FEDERAL BUDGET 2015: TAX CHANGES FOR BUSINESS

The 2015-16 federal Budget announced by Minister of Finance, Joe Oliver, included a number of announcements affecting Canadian businesses, especially the small business sector. Those announcements included reductions in the small business tax rate (to be phased in over several years), a change to the source deductions remittance schedule for new small employers, and changes to the calculation of employment insurance premiums.

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Reduction in small business tax rate

The federal government and each of the provinces and territories provides a reduced tax rate for small businesses, through the small business deduction. For federal purposes, that small business deduction reduces to 11% the general corporate income tax rate payable on the first $500,000 of active business income earned by a Canadian-controlled private corporation (CCPC) in a year. Access to that preferential rate is phased out for CCPCs which have between $10 million and $15 million of taxable capital employed in Canada.

The Budget proposes a reduction in the small business rate, beginning in 2016, to be implemented on the following schedule:

- effective January 1, 2016, the rate will be reduced to 10.5%;
- effective January 1, 2017, the rate will be reduced to 10%;
- effective January 1, 2018, the rate will be reduced to 9.5%; and
- effective January 1, 2019, the rate will be reduced to 9%.

In each year, the rate change will be pro-rated for companies which have non-calendar year year-ends.

Changes to dividend tax credit (DTC)

The Canadian tax system provides shareholders with a dividend tax credit (DTC) on dividends paid out by the corporation. That DTC gives the shareholder credit for tax paid at the corporate level on income subsequently paid out as dividends, through a mechanism known as the dividend gross-up and tax credit.

The proposed changes in the income tax rate applied to small business income necessitate a change in the DTC rates applied to dividends paid from income taxed at the new, lower rates. The DTC gross-up and tax credit rates will change annually from 2016 to 2019, to reflect the change in the small business tax rate in each of those years.

Consultation planned on small business deduction rules

Corporations which are eligible for the small business deduction receive the benefit of a significant tax rate reduction on eligible income. Where a corporation's purpose is to earn income from property (termed "specified investment businesses") it is generally not eligible for the small business deduction unless it has more than five full-time employees. Where the corporation has more than five full-time employees it is not considered to be a specified investment business and can claim the small business deduction.

Concerns have been expressed by stakeholders that the rules as currently drafted are not working as intended in some sectors. Consequently the federal government will be holding a review of the rules which permit income earned by businesses whose purpose is to earn income from property to be treated as active business income eligible for the small business deduction. The Department of Finance is seeking submissions on that issue, and such submissions can be sent to business-enterprise@fin.gc.ca before August 31, 2015.

Change to source deduction remittance schedule for new employers

All employers are required to withhold source deductions (generally for income tax, Canada Pension Plan contributions and Employment Insurance premiums) from employee remuneration and to remit those amounts, together with any required employer share, to the Canada Revenue Agency (CRA). The frequency with which those remittances must be made generally depends on the size of the employer and, specifically, on the amounts to be remitted.

Current rules require new employers to remit on a monthly basis for at least one year. At the end of that year, employers which have a perfect remittance record and an average monthly remittance of less than $3,000 can become quarterly remitters.

In order to reduce the compliance burden on new employers, the Budget proposes a change which will allow the smallest new businesses to remit on a quarterly basis from the outset. In order to qualify, a new business must have withholdings of less than $1,000 per month, and must maintain a perfect remittance record. Once monthly withholdings exceed $1,000, however, the employer will be required to remit on the schedule required by the general remittance rules.

The quarterly remittance option for new small employers will come into effect after 2015.

Changes to Employment Insurance premium structure

The Budget confirms that the federal government will, in 2017, implement the planned seven-year break-even EI premium rate-setting mechanism. That mechanism provides for EI premiums which are set no higher than the rate needed to pay for the EI program over time, meaning that any cumulative surplus which accrues to the EI Operating Account will be returned to employers and employees through lower EI premiums.

As outlined in the Budget papers, the federal government expects that the implementation of the new rate-setting mechanism will mean lower EI premium rates. Specifically, the government anticipates that the rate will drop from $1.88 in 2016 to $1.49 in 2017.

Streamlining of reporting requirements for foreign assets

For several years, Canadian taxpayers have been required to report their ownership of foreign property having a cost of more than $100,000. In 2013, the form on which that reporting is done—Form T1135—was revised to require taxpayers to provide greater detail with respect to each such foreign holding.

The federal government has heard from stakeholders that the compliance burden resulting from the changes is in some cases disproportionate to the amount of foreign investments held. Consequently, a revised form will be developed by the CRA for use by taxpayers whose foreign property holdings have a cost of less than $250,000 throughout the year.

The new form will be used for taxation years starting after 2014. Taxpayers having foreign holdings with a cost of more than $250,000 will continue to use the existing Form T1135.

Extension of accelerated capital cost allowance treatment for manufacturing and processing assets

In 2007, the federal government announced that the struggling manufacturing and processing (M&P) sector would benefit from a temporary accelerated capital cost allowance (CCA) rate of 50%, calculated on a straight-line basis, for qualifying M&P machinery and equipment acquired by a taxpayer before 2016.

This year's Budget extends the availability of the enhanced CCA rate to qualifying acquisitions made after 2015 and before 2026. There is one change to the accelerated CCA rate, in that it will be calculated after 2015 on a declining balance rather than a straight-line basis. The half-year rule which limits CCA claimed in the year of acquisition to one-half the usual amount will also apply.

Eligible assets acquired after 2025 will be depreciated at a rate of 30%, on a declining balance basis.

Tax treatment of patronage dividends

In 2005, the federal government introduced a deferral mechanism which permitted members of eligible agricultural co-operatives to defer the tax which would otherwise be payable on patronage dividends received in the form of shares. That tax would be payable, not when the share was received, but only when it was sold. The measure, which applied to such shares issued after 2005 and before 2016, was put in place to mitigate the negative financial impact that the issuance of patronage dividends in the form of shares could have on an agricultural co-op.

In recognition of the important role played by agricultural co-op corporations in rural communities and the significant financial burden placed on such corporations by the former rules, the federal government has determined that the tax deferral mechanism announced in 2005 should be extended to apply to eligible shares issued before 2021.