Sun Life GLOBAL Investments

BABY STEPS TOWARD 'ECONOMY OF TOMORROW'

It's a challenging time for Canada as a new U.S. government works to upend the status quo on everything from trade to immigration to taxation. Against that backdrop, Budget 2017 suggests Ottawa has little desire to rock the spending (and savings) boat with any major initiatives this time around. Still – laying the groundwork for the "economy of tomorrow" is clearly on the to-do list.

Finance Minister Bill Morneau says, "As we prepare for the global economy of tomorrow, we will put our best foot forward, always looking to develop strategic partnerships to attract talent and investment." He identified "six economic sectors where Canada will lead the way: digital, clean technology, agri-food, advanced manufacturing, bio-sciences, and clean resources."

"This is a pivotal moment in Canada-U.S. relations, that's for sure," says Sadiq S. Adatia, Chief Investment Officer for Sun Life Global Investments. "The pressure on our leaders to maintain and even deepen our economic relationship with the U.S. under President Donald Trump is only going to get more intense. Our competitive edge is crucial for economic growth."

This year's budget proposes spending on initiatives aimed at improving the country's technological edge, from energy-related ventures to supporting the development of appropriate job skills.

After accounting for the new proposals, Budget 2017 projects a deficit of $23 billion for 2016-17, falling to $19 billion by 2021-22. The debt-to-GDP ratio, which some economists consider a truer measure of a country's economic health, is projected to shrink from 31.5% this year to 30.9% in 2021-22.

On the tax front there were a few items conspicuous by their absence, including a speculated increase to the capital gains inclusion rate. And there were no changes to corporate or personal income tax rates. That said, here are a few highlights from this year's federal budget for individuals, families and advisors to be aware of:

BUDGET HIGHLIGHTS:

- **Anti-avoidance rules extended to RESPs and RDSPs.** Budget 2017 extends certain anti-avoidance rules that cover registered plans like RRSPs, TFSAs and RRIFs to RESPs and RDSPs. These rules prevent registered plans from offering tax advantages that are excessive or unrelated to the benefits they provide. Generally, the changes will apply as of Budget Day (March 22, 2017), and will likely have little impact on RESPs and RDSPs that offer conventional investment choices.

- **Tax planning using private corporations.** After initiating a broad review of tax strategies that typically benefit the wealthiest Canadians in last year's budget, the government says it's continuing to examine the use of tax planning strategies involving private corporations. No specific proposals were outlined in Budget 2017; the government says it expects to release a paper in the coming months with more detail.

- **Tax treatment of mutual funds organized as corporations.** The budget proposes to ease up on the tax treatment of mutual funds organized as corporations. Budget 2017 proposes to allow such mutual funds (also called "corporate class" funds) to reorganize themselves with one or more mutual fund trusts on a tax-deferred basis, the same as mutual fund trusts are currently permitted to do. The proposed change, effective March 22, 2017, would also apply to segregated funds.

- **Eliminating "ineffective" tax measures.** The budget proposes to eliminate certain tax measures that the government claims to be ineffective and inefficient, or those that were being used on a very limited basis and not achieving their intended purpose. Most notably, the measures being eliminated include the Public Transit Tax Credit, and the deduction available for employee home relocation loans. The budget also confirmed that the First-Time Donor's Super Credit for charitable donations will be discontinued in 2017, as had previously been planned.

- **Billed-based accounting for designated professionals.** Budget 2017 proposes to eliminate the ability of professionals such as doctors, lawyers, dentists and accountants to exclude the value of their "work in progress" when calculating income. The government intends to phase in the change, which takes effect the first tax year following March 22, 2017.

- **So long, CSB.** At less than 1% of outstanding federal debt, the Finance Ministry says the Canada Savings Bond program is "no longer a cost-effective source of funds." Sales of new Canada Savings Bonds will end this year, but of course all outstanding debt will be honoured.

- **Cracking down on tax evasion.** The budget proposes to spend $524 million over five years on curbing tax evasion and improving compliance. The efforts are projected to add up to $2.5 billion in revenue over the five-year period.

"It's impossible to say what the repercussions on Canada will be until U.S. policy takes better shape," says Adatia. "Yes, the stock markets have been on a tear since Trump's election win – but at this point we would say the positive impact has been baked in with not enough of the risk."

"Our job is to help clients enjoy a smoother investment experience without a lot of worry," he says. "Sometimes that means playing it safe."

Even with the uncertainty surrounding the impact of the young Trump administration, Adatia says he remains modestly optimistic on U.S. stocks. He characterizes his view on Canada as "neutral," while he's more bearish on foreign markets.

When it comes to bonds, Adatia says his views are largely in line with the market consensus. "We expect bond yields in the U.S. to grind higher as the Federal Reserve continues along the path of policy rate increases. In Canada, we expect a similar scenario. The caveat here of course is Trump. Truly, anything could happen."

All this points to the importance of keeping things in perspective.

"Markets are unpredictable. That's not news – but sometimes it takes a shakeup or even a string of record highs to remind us to keep our feet on the ground and our heads out of the clouds. If you're like us, then you're invested for the long term."

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