Federal Government Proposed Tax Changes

Inside This Issue

Introduction

On December 7, 2015, the new Liberal Federal Government announced several proposed tax changes, some of which will be implemented before the end of the current year. What follows is the Backgrounder provided by the Department of Finance Canada, outlining the various changes we have to look forward to in the new year.

As more information becomes available, McCann & Roque Chartered Accountants will begin planning to maximize the tax cut for our "middle class" clients and minimize the tax burden for our clients who fall in the "top 1%" group.

Backgrounder: Middle Class Tax Cut

The Government's proposed middle class tax cut and accompanying proposals will help make the tax system fairer so that all Canadians have the opportunity to succeed and prosper. The new measures consist of the following:

- Reducing the second personal income tax rate to 20.5 per cent from 22 per cent. This would take effect on January 1, 2016 and for subsequent taxation years.

Reducing the second personal income tax rate to 20.5 per cent from 22 per cent. This would take effect on January 1, 2016 and for subsequent taxation years.

- Introducing a 33-per-cent personal income tax rate on individual taxable income in excess of $200,000, effective for the 2016 and subsequent taxation years.

- Returning the Tax-Free Savings Account (TFSA) annual contribution limit to $5,500 from $10,000 and reinstating indexation of the TFSA annual contribution limit, effective for the 2016 and subsequent taxation years.

In addition to these proposed tax changes, other amendments to the Income Tax Act, as described below, are proposed as consequential to the introduction of the new 33-per-cent personal income tax rate.

Going forward, the Government will introduce proposals in the budget to create a new Canada Child Benefit. Payments under the new Canada Child Benefit would begin in July 2016. In addition to replacing the Universal Child Care Benefit, which is not tied to income, the proposed Canada Child Benefit would simplify and consolidate existing child benefits while ensuring that help is better targeted to those who

Address - 3075 Ridgeway Drive Unit 31 ON L5L 5M6
T 905.997.3333 F 905.997.3999
E info@mrcas.ca www.mrcas.ca

need it most. The Government also intends to introduce legislative amendments, at an early opportunity, to repeal income splitting for families with children (not pension income splitting) for the 2016 and subsequent taxation years.

Personal Income Tax Rate Changes

Reducing the Second Personal Income Tax Rate to 20.5 Per Cent

The Government proposes to reduce the second personal income tax rate to 20.5 per cent from 22 per cent. This reduced rate would take effect on January 1, 2016 and for subsequent taxation years. (Editorial comment: Please remember Ontario or other provincial taxes are in addition to the federal component being discussed here.)

About 9 million Canadians are expected to benefit from this measure in 2016. Single individuals who benefit will see an average tax reduction of $330 every year, and couples who benefit will see an average tax reduction of $540 every year. The maximum tax reduction will be $679 per individual and $1,358 per couple.

Introducing a Personal Income Tax Rate of 33 Per Cent

The Government proposes to introduce a new personal income tax rate of 33 per cent. This tax rate would apply to individual taxable income in excess of $200,000. This new rate would take effect on January 1, 2016 and for subsequent taxation years.
As with other bracket thresholds, the $200,000 threshold would be indexed to inflation. Approximately one per cent of Canadians who file a tax return are expected to pay more tax as a result of the Government's proposed changes to personal income tax rates. (Editorial comment: Please remember Ontario or other provincial taxes are in addition to the federal component being discussed here.)

Table 1 shows the existing and proposed personal income tax rate schedule for 2016.

Table 1
Existing and Proposed Personal Income Tax Rates, 2016

Taxable Income	Existing Rate (%)	New Rate (%)
Up to $45,282	15.0	15.0
$45,282 - $90,563	22.0	20.5
$90,563 - $140,388	26.0	26.0
$140,388 - $200,000	29.0	29.0
Over $200,000	29.0	33.0

Consequential Changes Due to the New Personal Tax Rate of 33 Per Cent

A number of other income tax rules either use the top personal income tax rate or use rates or formulas that reflect it. The main rules of this nature would be adjusted as part of today's proposals as described below. The Government will review other income tax rules to determine whether they require adjustment, and any required amendments will be announced at an early opportunity.

Trusts and Estates

Under the current tax rules applicable for 2016, trusts (other than qualified disability trusts) and estates (other than graduated rate estates) pay tax at the top federal marginal tax rate applicable to individuals.

Effective for the 2016 and subsequent taxation years, trusts and estates will remain subject to flat top-rate taxation at the new rate of 33 per cent. Qualified disability trusts and graduated rate estates will remain subject to the progressive personal income tax rate structure, including the 33-per-cent rate on taxable income in excess of $200,000.

Tax on Split Income

Under the income tax rules, the tax on split income applies the highest marginal tax rate to "split income" paid or payable to a minor. In general, split income comprises taxable dividends received directly or indirectly in respect of certain unlisted shares, capital gains from the disposition of such shares to persons dealing not at arm's length with the minor, and certain partnership or trust income.

Effective for the 2016 and subsequent taxation years, the tax on split income will remain subject to flat top-rate taxation at the new rate of 33 per cent.

Charitable Donations

Individuals who make charitable donations to registered charities and other qualified donees may be eligible to claim a federal Charitable Donation Tax Credit. The Government proposes to amend the Charitable Donation Tax Credit to allow higher-income donors to claim a 33-per-cent tax credit on the portion of donations made from income that is subject to the new 33-per-cent marginal tax rate. This change will be effective for the 2016 and subsequent taxation years.

Annual donations up to and including $200 will continue to receive the 15-per-cent credit rate. Donations in excess of $200:

- will continue to qualify for the 29-per-cent credit rate, except to the extent that the 33-per-cent credit rate applies; and

- will receive the 33-per-cent credit rate, on the lesser of the amount of those donations and the donor's taxable income in excess of $200,000.

For example:

- If a taxpayer had $220,000 in taxable income and charitable donations of $10,000, a 33-per-cent credit rate would be applied on the full amount of the donation above the first $200 (i.e., $9,800).

- If instead the individual donated $30,000, the 33-per-cent rate would be applied on $20,000 (15 per cent would apply to the first $200, and 29 per cent would apply to the remaining $9,800).

Investment Income of Private Corporations

Given that corporate tax rates are generally lower than personal tax rates, special refundable taxes are imposed on investment income of private corporations in order to limit the ability of individuals to defer taxation by holding investments in a private corporation. It is proposed that these refundable taxes and the related refund rate be increased effective January 1, 2016 to reflect the proposed new 33-per-cent personal income tax rate. Specifically:

- the refundable additional Part I tax on investment income of Canadian-controlled private corporations (CCPCs) will be increased by 4 percentage points (to 10.67 per cent from 6.67 per cent);

- the refundable portion of Part I tax on investment income of CCPCs will be increased by 4 percentage points (to 30.67 per cent from 26.67 per cent);

- the refundable Part IV tax on portfolio dividends received by private corporations will be increased by 5 percentage points (to 38.33 per cent from 33.33 per cent); and

- the rate at which refunds are made out of a private corporation's pool of refundable taxes previously paid (known as "Refundable Dividend Tax on Hand") when it pays dividends will be increased by 5 percentage points (to 38.33 per cent from 33.33 per cent of dividends paid).

Returning the TFSA Annual Contribution Limit to $5,500 and Reinstating Indexation

The Government proposes to return the Tax-Free Savings Account (TFSA) annual contribution limit to $5,500 from $10,000 effective January 1, 2016, and to reinstate indexation of the annual contribution limit. The TFSA annual contribution limit for 2015 remains $10,000.

In combination with other registered savings plans, a $5,500 TFSA annual contribution limit will permit most individuals to meet their ongoing savings needs in a tax-efficient manner.

Address - 3075 Ridgeway Drive Unit 31 ON L5L 5M6
T 905.997.3333 F 905.997.3999
E info@mrcas.ca www.mrcas.ca

The determination of tax payable on over-contributions to a TFSA will, as of January 1, 2016, be based on a $5,500 annual contribution limit for 2016.

Indexation maintains the real value of the TFSA annual contribution limit over time. The TFSA annual contribution limit was set at $5,000 in 2009 and was indexed to inflation using the Consumer Price Index (CPI), rounded to the nearest $500, until 2015. Consistent with the indexation system in place prior to 2015, the TFSA annual contribution limit for 2016 and subsequent years will be based on the $5,000 TFSA annual contribution limit available in 2009, indexed to inflation using the CPI for each year after 2009 and rounded to the nearest $500.

Fiscal Cost

Table 2 shows the net fiscal cost of the proposed tax measures.

Table 2
Fiscal Cost of Proposed Tax Changes
(millions of dollars)

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	Total
Personal Income Tax Rate Changes	355	1,430	1,510	1,580	1,645	1,715	8,235
Of which:							
Reducing second personal income tax rate to 20.5% from 22%	845	3,435	3,665	3,875	4,085	4,305	20,210
Introducing 33% personal income tax rate on taxable income in excess of $200,000[1,2]	(490)	(2,005)	(2,155)	(2,295)	(2,440)	(2,590)	(11,975)
Consequential Changes	30	(85)	(180)	(125)	(110)	(115)	(585)
Of which: Adjusting the Charitable Donation Tax Credit	30	125	130	135	140	145	705
Revising rates of refundable taxes on investment income of private corporations	0	(210)	(310)	(260)	(250)	(260)	(1,290)
Returning the TFSA Annual Contribution Limit to $5,500 and Reinstating Indexation	(15)	(80)	(150)	(215)	(275)	(330)	(1,065)
Net Fiscal Cost of Proposed New Measures	**370**	**1,265**	**1,180**	**1,240**	**1,260**	**1,270**	**6,585**

Note: Amounts are reported as costs to the Government, so negative amounts shown in parentheses represent increases in Government revenue.

1. The estimates of the revenue gain from introducing the 33-per-cent rate assume that those affected would respond by reducing their taxable income. The overall impact of tax rate changes on taxable income is captured by a measure known as the elasticity of taxable income. These estimates assume an elasticity of taxable income of 0.4.

2. The revenue estimates for the consequential changes for trusts and the tax on split income are included in the estimates of the revenue impact of the 33-per-cent rate.

Address - 3075 Ridgeway Drive Unit 31 ON L5L 5M6
T 905.997.3333 F 905.997.3999
E info@mrcas.ca www.mrcas.ca