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2018 FEDERAL BUDGET

Wealth Planning Group, Assante Private Client

Tax highlights from the 2018 federal budget

On February 27, 2018, federal Finance Minister Bill Morneau tabled the Liberal government's highly anticipated budget – the third since the October 2015 election. The budget, titled "Equality & Growth – A Strong Middle Class", focused primarily on gender equality and investing in the middle class.

After accounting for Budget 2018 proposals, the budgetary balance is expected to show deficits of $19.4 billion in 2017-18 and $18.1 billion in 2018-19. Over the remainder of the forecast horizon, deficits are expected to decline gradually from $17.5 billion in 2019-20 to $12.3 billion in 2022-23. The federal debt-to-GDP ratio is projected to decline gradually after 2019-20 to the end of the fiscal horizon, reaching 28.4% in 2022-23.

Budgetary revenues are expected to increase by 5.5% in 2017-18. Over the remainder of the forecast horizon, revenues are projected to grow at an average annual rate of 3.8%, in line with projected growth in nominal GDP.

There were no changes to personal or corporate income tax rates. The budget announced long-awaited measures that will affect corporations with passive investment income.

The following is a summary of changes announced in the budget that we feel are relevant to financial advisors and their clients. Please note that these changes are proposals until passed into law by the federal government.

PERSONAL TAX MATTERS

Personal income tax rates and tax brackets

There were no proposed changes to personal income tax rates. For 2018, federal personal income tax rates are as follows:

	2018 tax rates			
Taxable income range	Other income	Capital gains	Eligible dividends	Non-eligible dividends
First $46,605	15.0%	7.5%	0.0%	5.8%
$46,606-$93,208	20.5%	10.3%	7.6%	12.2%
$93,209-$144,489	26.0%	13.0%	15.2%	18.5%
$144,490-$205,842	29.0%	14.5%	19.3%	22.0%
$205,843 and over	33.0%	16.5%	24.8%	26.7%

Canada Workers Benefit

The Working Income Tax Benefit is a refundable tax credit that supplements the earnings of low-income workers.

Budget 2018 proposes to rename the program the Canada Workers Benefit and proposes that, for 2019, the amount of the benefit will be equal to 26% of each dollar of earned income in excess of $3,000 to a maximum benefit of $1,355 for single individuals without dependants and $2,335 for families (couples and single parents). The benefit will be reduced by 12% of adjusted net income in excess of $12,820 for single individuals without dependants and $17,025 for families.

Budget 2018 also proposes that the maximum amount of the Canada Workers Benefit disability supplement be increased to $700 in 2019, and the phase-out threshold of the supplement be increased to $24,111 for single individuals without dependants and to $36,483 for families. The reduction rate of the supplement will be decreased to 12% to match the proposed rate for the basic benefit, and to 6% where both partners in a family are eligible for the supplement.

This measure will apply to the 2019 and subsequent taxation years with indexation of certain amounts.

Medical expense tax credit – eligible expenditures

Budget 2018 proposes to expand the medical expense tax credit to recognize such expenses where they are incurred in respect of an animal specially trained to perform certain tasks for a patient with a severe mental impairment. This measure will apply in respect of eligible expenses incurred after 2017.

Registered Disability Savings Plan – qualifying plan holders

Where the capacity of an adult individual to enter into a contract is in doubt, the *Income Tax Act* requires that the plan holder of the individual's Registered Disability Savings Plan (RDSP) be the individual's legal representative, as recognized under provincial or territorial law.

Where the adult individual does not have a legal representative in place, a temporary federal measure exists to allow a qualifying family member (i.e., a parent, spouse or common-law partner) to be the plan holder of the individual's RDSP. Currently, this measure is legislated to expire at the end of 2018.

Budget 2018 proposes to extend the temporary measure by five years, to the end of 2023. A qualifying family member who becomes a plan holder before the end of 2023 could remain the plan holder after 2023.

Deductibility of employee contributions to the enhanced portion of the Quebec Pension Plan

On November 2, 2017, the Government of Quebec announced that the Quebec Pension Plan (QPP) would be enhanced in a manner similar to the enhancement of the Canada Pension Plan (CPP) that was announced in 2016.

To provide consistent income tax treatment of CPP and QPP contributions, Budget 2018 proposes to amend the *Income Tax Act* to provide a deduction for employee contributions (as well as the "employee" share of contributions made by self-employed persons) to the enhanced portion of the QPP. In this regard, the Government of Quebec announced on November 21, 2017 that the enhanced portion of employee CPP and QPP contributions will be deductible for Quebec income tax purposes.

This measure will apply to the 2019 and subsequent taxation years.

Mineral exploration tax credit for flow-through share investors

Flow-through shares allow resource companies to renounce or "flow through" tax expenses associated with their Canadian exploration activities to investors, who can deduct the expenses in calculating their own taxable income. The mineral exploration tax credit provides an additional income tax benefit for individuals who invest in mining flow-through shares, which augments the tax benefits associated with the deductions that are flowed through.

The Government proposes to extend eligibility for the mineral exploration tax credit for an additional year, to flow-through share agreements entered into on or before March 31, 2019.

Reporting requirements for trusts

Budget 2018 proposes to require that certain trusts provide additional information on an annual basis. The new reporting requirements will also impose an obligation on certain trusts to file a T3 return where one does not currently exist.

The proposals will apply to express trusts that are resident in Canada and to non-resident trusts that are currently required to file a T3 return. An express trust is generally a trust created with the settlor's express intent, usually made in writing (as opposed to a resulting or constructive trust, or certain trusts deemed to arise under the provisions of a statute). Some exceptions will apply.

Where the new reporting requirements apply to a trust, the trust will be required to report the identity of all trustees, beneficiaries and settlors of the trust, as well as the identity of each person who has the ability to exert control over trustee decisions regarding the appointment of income or capital of the trust (e.g., a protector).

These proposed new reporting requirements will apply to returns required to be filed for the 2021 and subsequent taxation years.

CORPORATE TAX MATTERS

Corporate income tax rates

There were no proposed changes to federal corporate income tax rates or the small business limit for 2018.

The table below shows federal tax rates and the small business limit for 2018.

Category	2018 tax rates
General rate	15.0%
Manufacturing & processing rate	15.0%
Investment income	38.7%
Small business rate	10.0%
Small business limit	$500,000

Passive investment proposals

Budget 2018 proposes the following two new measures to limit what the federal government has identified as tax-deferral advantages from holding passive investments in a corporation:

1. Reducing access to the small business tax rate for corporations with passive investment income through the introduction of an additional eligibility mechanism based on the corporation's passive investment income levels; and

2. Limiting refundable taxes in connection with the payment of eligible dividends.

1. Reducing access to the small business tax rate rate where passive investment income exceeds $50,000

Gradual reduction of access to small business tax rate

Budget 2018 proposes that if a corporation and its associated corporations earn more than $50,000 of passive investment income in a given year, the amount of the corporation's income eligible for the small business tax rate will be gradually reduced by $5 for every $1 of investment income above the $50,000 threshold. Under this measure, a corporation's limit of $500,000 in income that can be taxed at the small business tax rate (the "small business limit") is reduced to zero if the corporation and its associated corporations together earn $150,000 or more of passive investment income (which, for example, is equivalent to the annual return on $3 million in passive investment assets at a 5% rate of return).

This measure will result in potential taxation at the general corporate tax rate (15% federally in 2018) of active business income that is currently taxed at the small business tax rate (10% federally in 2018) for a corporation that, together with its associated corporations, earns more than $50,000 of passive investment income annually.

"Adjusted aggregate investment income"

For the purposes of the $50,000 threshold, a corporation's passive investment income will be measured by a new concept called "adjusted aggregate investment income". "Adjusted aggregate investment income" will be based on "aggregate investment income" (a concept currently used in computing the amount of refundable taxes in respect of a corporation's investment income and which includes net taxable capital gains) with certain adjustments, as follows:

- Taxable capital gains (and losses) will be excluded to the extent they arise from the disposition of certain active business assets, or shares in connected Canadian-controlled private corporations (CCPCs) where the fair market value of the connected CCPCs are attributable to certain active business assets used principally in an active business;
- Net capital loss carryovers will be excluded;
- Dividends from non-connected corporations will be added; and
- Income from savings in a non-exempt life insurance policy will be added to the extent the income is not otherwise included in aggregate investment income.

As is the case with aggregate investment income, adjusted aggregative investment income will not include income incidental to an active business.

Interaction with current small business reduction

Currently, the $500,000 small business limit is reduced on a straight-line basis for a CCPC and its associated corporations having between $10-15 million of total taxable capital employed in Canada. Budget 2018 proposes that the reduction in a corporation's small business limit will be the greater of the reduction under this Budget 2018 measure reducing access to the small business tax rate for corporations with significant passive investment income and the existing reduction based on taxable capital.

Application and anti-avoidance

Budget 2018's measure to reduce access to the small business tax rate for corporations with significant passive investment income will apply to taxation years that begin after 2018.

The federal government indicated in Budget 2018 that rules will apply to prevent transactions intended to avoid this measure, such as the creation of a short taxation year to defer its application, as well as the transfer of assets by a corporation to a non-associated related corporation.

2. Limiting refundable taxes in connection with the payment of eligible dividends

Budget 2018 proposes that a refund of a corporation's refundable dividend tax on hand (RDTOH) be available only in cases where a corporation pays non-eligible dividends. An exception will be provided in respect of RDTOH arising from eligible portfolio dividends received by a corporation. In this case, the corporation will still be able to obtain a refund of that RDTOH when it pays eligible dividends.

Addition of second RDTOH account

To implement this measure, Budget 2018 proposes to add a new RDTOH account, such that a corporation will now have two RDTOH accounts:

i. **Eligible RDTOH Account:** This account will track Part IV refundable taxes on eligible portfolio dividends. The payment of any taxable dividend (i.e., both eligible and non-eligible) can trigger a refund from this account;

ii. **Non-Eligible RDTOH Account:** This account will track Part I refundable taxes on investment income as well as Part IV refundable taxes on non-eligible portfolio dividends . Only the payment of non-eligible dividends can trigger a refund from this account.

An ordering rule will apply with respect to these two accounts, which will require a corporation to obtain a refund from its Non-Eligible RDTOH Account first before it can obtain a refund from its Eligible RDTOH Account when paying non-eligible dividends.

Existing RDTOH balances

In connection with this measure, Budget 2018 proposes that a corporation's existing RDTOH balance will be allocated as follows:

- For CCPCs, the lesser of the existing RDTOH balance and an amount equal to 38 and 1/3% of the balance of its general rate income pool, if any, will be allocated to its Eligible RDTOH Account, and any remaining balance allocated to its Non-Eligible RDTOH Account.
- For non-CCPCs, all of the existing RDTOH balance will be allocated to its Eligible RDTOH Account.

Application and anti-avoidance

Budget 2018's measure to limit refundable taxes refunded in connection with the payment of eligible dividends will apply to taxation years that begin after 2018.

The federal government indicated in Budget 2018 that rules will apply to prevent deferral of the application of this measure through the creation of a short taxation year.

Tax support for clean energy

Class 43.2 of the capital cost allowance regime provides an accelerated capital cost allowance rate (50% on a declining-balance basis) for certain investments in specified clean energy generation and conservation equipment. Class 43.2 is currently available in respect of property acquired before 2020.

Budget 2018 proposes to extend eligibility for Class 43.2 by five years so that it is available in respect of property acquired before 2025.

At-risk rules for tiered partnerships

Budget 2018 proposes to clarify that the at-risk rules apply to a partnership that is itself a limited partner of another partnership. This measure, along with a number of consequential changes, will ensure that the at-risk rules apply appropriately at each level of a tiered partnership structure. In particular, for a partnership that is a limited partner of another partnership, the losses from the other partnership that can be allocated to the partnership's members will be restricted by that partnership's at-risk amount in respect of the other partnership.

In addition, limited partnership losses of a limited partner that is itself a partnership will not be eligible for an indefinite carry-forward. Such losses will be reflected in the adjusted cost base of the partnership's interest in the limited partnership.

This measure will apply in respect of taxation years that end on or after Budget Day, including in respect of losses incurred in taxation years that end prior to Budget Day. In particular, losses from a partnership incurred in a taxation year that ended prior to Budget Day will not be available to be carried forward to a taxation year that ends on or after Budget Day if the losses were allocated – for the year in which the losses were incurred – to a limited partner that is another partnership.

Health and Welfare Trusts

The Canada Revenue Agency (CRA) will no longer apply their administrative positions with respect to Health and Welfare Trusts after the end of 2020. To facilitate the conversion of existing Health and Welfare Trusts to Employee Life and Health Trusts, transitional rules will be added to the *Income Tax Act*.

Miscellaneous business income tax measures

Budget 2018 also introduced a number of other business income tax measures which will primarily affect Canadian financial institutions, including:

- Proposals to clarify certain aspects of the synthetic equity arrangement rules and the securities lending arrangement rules to prevent taxpayers from realizing artificial tax losses through the use of equity-based financial arrangements to circumvent those rules; and
- Proposals to amend provisions pertaining to shares held as mark-to-market property so that the tax loss otherwise realized on a share repurchase is generally decreased by the dividend deemed to be received on that repurchase when that dividend is eligible for the inter-corporate dividend deduction.

OTHER PROPOSALS

Employment insurance – increased flexibility

The Government proposes to introduce a new EI Parental Sharing Benefit. The Benefit will provide additional weeks of "use it or lose it" EI parental benefits, when both parents agree to share parental leave. This incentive is expected to be available starting June 2019.

The proposed benefit will be available to eligible two-parent families, including adoptive and same-sex couples, to take at any point following the arrival of their child. This benefit would increase the duration of EI parental leave by up to five weeks in cases where the second parent agrees to take a minimum of five weeks of the maximum combined 40 weeks available using the standard parental option of 55% of earnings for 12 months.

Alternatively, where families have opted for extended parental leave at 33% of earnings for 18 months, the second parent would be able to take up to eight weeks of additional parental leave. In cases where the second parent opts not to take the additional weeks of benefits, standard leave durations of 35 weeks and 61 weeks will apply.

The EI Working While on Claim pilot project allows claimants to keep 50 cents of their EI benefits for every dollar they earn, up to a maximum of 90% of the weekly insurable earnings used to calculate their EI benefit amount. This pilot project is scheduled to expire in August 2018. The Government proposes to introduce amendments to make the current EI Working While on Claim pilot rules permanent.

While these provisions already apply to parental and caregiving benefits, they do not currently apply to maternity and sickness benefits. Extending the Working While on Claim pilot provisions to EI maternity and sickness benefits will enable greater flexibility.

GST and investment limited partnerships

On September 8, 2017, the Government released draft legislative and regulatory proposals relating to the application of the Goods and Services Tax/Harmonized Sales Tax (GST/HST) to investment limited partnerships.

Budget 2018 confirms the Government's intention to proceed with these proposals subject to certain changes.

Tobacco taxation

Excise duty rates on tobacco products are currently set to automatically increase every five years to account for inflation. Under this approach, tobacco excise duty rates would be adjusted on December 1, 2019. Budget 2018 proposes to advance the existing inflationary adjustments for tobacco excise duty rates to occur on an annual basis rather than every five years. To ensure consistency in the excise framework, inflationary adjustments will take effect on April 1 of every year, starting in 2019.

Budget 2018 also proposes to increase the excise duty rates by an additional $1 per carton of 200 cigarettes, along with corresponding increases to the excise duty rates on other tobacco products.

Cannabis taxation – excise duty framework and taxation coordination

Budget 2018 proposes a new federal excise duty framework for cannabis products to be introduced as part of the Excise Act, 2001. The duty will generally apply to all products available for legal purchase, which at the outset of legalization will include fresh and dried cannabis, cannabis oils, and seeds and seedlings for home cultivation. Cannabis cultivators and manufacturers will be required to obtain a cannabis licence from the CRA and remit the excise duty, where applicable. The framework will come into effect when cannabis for non-medical purposes becomes available for legal retail sale.

The excise duty framework will generally apply to cannabis products that contain Tetrahydrocannabinol (THC).

Consultations on the GST/HST holding corporation rules

A GST/HST rule, commonly referred to as the "holding corporation rule", generally allows a parent corporation to claim input tax credits to recover GST/HST paid in respect of expenses that relate to another corporation.

The Government intends to consult on certain aspects of the holding corporation rule.

Combating international tax avoidance

To strengthen Canada's international tax rules, the Government is proposing measures to:

- Ensure these rules cannot be avoided through the use of so-called "tracking arrangements" (which allow taxpayers to "track" to their specific benefit the return from assets that they contribute to a foreign resident corporation);
- Prevent unintended, tax-free distributions by Canadian corporations to non-resident shareholders through the use of certain transactions involving partnerships and trusts.

Reassessment period – requirements for information and compliance orders

Budget 2018 proposes to amend the *Income Tax Act* to introduce a "stop-the-clock" rule for requirements for information generally and for compliance orders. This rule will extend the reassessment period of a taxpayer by the period of time during which the requirement or compliance order is contested. This measure will apply in respect of challenges instituted after Royal Assent to the enacting legislation.

WE CAN HELP

Your Assante advisor can help you assess the impact of these proposals on your personal finances or business affairs, and show you ways to take advantage of their benefits or ease their impact. The resources available to you and your advisor include Assante Private Client's Wealth Planning Group, a multi-disciplinary team of accountants, lawyers and financial planners.

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