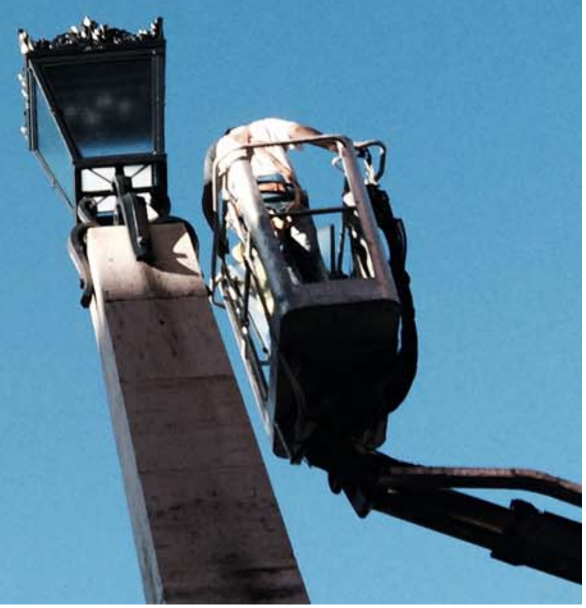
FEI Canada 2017 Tax Update

April 20, 2017



Disclaimer

This presentation may contain a discussion or analysis of decided tax cases. Any discussion or description of the facts of the case or the positions argued by the parties is based solely on publicly available information. For greater certainty no confidential client or taxpayer information is disclosed.

Agenda - 2017 Tax Update

1. **Current tax rate environment**
2. **Federal budget highlights**
3. **Provincial budget highlights**
4. **Recent tax changes**
5. **Tax administration**

Current Tax Rate Environment

Corporate Tax Rates at a Glance

2017 Corporate Tax Rates for Canadian Controlled Private Corporations

Combined Federal and Provincial Corporate Income Tax Rates

	Small Business Income up to $500,000*	General Active Business Income	Investment Income
British Columbia	13.0%	26.0%	49.7%
Alberta	13.5/12.5	27.0	50.7
Saskatchewan	12.5	27.0	50.7
Manitoba	**10.5/22.5**	**27.0**	**50.7**
Ontario	15.0	26.5	50.2
Quebec	18.5	26.9/26.8	50.6/50.5
New Brunswick	14.5/14.0	27.0/29.0	50.7/52.7
Nova Scotia	13.5/26.5	31.0	54.7
Prince Edward Island	15.0	31.0	54.7
Newfoundland & Labrador	13.5	30.0	53.7

2017 Corporate Tax Rates for General Corporations

Combined Federal and Provincial Corporate Income Tax Rates

	Active Business Income	M&P Income	Combined Active Income	Combined M&P Income
Federal	15.0%	15.0%	–	–
British Columbia	11.0	11.0	26.0%	26.0%
Alberta	12.0	12.0	27.0	27.0
Saskatchewan	12.0	10.0	27.0	25.0
Manitoba	**12.0**	**12.0**	**27.0**	**27.0**
Ontario	11.5	10.0	26.5	25.0
Québec	11.8	11.8	26.8	26.8
New Brunswick	14.0	14.0	29.0	29.0
Nova Scotia	16.0	16.0	31.0	31.0
Prince Edward Island	16.0	16.0	31.0	31.0
Newfoundland	15.0	15.0	30.0	30.0

Manitoba Corporate Tax Rates for 2017

Canadian-Controlled Private Corporations

	Active Business Income up to $450,000	Active Business Income between $450,000 and $500,000	Active Business Income over $500,000	Investment Income
Federal	10.5%*	10.5%	15.0%	38.7%**
Manitoba	0.0%	12.0%	12.0%	12.0%
TOTAL	**10.5%**	**22.5%**	**27.0%**	**50.7%**

* Federal small business tax rate reduced to 10.5% (from 11%) on January 1, 2016.
** Federal tax on investment income earned by a CCPC increased to 38.7% (from 34.7%) on January 1, 2016. This increase is to maintain integration as a result of the increase in the top Federal personal income tax rate to 33%.

Small Business Deduction Threshold

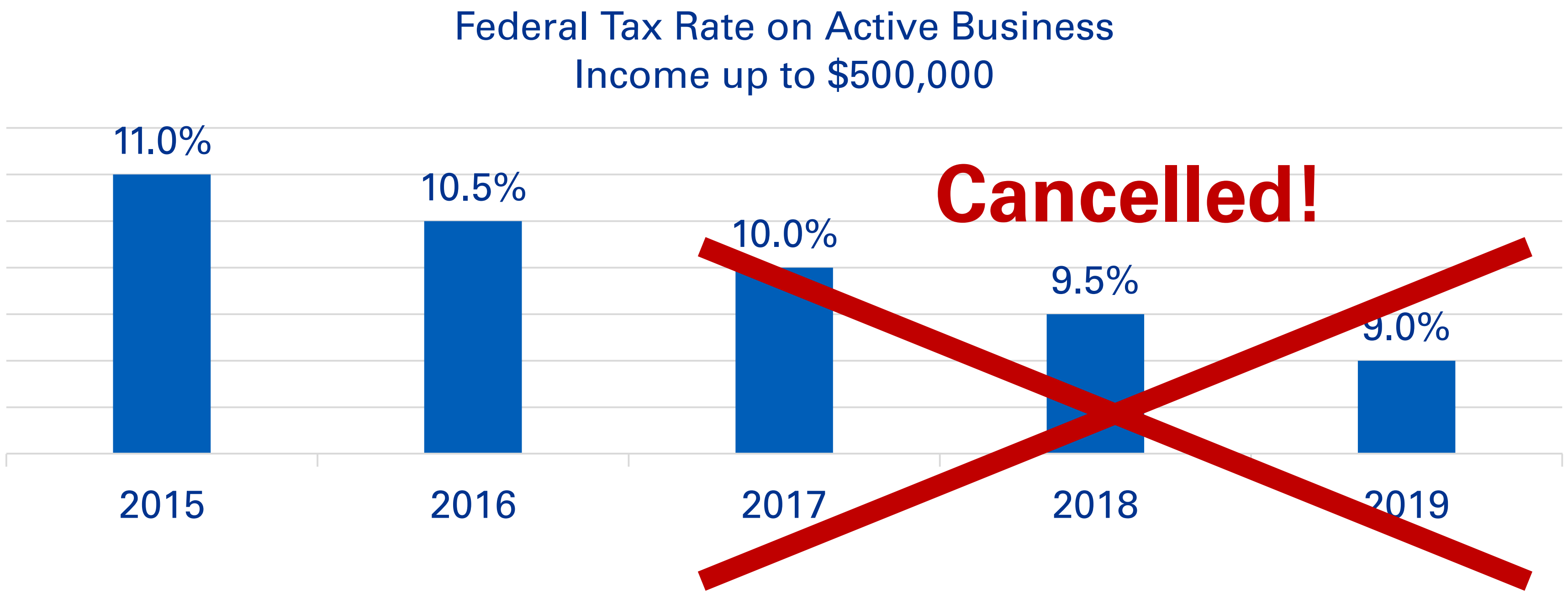
— Federal $500,000

— Manitoba $450,000 effective January 1, 2016

— Increase to $500,000 was not legislated in the 2017 Manitoba Budget.

Reductions to the Small Business Tax Rate

Federal small business corporate income tax rate was scheduled to decrease from 11% to 9% by 2019 (2015 PC Budget)



- Small business corporate tax rate will remain at 10.5% for 2016 and beyond
- Dividend gross-up factor on non-eligible dividends will also remain at 17%

Personal Tax Rates at a Glance

Manitoba Personal Tax Rates

Top Marginal Personal Income Tax Rates

	2016 & 2017	2015
Interest and regular income	50.40%	46.40%
Capital gains	25.20%	23.20%
Eligible dividends	37.78%	37.78%
Non-eligible dividends	45.74%	45.74%

— No changes to the tax rates for 2017

— Personal income tax brackets and Basic Personal Amount – Indexed for inflation beginning 2017

— Seniors' School Tax Rebate – Eliminated if family net income exceeds $63,500

Income Thresholds – Top Tax Bracket

	2016	2017
Federal	200,000	202,800
British Columbia	106,544	108,460
Alberta	300,000	303,900
Saskatchewan	127,431	129,914
Manitoba[1]	67,000	68,005
Ontario	220,000	220,000
Québec	103,151	103,915
New Brunswick	150,000	152,100
Nova Scotia	150,000	150,000
Prince Edward Island	63,970	63,970
Newfoundland	175,700	179,214

[1] Manitoba's top marginal bracket is scheduled to increase at a rate of approx. 2.0% per year through 2020

Federal Budget Highlights

2017 Federal Budget Highlights - The Headlines - "Wait & See Budget"

This is a budget for a tentative, wait-and-see government. Donald Trump is creating uncertainty.

Globe & Mail 2017-03-22

Canada unveils wait-and-see budget amid U.S. policy uncertainty.

Reuters 2017-03-22

Liberals table wait-and-see budget.

Morneau holds off on closing loopholes.

Globe & Mail 2017-03-23

2017 Federal Budget Highlights – Personal Highlights

Capital gains inclusion/tax rate

- Despite significant rumors there was no change to the capital gains rate (yet?)

Caregiver credits

- Aims to simplify the caregiver credit, infirm dependent credit, and family caregiver credit with the new **Canada Caregiver Credit**

Tuition tax credit

- Extends tuition tax credit paid for occupational skills courses that are not at the post-secondary level
- Available if the course is taken to provide life skills to the individual

Public transit tax credit

- Budget 2017 proposes to eliminate the tax credit effective July 1, 2017. Any public transit costs incurred after June 2017 will no longer be eligible.

Home relocation loans deduction

- Budget 2017 proposes to eliminate the deduction in respect of eligible home relocation loans effective for benefits arising in and subsequent to 2018.

2017 Federal Budget Highlights – Corporate Highlights

Factual control

— Refines legislation in respect of determination of association between two or more corporations

Electronic distribution of T4 slips

— Eliminates the need to obtain consent before electronically distributing T4s to employees

Child care space investment tax credit

— Budget 2017 proposes to eliminate the 25% non-refundable tax credit on costs incurred to build/expand child care spaces

2017 Federal Budget Highlights - Corporate Highlights (continued)

Review of tax planning strategies involving private corporations

- Budget 2017 discussed the planned review of the use of various tax planning strategies involving private corporations "that inappropriately reduce personal taxes of high-income earners"
- "to ensure that no taxpayer is able to get a tax advantage at the expense of those who pay their fair share"

"Sprinkling income using private corporations" — The budget states that this strategy can reduce income taxes by causing income that would otherwise be realized by an individual at a high personal income tax rate to instead be realized by family members who are subject to lower personal tax rates.

- Unknown what this will mean – Changes to use of family trusts? Who can own shares of a business? Who can receive dividends from a corporation?

2017 Federal Budget Highlights – Corporate Highlights (continued)

Review of tax planning strategies involving private corporations

- Budget 2017 discussed the planned review of the use of various tax planning strategies involving private corporations "that inappropriately reduce personal taxes of high-income earners"
- "to ensure that no taxpayer is able to get a tax advantage at the expense of those who pay their fair share"

"Holding a passive investment portfolio inside a private corporation" — The budget states that, since corporate income tax rates are generally lower than personal tax rates, this strategy can facilitate the accumulation of earnings by owners of private corporations.

- Unknown what this will mean – investment income inside a corporation is subject to higher tax rates than if owned personally. New tax system for accumulated earnings being used for non-business investment purposes?

2017 Federal Budget Highlights – Corporate Highlights (continued)

Review of tax planning strategies involving private corporations

- Budget 2017 discussed the planned review of the use of various tax planning strategies involving private corporations "that inappropriately reduce personal taxes of high-income earners"
- "to ensure that no taxpayer is able to get a tax advantage at the expense of those who pay their fair share"

"Converting a private corporation's regular income into capital gains" – The budget states that, since only one-half of capital gains are included in income, this strategy takes advantage of the lower tax rates on capital gains

- Unknown what this will mean – Changes to legislation to prevent using capital gains rates to withdraw funds? Changes to capital gains rates?

Provincial Budget Highlights

2017 Provincial Budget Highlights – Personal Highlights

Indexing of Personal Brackets and Basic Personal Amount

- Manitoba Budget 2017 plans to index the personal brackets and basic personal amount to the Manitoba Consumer Price Index
- Through 2020, the BPA and brackets will increase approximately 2.0% per year

Tuition Fee Income Tax Rebate and Tax Rebate Advance

- Rebate is being phased out beginning in 2017
- The annual cap for 2017 on any claim in respect of the rebate is $500 (reduced from $2,500) with the rebate being fully eliminated in 2018
- Tuition Rebate Advance eliminated effective for tuition and ancillary fees paid for a school term that begins after April 2017

Primary Caregiver Tax Credit

- Credit is being amended to cap the credit to a maximum of $1,400 per year beginning in 2017 and to revise terms of eligibility.

Political Contributions Tax Credit

- Credit enhanced to increase maximum contribution from $1,275 to $2,325

2017 Provincial Budget Highlights - Corporation Highlights

Research & Development Tax Credit

— Reduction in R&D tax credit from 20% to 15% which is effective for eligible expenditures incurred on or after April 12, 2017

Manufacturing Investment Tax Credit

— Non-refundable portion reduced from 2% to 1%.

— No impact to 8% refundable credit. Total credit reduced from 10% to 9% of cost of qualifying property. Change to property acquired on or after April 12, 2017

Small Business Deduction

— Budget 2016 promised an increase to the SBD in Manitoba from $450,000 to $500,000 in 2017.

— Budget 2017 and the related legislation was silent on this increase and it appears the increase will not be enacted

Income Thresholds for Small Business Deduction Applicable to Canadian-Controlled Private Corporations

	2016	2017
Federal	$500,000	$500,000
British Columbia	$500,000	$500,000
Alberta	$500,000	$500,000
Saskatchewan	$500,000	$500,000
Manitoba	**$450,000**	**$450,000**
Ontario	$500,000	$500,000
Quebec	$500,000	$500,000
New Brunswick	$500,000	$500,000
Nova Scotia	$350,000	$350,000
Prince Edward Island	$500,000	$500,000
Newfoundland and Labrador	$500,000	$500,000

Recent Significant Tax Changes - Personal

Significant Personal Changes - 2016

01 – Income splitting for couples
Eliminated beginning 2016

02 – Children's Fitness Tax Credit
Maximum eligible amount reduced to $500 (from $1,000) for 2016
Eliminated in 2017

03 – Children's Arts Credit
Maximum eligible amount reduced to $250 (from $500) for 2016
Eliminated in 2017

04 – Education and Textbook Tax Credits
Eliminated in 2017

05 – Canada Child Tax Benefit and Universal Child Care Benefit
Replaced with new Canada Child Benefit

06 – Teacher and Early Childhood Educator School Supply Tax Credit
Refundable 15% credit on up to $1,000 eligible suipplies
Effective 2016

07 – Canada Child Benefit
Replaced Canada Tax Benefit and Universal Child Care Benefit
Monly non-taxable payments began July 2016

08 – Donations of Proceeds – Sale of Share or Real Estate
Originally proposed in 2015 Federal Budget
2016 Federal Budget announced this measure will not proceed

09 – Taxation of "switch" fund shares
Currently switching between classes of a mutual fund corporation share not taxed
Effective for dispositions after September 2016, switching classes of share will be a disposition at FMV (triggering capital gains/losses)

Personal Tax Planning – Income Splitting
What Basic Opportunities Remain?

Use of Family Trusts

Dividend Income

- Dividend income paid or made payable to children that are 18 years of age or older at the end of a particular taxation year
  - Excellent strategy for assisting with post-secondary education or other needs in early adulthood
- Dividend income paid to low income spouse

Capital gains

- Capital gains realized on a disposition of shares:
    - By minor beneficiaries (where the shares are sold to an arm's length third party)
  - May be eligible for the capital gains deduction
    - By adult beneficiaries
  - May be eligible for the capital gains deduction

Personal Tax Planning – Income Splitting

What Basic Opportunities Remain?

Use of Prescribed Rate Loans

Basic Elements of the Plan

- Loan funds to spouse or non-arm's length minor which they can use to earn investment income
  - Loan must bear interest at the rate of interest prescribed in the Income Tax Act at the commencement of the loan (currently 1%)
  - Interest on loan for a particular calendar year must be paid within 30 days of the end of the year (each and every year)
  - Spouse or minor child is allowed to earn the spread between their actual rate of return and the interest payable to the lender
  - If the investment returns increase, the amount paid to the (parent) lender does not need to change (which will increase the amount of income effectively transferred to the borrower)

Personal Tax Planning – Income Splitting
What Basic Opportunities Remain?

Payment of Wages and Salaries to Family Members

Basic Requirements

- Spouse, minor children must provide services to be entitled to payments for wages and salaries
- Only reasonable amounts paid for services provided will be deductible by the employer

Withdrawing Corporate Funds

Decision to bonus out high rate income is no longer automatic

- Personal need for cash
- Ability to pay tax-free capital dividends
- Refundable Dividend Tax on Hand (RDTOH) balance
- RRSP contribution room (Approximately $144,500 of earned income in previous year is required to max out 2017 contribution limit of $26,010)
- Managing income levels to take advantage of loss carry forwards or loss carry backs from unprofitable years
- Cash flow considerations and impact on instalments
  - Consider alternating bonus years to manage instalments
- Consider provincial payroll taxes

Recent Significant Tax Changes - Corporate

Life Insurance Policies

Transfer of life insurance policies to corporation

— Planning to extract cash from corporation and maximize capital dividend account in respect of life insurance proceeds curtailed

Old rules

— Receive fair market value proceeds on transfer of policy to corporation without tax

— Provided a way to remove corporate cash on a tax free basis

Federal Budget 2016

— Fair market value consideration to be included as proceeds of disposition

— Capital dividend account restricted where transfers made prior to budget date (**retroactive impact of change**).

— Applicable to dispositions on or after March 22, 2016

Life Insurance Changes

New legislative changes

- Insurers using updated mortality tables that reflect Canadians living longer
- Policies issued before Jan 1, 2017 grandfathered

Capital dividend account

- Will take longer for company to get full credit to CDA on life insurance payout

Tax sheltered investment

- Reduction in amount that can be invested in life insurance policy earning tax sheltered rate of return

Other observations

- Decrease in tax deduction portion of life insurance premium where policy used a collateral security for loan

Limiting Multiple Access to the Small Business Deduction

Doctors warn thousands could leave for U.S. over new federal tax hikes.

Globe & Mail 2016-12-01

The tax man eyes the One Percenters in white coats as doctors' pay keeps climbing

National Post 2016-12-12

Limiting Multiple Access to the Small Business Deduction

Current rules

- Small business deduction tax rate in Manitoba is 10.5% which is a 16.5% lower tax rate than on regular active business income (regular rate is 27%). Tax deferral **savings of $76,500**.
- $500,000 annual limit ($450,000 in MB) of the small business deduction (SBD) must be allocated amongst associated corporations and members of a partnership
  - (i.e. **one $500,000 SBD per group**)
- Access to the SBD is phased out on a straight line basis for Canadian Controlled Private Corporations and associated corporation having between $10 million and $15 million of taxable capital (debt and equity) employed in Canada

Federal Budget 2016

- Address concerns about partnership and corporate structures that create and/or multiply access to the SBD
- Apply to tax years that begin after March 21, 2016

Limiting Multiple Access to the Small Business Deduction

Federal Budget 2016

- 2016 Budget announced changes to combat perceived abuses re: partnership and corporate structures that:
  - Multiply or create access to the SBD through use of specific sections of the Act
  - Multiply access to the SBD through different ownership of companies and intercompany fee structures
  - Provided for multiple SBD's for professionals (lawyers, doctors, accountants, etc.) working for the same firm/association.

New Rules are broad

- The new rules catch many of the perceived abuses but are much more far reaching than expected and may impact unintended structures

Income from Services / Property to NAL Private (Non-Associated) Corporations

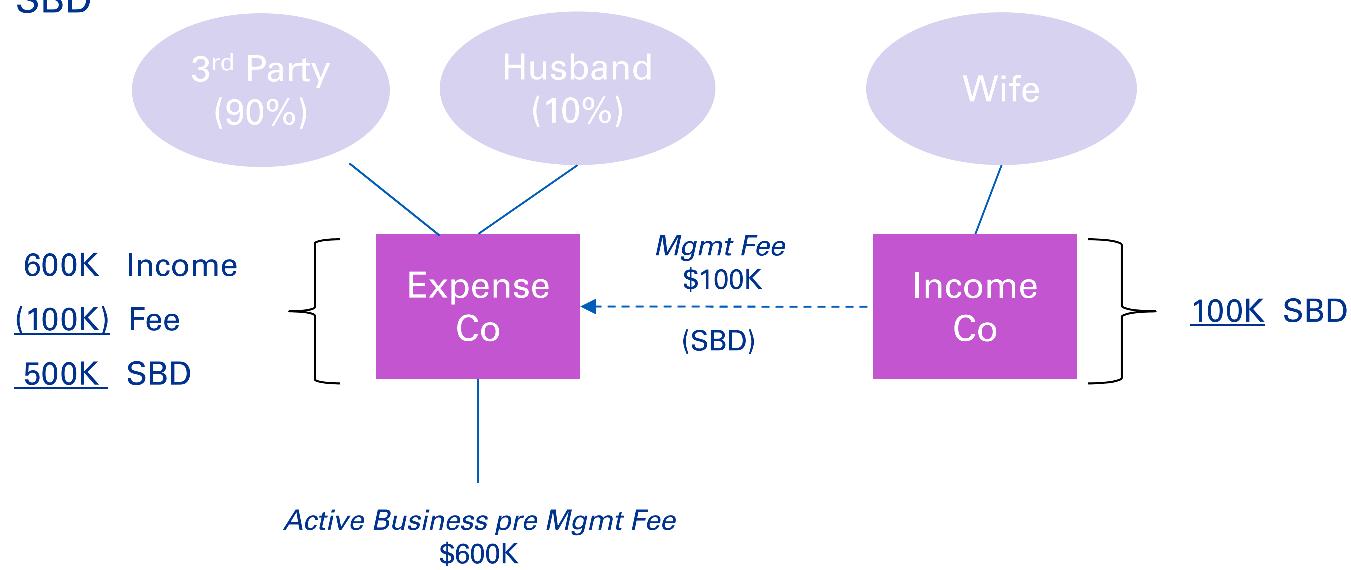
Example #1:

Facts

1. Income Co and Expense Co are not associated
2. Income Co provides management consulting “services” to Expense Co

Conclusion (Old Rules)

1. Income Co. and Expense Co. would each be eligible to claim a SBD
2. Mgmt fee earned by Income Co is eligible for SBD
3. Expense Co is not required to consider mgmt. fee earned by Income Co in determining income eligible for SBD



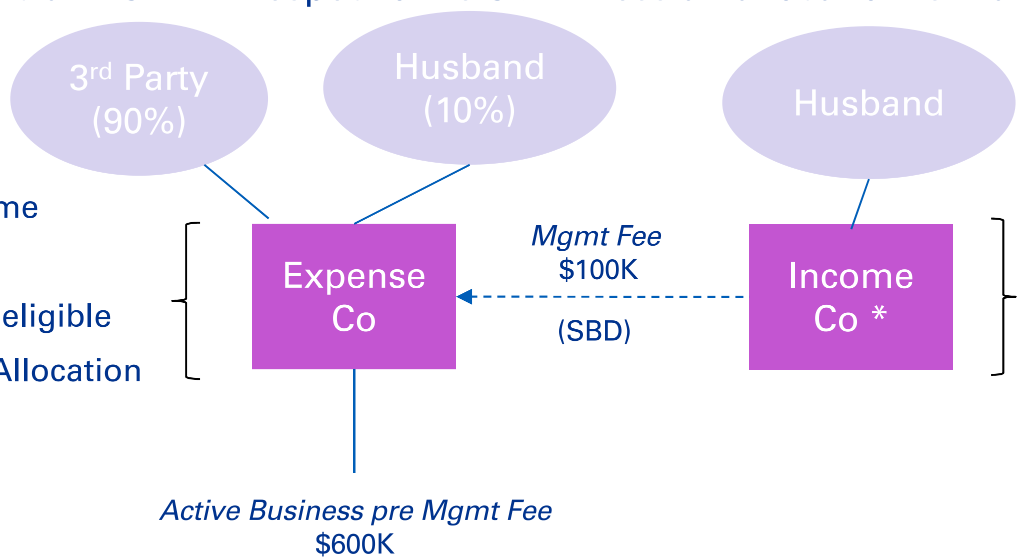
Income from Services / Property to NAL Private (Non-Associated) Corporations

Example #1 (cont):

Conclusion (New Rules)

1. Income earned by Income Co would not be considered ABI eligible for SBD in the absence of the SCI rules (carved out)
2. Income earned by Income Co would be SCI (NAL person (Husband) holds interest in Expense Co)
3. Income Co cannot claim SBD in respect of its SCI unless an allocation is made to it by Expense Co

600K	Income
(100K)	Fee
500K	SBD eligible
(100K)	SCI Allocation
400K	SBD



100K SBD

(if Expense Co allocates)

* Note – Assumes Income Co does not earn all/substantially all its income from arm's length persons other than Expense Co

Inter-Corporate Dividends and Subsection 55(2)

Does your company receive or pay dividends?

- Consider if the changes in the 2015 budget impacts the taxation of the dividends you pay and receive
- Subsection 55(2) can convert a tax free inter-corporate dividend into a taxable capital gain to the recipient (SURPRISE!!)

Inter-Corporate Dividends and Subsection 55(2)

Steps

1. Opco pays cash dividend to Holdco
2. Holdco lends cash to Opco

Issues:

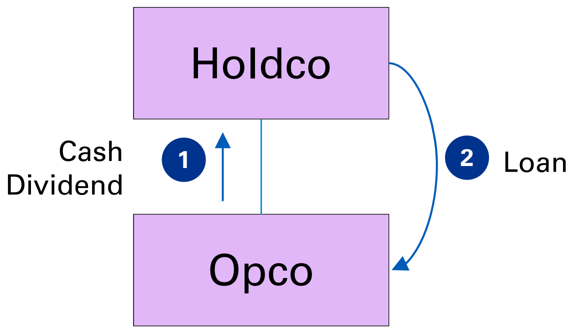
— Previously this would be tax free inter-corporate dividend and subsection 55(2) would typically not convert the tax free dividend into a taxable capital gain

— New 55(2) likely causes this to be a taxable capital gain unless there is sufficient "safe income" on hand in Opco.

— On $1M dividend this would be $135k surprise!

— "Safe income" is historical calculation for Opco so may be significant work involved to go back to calculate this balance.

— Effective for dividends after April 20, 2015



Inter-Corporate Dividends & 55(2)

Safe income

- Only available if there is a gain on the share
  - Consider impact on computation of safe income
  - Consider temporary decrease in fair market value of share due to market conditions

Inter-Corporate Dividends & 55(2)

Calculating safe income

- "Safe income" is historical calculation for Opco so may be significant work involved to go back to calculate this balance
- Calculation can be complex
- Consider:
  - Number of companies in corporate group
  - How many years are involved
  - Change in shareholders
  - Corporate reorganizations
- A best practice is to calculate safe income for all inter-corporate dividends
- If you have audited financial statements and receive inter-corporate dividends to which 55(2) might apply, a safe income calculation is likely required to support the tax provision.

Tax Administration

Foreign Taxes Paid – CRA Requesting Extra Proof

— New “compliance letter” campaign for individuals claiming foreign tax credit for U.S. taxes paid

— CRA requiring individual to provide notice of assessment or proof of taxes paid from U.S.

— Taxpayer will need to request tax account transcript from U.S. federal and state tax authorities

— If transcript not available, CRA will accept cancelled cheque or bank statement as proof of payment

T1135 Reporting – Rights to Amounts under Foreign Retirement Plan

- Canadian resident individual with interest in foreign pension fund trust required to report on T1135
  - Foreign pension fund trust not considered "specified foreign property" so not excluded from T1135 reporting
- Cost amount of interest is amount individual legally entitled to receive, including future amounts
  - Onus on taxpayer to determine/reasonably estimate amount
  - CRA provides guidance on determining cost amount of interest in fund (present value of rights to pension)
  - No guidance on how much effort needed to reasonably estimate amount

Tax Dispute Resolution

Tax Dispute Resolution – Tax Planning - Historical

Inland Revenue Commissioners v. ***Duke of Westminster*** [1936] A.C. 1, 19 TC 490

“Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax”

Supreme Court of Canada in Canada Trustco Mortgage Co [2005]

“…the Duke of Westminster principle “that tax planning — arranging one's affairs so as to attract the least amount of tax — is a legitimate and accepted part of Canadian tax law”

Tax Dispute Resolution - Current environment

Minister of National Revenue – September 7, 2016

— "The vast majority of Canadians pay their fair share of taxes, but some wealthy Canadians buy their way out of paying what they owe. This has to change in order to ensure a tax system that is more responsive and fair for all Canadians"

Federal Budget – March 2017

— "The commitment to tax fairness is what drives the Government to close loopholes and to ensure that no taxpayer is able to get a tax advantage at the expense of those who pay their fair share"

Themes in the Current Tax Dispute Area

Underlying messages/drivers:

- Tax authorities believe strongly in tax morality (paying "fair" share)
- Tax authority role is to deter and correct taxpayer "non-compliance"
- "Non-compliance" is viewed from the tax result – i.e. tax planning is not moral
- Difficult to make successful "rule of law" arguments at audit and objection stages
  - Taxpayer stuck arguing against the CRA's positions rather than the law
- No benefit of the doubt in discussions with tax authorities
  - need to prove and support all information. If no support then CRA reassesses to their position

Best practices for Companies

- Importance of compliance – need to ensure the tax return is complete and accurate
  - Information is used for data analytics risk assessment
- Books and records
  - 6 years from the end of the last taxation year to which they relate
  - In some cases this is much longer than 6 years (safe income, capital assets, etc). May need records for last 45 years!
- Maintain good relationship with Tax Authorities
- Dealing with audit -
  - Voluminous information requests – fair to push back – but be timely
- Notices of objection
  - Quicker for less complex issues, longer for complex files – provide full information unless plan is to go to court
- Litigation as a strategy to settle. Skip CRA appeals for shorter resolution.
- CRA rulings and appeals – objections have tripled in last 10 years.

Hot topics/issues

- Aggressive tax planning
  - Triggered by reorganizations, perceived tax planning
- Brave new world General Anti-Avoidance Rule
  - Sham, ineffective transactions, no business purpose
- International
  - Base Erosion and Profit Shifting, transfer pricing, “tax havens” – e.g. Luxembourg
  - Same result oriented approach as GAAR
- Valuations (shares, real estate), reasonableness (interest rates, management fees)
- Business travelers, Regulation 102 & 105, permanent establishment
  - https://i94.cbp.dhs.gov/I94/#/home

Hot topics/issues (cont'd)

- Basic books and records
  - Reconciliations, invoices, supporting evidence, carry-forward amounts, foreign tax credits
- General
  - Professional fees/engagement letters (lawyers, accountants and other advisors),
  - meals and entertainment,
  - taxable benefits
- Competent Authority solution for transfer pricing issues
  - Don't always assume double tax will be cured

U.S. Tax Reform

U.S. Primed for Tax Reform Changes?

Potential U.S. tax changes

- Reduced personal tax rates and tax brackets
- Reduced corporate tax rates (from federal rate of 35% to 15%?)
- Elimination of many tax benefits (specific tax credits)
- Elimination of alternative minimum tax
- Eliminate deductions for interest expenses
- Introduce faster or immediate write-offs of capital assets especially in specific industries such as manufacturing
- Introduce a border adjustment which would impose tax on imports and exempt exports
- Introduce a one-time accumulated foreign profits tax (deemed repatriation)
- Repeal the estate tax but subject capital gains to tax on death above a threshold

Thank you

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