things, impose special reporting requirements and restrict the ability of such entities to recover GST/HST paid on certain of their business inputs. This applies to traditional financial institutions, such as banks, insurance companies and trust companies, as well as other entities, referred to as "*de minimis* financial institutions" that are deemed to be financial institutions for GST/HST purposes. A person can be deemed to be a financial institution for a taxation year if it has earned more than $1 million in interest income in respect of bank deposits in its preceding taxation year.

Budget 2016 proposes that interest earned in respect of demand deposits, as well as term deposits and guaranteed investment certificates issued for 364 days or less, not be included in determining whether a person exceeds the $1 million threshold.

This measure will apply to taxation years beginning after March 21, 2016, and to fiscal years that begin before March 22, 2016, for the purposes of determining if the person is required to file the Financial Institution GST/HST Annual Information Return.

Exported Call Centre Services

Budget 2016 proposes, generally, to add to the list of zero-rated supplies, the exported supply of a call centre service, as long as the service is supplied to a non-resident person that is not registered for GST/HST and it can reasonably be expected at the time that the supply is made that the technical or customer support is to be rendered primarily to individuals who are outside Canada at the time that the support is rendered.

This measure is proposed to be effective for supplies made after March 22, 2016, or to supplies made before such date if no amount of GST/HST was charged, collected or remitted thereon prior to March 22, 2016.

Reporting of Grandparented Housing Sales

Under the transitional rules that applied when a province either joined the HST since 2010 or increased its HST rate, certain sales of newly constructed or substantially renovated homes were relieved from the application of the provincial component of the HST or the increased HST rate, as the case may be. In respect of these grandparented sales, builders have certain reporting obligations. Budget 2016 proposes to simplify builder reporting by limiting the reporting requirement to those grandparented housing sales for which the consideration is equal to or greater than $450,000, and providing builders with an opportunity to correct past misreporting and avoid potential penalties by allowing them to elect to report all past grandparented housing sales for which the consideration was equal to or greater than $450,0000.

This measure will apply in respect of any reporting period of a person that ends after March 22, 2016. In addition, if the above election is made, the measure will also apply to any supply of grandparented housing in respect of which the federal component of the HST became payable on or after July 1, 2010. Builders will generally have between May 1, 2016, and December 31, 2016, to make the election.

GST/HST on Donations to Charities

Budget 2016 proposes that, in cases where a person makes a donation to a charity and, in return, receives property or services on which the charity is required to charge GST/HST, provided that an income tax receipt may be issued for a portion of the donation, only the value of the property or services, and not the full value of the donation, will be subject to GST/HST.

This proposal will apply to supplies of property or services made after March 22, 2016. In addition, transitional relief will be provided in respect of supplies that were made by a charity between December 21, 2002 (when the income tax split-receipting rules came into effect) and March 22, 2016 where the charity did not collect GST/HST on the full value of donations made in exchange for an inducement.

Health Measures

Budget 2016 proposes to add insulin pens, insulin pen needles and intermittent urinary catheters to the list of zero-rated medical devices, for a supply of such devices made after March 22, 2016, or made before such date if no amount of GST/HST was charged, collected, or remitted thereon prior to March 22, 2016.

Budget 2016 also proposes to apply GST/HST on supplies, made after March 22, 2016, of purely cosmetic procedures provided by all suppliers. Cosmetic procedures will continue to be exempt if paid for by a provincial health plan or if required for medical or reconstructive purposes.

Previously Announced Measure Relating to the GST/HST Joint Venture Election

Budget 2016 confirms the government's intention to proceed with the measure to expand the scope of the GST/HST joint venture election, which has been promised in previous budget proposals.

Excise Tax – Diesel and Aviation Fuel

The *Excise Tax Act* imposes an excise tax on certain diesel fuel manufactured and delivered in, or imported into, Canada. The Act contains a limited number of provisions that relieve the application of the excise tax on diesel fuel that is used as heating oil or to generate electricity, in specific circumstances.

Budget 2016 proposes to restrict the relief for heating oil to fuel oil that is consumed exclusively for providing heat to a home, building or similar structure and not consumed for generating heat in an industrial process. Budget 2016 also proposes to remove the generation of electricity exemption for diesel fuel used in or by a vehicle, including a conveyance attached to the vehicle, of any mode of transportation.

Excise Duty Measures

Budget 2016 proposes amendments to the *Excise Act, 2001*, which imposes excise duty on tobacco products, spirits and wine. The proposed measures will enhance certain security and collection rules in that Act.

OUTSTANDING TAX MEASURES

Budget 2016 confirms the government's intention to proceed with certain tax and related measures in the following areas, which were originally proposed in previous budgets, during the last Parliament or in the current session of Parliament but have not yet been legislated:

- the common reporting standard for the automatic exchange of financial account information between tax authorities
- legislative proposals on the income tax rules for certain trusts and their beneficiaries
- "synthetic equity arrangements" under the dividend rental arrangement rules
- the conversion of capital gains into tax-deductible inter-corporate dividends (section 55 of the ITA)
- the offshore reinsurance of Canadian risks
- alternative arguments in support of an assessment
- an exception to the withholding tax requirements for payments by qualifying non-resident employers to qualifying non-resident employees
- the repeated failure to report income penalty
- the acquisition or holding of limited partnership interests by registered charities
- the qualification of certain costs associated with undertaking environmental studies and community consultations as Canadian exploration expenses
- the sharing of taxpayer information within the CRA to facilitate the collection of certain non-tax debts and with the Office of the Chief Actuary
- the tax deferral in respect of the commercialization of the Canadian Wheat Board
- the relief of the GST/HST for feminine hygiene products

View Budget 2016

If you have any questions or require additional analysis on Budget 2016, please contact any member of our National Tax Department.

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