Personal Tax Rate Changes Confirmed for 2016

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Today the new federal government announced two tax rate changes for individuals: a reduction in the federal tax rate for income between $45,283 and $90,563 to 20.5% (from 22%) and an increase of 4% in the tax rate for income over $200,000 to 33% (from 29%), starting January 1, 2016.

The government also announced that the contribution limit for Tax-Free Savings Accounts will be reduced to $5,500 per year (from $10,000 per year), starting in 2016.

As a result of the increase in the top federal tax rate to 33%, consequential changes were made to the tax rate for inter vivos trusts, as well as the refundable tax on Canadian controlled private corporations' investment income, among other things.

Tax changes — Bill expected soon
Today's tax changes were announced in a Notice of Ways and Means Motion. We expect that the changes will be incorporated into a bill in Parliament shortly so that the personal tax rate changes can take effect for January 1, 2016.

The middle rate tax change was highlighted in the Speech from the Throne on December 4, 2015 (see KPMG's *TaxNewsFlash-Canada* 2015-37, "Throne Speech Kicks Off New Tax Agenda".)

The government further announced that it will introduce legislation "at an early opportunity" to repeal income splitting for families with children (but not pension income splitting), starting in 2016. As well, payments under a new Canada Child Benefit will begin in July 2016.

Today's announcement did not include any proposals to change the taxation of stock options, as stated in the Liberal party's campaign platform. (For details, see KPMG's *TaxNewsFlash-Canada* 2015-34, "Anticipated Stock Option Changes — Government Announces Grandfathering".)

Highlights of today's changes are as follows.

Personal tax rates

As expected, the federal tax rate for income between $45,283 and $90,563 will be reduced to 20.5% (from 22%), effective January 1, 2016.

However, the federal tax rate for income over $200,000 will increase by 4% to 33% (from 29%), effective January 1, 2016.

As a result of these tax rate changes and the indexation of tax brackets for 2016, the federal tax rates and brackets for 2016 will be as follows:

Federal Income Tax Rates and Brackets for 2016	
Tax rates	**Tax brackets**
15%	Up to $45,282
20.5%	$45,283 to $90,563
26%	$90,564 to $140,388
29%	$140,389 to $200,000
33%	$200,001 and over

The combined federal and provincial tax rate for income over $200,000 will range from 48% to 59%, depending on the individual's province of residence. Combined federal and provincial top marginal tax rates for income over $200,000 will be as follows for 2016.

Combined Top Marginal Personal Tax Rates – 2016				
Province	**Salary**	**Capital Gains**	**Eligible Dividends**	**Non-eligible Dividends**
British Columbia	47.70%	23.85%	31.30%	40.61%
Alberta	48.00%	24.00%	31.71%	40.24%
Saskatchewan	48.00%	24.00%	30.33%	40.06%
Manitoba	50.40%	25.20%	37.78%	45.69%
Ontario	53.53%	26.76%	39.34%	45.30%
Quebec	53.31%	26.65%	39.83%	44.23%
New Brunswick	58.75%	29.38%	43.79%	51.75%
Nova Scotia	54.00%	27.00%	41.58%	46.97%
Prince Edward Island	51.37%	25.69%	34.22%	43.87%
Newfoundland	48.30%	24.15%	38.47%	39.40%

See the Appendix for a comparison of the combined top marginal tax rates on different types of income for 2015 and 2016. As these tables show, the tax rate increase is not 4% across the board because of provincial tax rate increases in Alberta and Newfoundland and decreases in British Columbia and Quebec.

If you are affected by the federal tax rate increase, you may want to consider accelerating income into 2015 versus 2016 (or, where possible, deferring expenses or deductions until 2016) to realize tax savings. For more, see KPMG's *TaxNewsFlash-Canada* 2015-30, "Post-Election Personal Tax Savings — Act Fast".

Impact of new top tax rate

Changes affecting taxation of CCPCs

The introduction of a new top personal income tax rate of 33% (up from 29%) results in changes to several tax measures affecting Canadian controlled private corporations (CCPCs).

Investment income earned by a CCPC is subject to a refundable corporate tax. Finance notes that this additional tax is intended to reduce the personal income tax deferral possibilities that individuals earning investment income directly might otherwise obtain by earning such income through a CCPC.

Consequential to the introduction of a new top personal income tax rate of 33% (up from 29%) Finance proposes the following amendments:

- *Refundable tax on CCPCs' investment income* — increased to 10 2/3% (from 6 2/3%), effective for tax years that end after 2015. For tax years beginning before 2016, the rate increase is prorated for the number of days in the tax year that are after 2015.
- *Refundable dividend tax on hand* — the definition of refundable dividend tax on hand (RDTOH) is being amended to increase the percentage of investment income of a CCPC that can be included in the corporation's RDTOH and to adjust the amount of foreign investment income that can be included in the corporation's RDTOH. In particular:
    - The percentage of aggregate investment income that can be included in RDTOH will be increased to 30 2/3% (from 26 2/3%)
    - The adjustment to the foreign tax credit reduction related to foreign investment income is decreased to 8% (from 9 1/3%) of foreign investment income
    - The adjustment factor for taxable income of a corporation for the year that exceeds the total of the portions of that income that has benefited from either the small business deduction or foreign tax credits is also adjusted to 30 2/3% (from 26 2/3%)
    - The gross-up factor for foreign non-business income is changed to 100/(38 2/3) (from 100/35).

These changes are effective for tax years that end after 2015. For tax years beginning before 2016, the rate increase is prorated for the number of days in the tax year that are after 2015.

- *Dividend refund* — the dividend refund rate for private corporations will increase to 38 1/3% (from 33%) effective for tax years that end after 2015. For tax years beginning before 2016, the dividend refund rate increase is prorated for the number of days in the tax year that are after 2015.

Part IV tax

Part IV tax is imposed on certain taxable dividends received by private corporations that are otherwise deductible in computing taxable income. Due to the changes to the top personal marginal tax rate and the changes to the computation of a corporation's RDTOH balance, the Part IV tax rate will increase to 38 1/3% (from 33 1/3%). Finance notes that these rates reflect a federal small business tax rate in 2019 of 9%. This amendment applies to tax years ending after 2015. For tax years beginning before 2016, assessable dividends are taxed at 33 1/3% if they are received before 2016 and at 38 1/3% if received after 2015.

The percentage of unused non-capital losses and farm losses that may reduce Part IV tax is also increased to 38 1/3% (from 33 1/3%) for tax years that end after 2015. For tax years that begin before 2016, losses applied to reduce Part IV tax are used first to offset assessable dividends that are subject to the higher 38 1/3% rate.

Trusts

Trusts created during the lifetime of the settlor are known as inter vivos trusts. These trusts pay tax at the combined federal and provincial top tax rate for individuals. As a result, the new top tax rate of 33% for income over $200,000 will also apply to these trusts, starting in 2016. If your inter vivos trust is affected by the tax rate increase, you may want to consider accelerating income into 2015 versus 2016 to realize tax savings.

Testamentary trusts are created on an individual's death. These trusts pay tax at the same graduated rates as individuals until December 31, 2015. Beginning in 2016, testamentary trusts (except certain estates and qualified disability trusts) will also pay tax at the top rate of 33%. For details, see KPMG's *TaxNewsFlash-Canada* 2015-31, "New Estate Tax Changes — Act Before December 31, 2015".

Charitable donations

Currently, individuals can claim a 29% federal tax credit for charitable donations over $200. A new tax credit rate of 33% will apply to gifts over $200 to the extent that an individual has income that is subject to the new 33% tax rate.

This change will apply to gifts made after 2015. Gifts made in 2015 and previous years but claimed in 2016 or a later year will not be eligible for the new 33% tax credit rate.

Tax on split income

Some income splitting arrangements with minor children attract a special "income splitting tax" in the minor child's hands (sometimes called the "kiddie tax"). This tax neutralizes the tax benefits of certain arrangements, including some types of plans involving the use of family trusts. The tax subjects certain types of dividend, partnership or trust income or certain capital gains received by, or used for the benefit of, minor children to tax at the top marginal rate, instead of the lower rate that would usually apply to income received by a minor child.

As a result, the new top tax rate of 33% for income over $200,000 will also apply to this split income, starting in 2016.

Tax-Free Savings Accounts — Contribution limit

The annual contribution limit for Tax-Free Savings Accounts (TFSA) has been reduced to $5,500 (from $10,000) for 2016 and later years.

The annual contribution limit has changed several times since TFSAs were first introduced in 2009, as illustrated in the table below. You can contribute to a TFSA as long as you are 18 or older and resident in Canada. You can carry forward unused contribution room indefinitely. You can hold more than one TFSA, subject to your contribution limit. TFSA contributions are not tax-deductible but contributions together with accumulated income can be withdrawn tax-free at any time.

Years	TFSA contribution limit	Total
2009-2012	$5,000 per year	$20,000
2013-2014	$5,500 per year	$11,000
2015	$10,000	$10,000
		$41,000
2016	$5,500	$5,500
		$46,500

If you have made no contributions to date and you are 24 or older in 2015, you can contribute a total of $41,000 before the end of 2015.

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We can help

Your KPMG adviser can help you assess the effect of the tax changes on your personal finances and point out ways to take advantage of any benefits arising from the changes or help mitigate their impact. For details on these changes and their potential impact, contact your KPMG adviser.

Appendix — Combined Top Marginal Tax Rates on Different Types of Income 2016 vs. 2015

As these tables show, the tax rate increase for income over $200,000 is not 4% across the board because of provincial tax rate increases in Alberta and Newfoundland and decreases in British Columbia and Quebec.

Province	Salary		
	2016	2015	Increase*
British Columbia	47.70%	45.80%	1.90%
Alberta	48.00%	40.25%	7.75%
Saskatchewan	48.00%	44.00%	4.00%
Manitoba	50.40%	46.40%	4.00%
Ontario	53.53%	49.53%	4.00%
Quebec	53.31%	49.97%	3.34%
New Brunswick	58.75%	54.75%	4.00%
Nova Scotia	54.00%	50.00%	4.00%
Prince Edward Island	51.37%	47.37%	4.00%
Newfoundland	48.30%	43.30%	5.00%
*Potential tax savings for income accelerated into 2015.			

Province	Capital Gains		
	2016	2015	Increase
British Columbia	23.85%	22.90%	0.95%
Alberta	24.00%	20.13%	3.88%
Saskatchewan	24.00%	22.00%	2.00%
Manitoba	25.20%	23.20%	2.00%
Ontario	26.76%	24.77%	2.00%
Quebec	26.65%	24.99%	1.67%
New Brunswick	29.38%	27.38%	2.00%
Nova Scotia	27.00%	25.00%	2.00%
Prince Edward Island	25.69%	23.69%	2.00%
Newfoundland	24.15%	21.65%	2.50%

Province	Eligible Dividends		
	2016	2015	Increase
British Columbia	31.30%	28.68%	2.62%
Alberta*	31.71%	21.02%	10.69%
Saskatchewan	30.33%	24.81%	5.52%
Manitoba	37.78%	32.26%	5.52%
Ontario	39.34%	33.82%	5.52%
Quebec	39.83%	35.22%	4.61%
New Brunswick	43.79%	38.27%	5.52%
Nova Scotia	41.58%	36.06%	5.52%
Prince Edward Island	34.22%	28.71%	5.51%
Newfoundland	38.47%	31.57%	6.90%

*The 2016 rates do not reflect potential changes Alberta may make to the taxation of eligible dividends for 2016 subject to its review.

Province	Non-eligible Dividends		
	2016	2015	Increase
British Columbia	40.61%	37.98%	2.63%
Alberta	40.24%	30.84%	9.40%
Saskatchewan	40.06%	34.91%	5.15%
Manitoba	45.69%	40.77%	4.92%
Ontario	45.30%	40.13%	5.17%
Quebec	44.23%	39.78%	4.45%
New Brunswick	51.75%	46.89%	4.86%
Nova Scotia	46.97%	41.87%	5.10%
Prince Edward Island	43.87%	38.74%	5.13%
Newfoundland	39.40%	33.26%	6.14%