2016 Canadian federal budget predictions

Kim G C Moody FCPA, FCA, TEP
January 21, 2016

In what's becoming our firm's annual tradition, the purpose of this blog is to gaze into the crystal ball to predict what the tax goodies might look like when the 2016 federal budget is released. The timing of such a release is anyone's guess, but some prognosticators are suggesting the third week of March 2016. We certainly can't add any credibility to that guess since the timing of the budget release is usually a carefully guarded secret – and rightly so.

With the above in mind, here are our predictions and a bit of a wish list.

Predictions:

1. Stock options

The federal liberal election platform included a policy to eliminate certain tax benefits associated with the granting and exercise of employment stock options. The proposed changes suggested by the Liberal Party appeared to target the ability to claim the 50 per cent stock option deduction associated with such benefits. Shortly after the election, the new finance minister announced at a press conference that any changes would provide for grandfathering for existing options. In addition, the finance minister stated that employees with no more than $100,000 of annual stock option benefits will be unaffected.

Tax is a game of details and the lack of them at the press conference makes me wonder how the minister plans to accomplish this and, frankly, I'm not really sure what he had in mind. Many of my peers have provided bold predictions as to what the announcement could mean. I decline to speculate on exactly what changes are coming, but I don't think it's much of a leap of logic to suggest that changes in the arena of stock options are coming.

2. Taxation of Canadian-Controlled Private Corporations (CCPCs)

The federal liberal election platform contained a lot of rhetoric that CCPCs have often been used for inappropriate tax avoidance by the affluent. Such comments appear to have been based on a recent paper authored by certain academics on the topic of CCPCs and income of the affluent. As an advisor for CCPCs, I thought the paper was incomplete in its analysis. Notwithstanding, it appears to have attracted the attention of the Liberal Party. In conjunction with the paper, the province of Quebec has proposed changes to the taxation of certain CCPCs in its 2015 provincial budget. Will the 2016 federal budget tighten up access to the small business deduction? My guess is that the Department of Finance will announce a consultation on this topic. I would be very surprised if detailed proposals to change the existing regime were proposed in the upcoming budget.

3. Charitable stretch credit

Imagine Canada, an organization that acts as a voice for Canada's charitable sector, once again advocated for a charitable stretch credit to be introduced in its August 2015 budget submission. A stretch credit would grant a tax credit for individuals for charitable donations made over a certain hurdle amount that would be in excess of the highest marginal tax rate applicable for individuals. My guess as to whether we see this introduced? I think it would be good but I'm not holding my breath.

4. Eligible capital property amendments

The 2015 federal budget made the announcement that the government was still committed to making amendments to the eligible capital property regime and it would release draft legislation before inclusion in a bill. I'm guessing we'll either have an announcement regarding the status of the release of the draft legislation or such draft legislation will be released before the budget.

5. BEPS announcements

The OECD has made significant progress in the last 12 months regarding its BEPS project. While the success of such a project is still years away from being able to assess, I'm guessing we'll see various status announcements regarding Canada's position on treaty shopping and the adoption of the common reporting standard (which the government announced in the 2015 budget that it was committed to adopting such standard by July 1, 2017).

6. Introduction of more personal tax credits

As regular readers know, I'm not a big fan of personal tax credits. Will the new Liberal Government carry on the tradition of the previous regime where there was an endless stream of such credits introduced in each budget? I really hope the answer is no. However, such credits can easily be used to try to obtain political gain and I'm guessing the Liberal Party is not immune to the personal tax credit addiction. What are my guesses for such credits? Well, take your pick… it could really be anything. The "*Those Affected by the Decline in Oil Prices*" personal tax credit would be novel. In a recent silly New York Times article, apparently Canadians are now hip after the election of the Liberal Government. In that vein, perhaps "hip" Canadians should be entitled to the new "*hipster*" personal tax credit. Maybe we could even get one of Canada's favorite rock bands, The Tragically Hip, to endorse such a new personal tax credit. I could go on… but comedy is best left to comedians and not (slightly) opinionated tax professionals.

7. Increased capital gains inclusion rates

With increased tax rates and a 50 per cent inclusion rate for capital gains, there is now a significant discrepancy between ordinary income rates and capital gains rates. The same can be said for dividend tax rates… they are much higher than capital gains rates. Given such a large discrepancy, it does not require a huge inferential leap to conclude that good tax advisors will look for opportunities to convert ordinary income to capital gain. Could such planning be minimized by the government increasing the capital gains inclusion rate from 50 per cent to say 66.67 per cent or 75 per cent? Certainly. And such increases are not without precedent before they were reduced again to 50 per cent in 2000. I really hope the government doesn't do this but the temptation to do so might be large given the current economic conditions and the disparity in tax rates.

8. Active income vs. passive income

In the 2015 budget, the government announced a review of the circumstances in which income from property might qualify as active business income eligible for the small business deduction. Comments were made by various parties to the Department of Finance regarding this consultation. In practice, the distinction between passive versus active income can be difficult. For CCPCs, it's important to get it right: passive income by a CCPC will generate corporate refundable tax which ultimately is designed to prevent tax deferrals, whereas active income may be eligible for a reduced corporate tax rate with tax deferral available. My guess is that the 2016 budget will contain an update regarding the status of the review which asked for comments to be submitted by the public no later than Aug. 31, 2015. I'm hopeful that additional clarity will be provided on this topic in the upcoming budget.

One wish:

1. A re-think of the increased tax rates for the "wealthy"

Overall, I think taxing the "wealthy" at very high rates – which is where we are at presently with the recently announced liberal tax increases (and for Albertans, the increased tax rates announced by the NDP government in July 2015) – is poor tax policy and can have dramatic unintended consequences such as a flight of capital (both financial and human) and loss of jobs. Such a policy can also result in significant and aggressive tax avoidance being done by the "wealthy." In our practice, we are already seeing firsthand the results of that policy and it appears that certain sectors of the media and government are too. My wish is a reversal of the liberal federal tax rate increases would show up in the 2016 federal budget. However, I'm guessing that my wish is simply too fantastical to see the light of day.

Well, that's it… I look forward to seeing how shiny or dusty that old crystal ball is.