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Budget Canada 2018

February 27, 2018

Individuals

1. Canada Workers Benefit (Working Income Tax Benefit)

The Working Income Tax Benefit is a refundable tax credit that supplements the earnings of low-income workers. The 2017 Fall Economic Statement announced the Government's intention to enhance the credit starting in 2019. Budget 2018 specifies the enhancement and proposes to rename the program The Canada Workers Benefit. For 2019, the maximum benefit will be increased to $1,355 ($1,192 in 2018) for single individuals without dependants and to $2,335 ($2,165 in 2018) for families (couples and single parents). The benefit will be reduced by 12 per cent (14% in 2018) of adjusted net income in excess of $12,820 for single individuals without dependants and $17,025 for families. Finally, measures are announced to improve the accessibility of the benefit.

2. 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. Establishing a legal guardian or other representative can be a lengthy and expensive process that can have significant repercussions for individuals. 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. 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.

3. 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.

Since contributions to the enhanced portion of the QPP will begin to be phased in starting in 2019, this measure will apply to the 2019 and subsequent taxation years.

4. Mineral Exploration Tax Credit for Flow-Through Share Investors

Budget 2018 proposes, once again, to extend eligibility for the mineral exploration tax credit for one year, to flow-through share agreements entered into on or before March 31, 2019.

5. Reporting Requirements for Trusts

Authorities require sufficient information in order to determine taxpayers' tax liabilities and to effectively counter aggressive tax avoidance as well as tax evasion, money laundering and other criminal activities. Some taxpayers have used trusts in complex arrangements to prevent the appropriate authorities from acquiring this required information. A trust that does not earn income or make distributions in a year is generally not required to file an annual (T3) income tax return. A trust is required to file a T3 return if the trust has tax payable or it distributes all or part of its income or capital to its beneficiaries. Even if a trust is required to file a return of income for a year, there is no requirement for the trust to report the identity of all its beneficiaries. Given the absence of an annual reporting requirement, and the limitations with respect to the information collected when reporting is required, there are significant gaps with respect to the information that is currently collected with respect to trusts.

To improve the collection of beneficial ownership information with respect to trusts, Budget 2018 proposes to require that certain trusts provide additional information on an annual basis.

Businesses

6. Holding Passive Investments inside a Private Corporation

Corporate income is taxed at lower rates than personal income to provide businesses with more money to invest.

Currently, corporate owners can gain tax advantages by holding corporate income inside their corporation for personal savings purposes. Action is needed to ensure that the tax system encourages corporate owners to use low corporate tax rates to support their business, not for personal tax advantages.

Where funds invested passively within a private corporation have been financed with retained earnings that have been taxed at preferential corporate income tax rates, owners of the corporation can benefit from a tax deferral advantage relative to a situation where the corporation distributes the retained earnings and the owners invest personally in passive investments. This issue was the subject of public consultations that were launched in July 2017.

Budget 2018 proposes two measures, applicable to taxation years that begin after 2018, to limit tax deferral advantages on passive investment income earned inside private corporations.

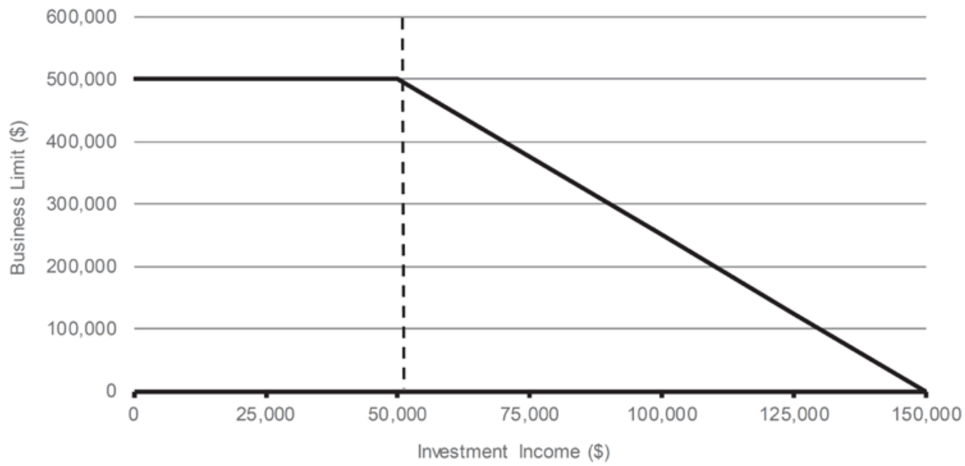
a) Limiting Access to the Small Business Deduction (SBD)

The first measure proposes to limit the ability of businesses with passive savings to benefit from the preferential small business rate (the federal small business deduction rate (SBD) is 10% for 2018 and will be reduced to 9% in 2019). The current small business deduction limit allows for up to $500,000 of active business income to be subject to the lower small business tax rate. Access to the lower tax rate is phased out on a straight-line basis for associated Canadian-controlled private corporations (CCPCs) having between $10 million and $15 million of aggregate taxable capital employed in Canada.

Rather than remove access to the refundable taxes as proposed in July 2017, an alternative proposed approach is instead to gradually reduce access to the small business tax rate for corporations that have passive investment income.

Under the proposal, if a corporation and its associated corporations earn more than $50,000 of passive investment income in a given year, the amount of income eligible for the small business tax rate would be gradually reduced on a straight line basis.

Reduction in the Small Business Deduction Limit Based on Passive Investment Income



It is proposed that the small business deduction limit be reduced by $5 for every $1 of investment income above the $50,000 threshold (equivalent to $1 million in passive investment assets at a 5-per-cent return), such that the business limit would be reduced to zero at $150,000 of investment income (equivalent to $3 million in passive investment assets at a 5-per-cent return).

Active business income qualifying for the small business tax rate under new business limit ($)

Business Income	Investment Income				
	50,000	75,000	100,000	125,000	150,000
50,000					0
75,000	NOT AFFECTED				0
100,000					0
200,000				125,000	0
300,000			250,000	125,000	0
400,000		375,000	250,000	125,000	0
500,000		375,000	250,000	125,000	0

Note: Assumes that the corporation has less than $10 million of taxable capital.

The proposal represents a different approach to the one announced in July. The design does not directly affect taxes on passive investment income. Under this proposal, the tax applicable to investment income remains unchanged—refundable taxes and dividend tax rates will remain the same, unlike the July 2017 proposal. No existing savings will face any additional tax upon withdrawal.

The new approach will not require the tracking of new and legacy pools of passive investments, and will target private corporations with approximately $1 million in passive investment assets (assuming an average 5-per-cent return) or 2.5 million (assuming an average 2-per-cent return).

Active business income qualifying for the small business tax rate under new business limit for illustrative passive assets ($)

Business Income	Passive Assets				
	1,000,000(*)/ 2,500,000(**)	1,500,000(*)/ 3,750,000(**)	2,000,000(*)/ 5,000,000(**)	2,500,000(*)/ 6,250,000(**)	3,000,000(*)/ 7,500,000(**)
50,000					0
75,000	NOT AFFECTED				0
100,000					0
200,000				125,000	0
300,000			250,000	125,000	0
400,000		375,000	250,000	125,000	0
500,000		375,000	250,000	125,000	0

Note: Assumes that the corporation has less than $10 million of taxable capital.
(*) Assuming a five-per-cent rate of return.
(**) Assuming a two-per-cent rate of return.

The business limit reduction under this measure will operate alongside the business limit reduction that applies in respect of taxable capital in excess of $10 million. The reduction in a corporation's business limit will be the greater of the reduction under this measure and the existing reduction based on taxable capital.

Business Limit – Adjusted Aggregate Investment Income

For the purpose of determining the reduction of the business limit of a Canadian Controlled Private Corporation (CCPC), investment income will be measured by a new concept of "*adjusted aggregate investment income*" which will be based on "*aggregate investment income*" with certain adjustments.

The adjustments will include the following:

- taxable capital gains (and losses) will be excluded to the extent they arise from the disposition of
  - a property that is used principally in an active business carried on primarily in Canada by the CCPC or by a related CCPC; or
  - a share of another CCPC that is connected with the CCPC, where, in general terms, all or substantially all of the fair market value of the assets of the other CCPC is attributable directly or indirectly to assets that are used principally in an active business carried on primarily in Canada, and certain other conditions are met;
- net capital losses carried over from other taxation years will be excluded;
- dividends from non-connected corporations will be added; and
- income from savings in a life insurance policy that is not an exempt policy will be added, to the extent it is not otherwise included in aggregate investment income.

Application

This measure will apply to taxation years that begin after 2018.

Rules will apply to prevent transactions designed to avoid the measure, such as the creation of a short taxation year in order to defer its application and the transfer of assets by a corporation to a related corporation that is not associated with it.

b) Limiting Access to the Refundable Tax on Hand (RDTOH)

The second measure will limit tax advantages that Canadian Controlled Private Corporations (CCPC) can obtain by accessing refundable taxes on the distribution of certain dividends.

The tax system is designed to tax investment income earned by private corporations at a higher rate, roughly equivalent to the top personal income tax rate, and to refund a portion of that tax when investment income is paid out as a dividend to shareholders.

For income tax purposes, dividends paid by corporations are either "*eligible*" or "*non-eligible*".

Generally, investment income earned by private corporations must be paid as *non-eligible dividends*. A corporation, however, may obtain a refund of taxes paid on investment income, reflected in the corporation's *Refundable Dividend Tax on Hand* (RDTOH) account, regardless of whether the dividends paid are eligible or non-eligible.

As a result, the current system allows a corporation to receive an RDTOH refund upon the payment of an eligible dividend in situations where the corporation's RDTOH was generated from investment income that would need to be paid as a non-eligible dividend.

To better align the refund of taxes paid on passive income with the payment of dividends sourced from passive income, Budget 2018 proposes that a refund of RDTOH be available only in cases where a private corporation pays non-eligible dividends. *An exception will be provided in respect of RDTOH that arises from eligible portfolio dividends received by a corporation, in which case the corporation will still be able to obtain a refund of that RDTOH upon the payment of eligible dividends.*

The different treatment proposed regarding the refund of taxes imposed on eligible portfolio dividend income will necessitate the addition of **a new** RDTOH account (referred to as "*eligible RDTOH" account*). The current RDTOH account will now be referred to as "non-eligible RDTOH").

RDTOH Refunds – Ordering Rule

Upon the payment of a non-eligible dividend, a private corporation will be required to obtain a refund from its non-eligible RDTOH account before it obtains a refund from its eligible RDTOH account.

Application

This measure will apply to taxation years that begin after 2018.

An anti-avoidance rule will apply to prevent the deferral of the application of this measure through the creation of a short taxation year.

Transitional measures will allocate a corporation's existing RDTOH balance between the two RDTOH accounts (eligible RDTOH and non-eligible RDTOH).

7. Closing Tax Loopholes

The Government proposes to add to existing anti-avoidance rules meant to prevent some strategies from gaining a tax advantage by creating artificial losses that can be used against other income through the use of sophisticated financial instruments and structured share repurchase transactions.

The Government also proposes to clarify the application of certain rules for limited partnerships in order to prevent taxpayers from obtaining unintended tax advantages through the use of complex partnership structures.

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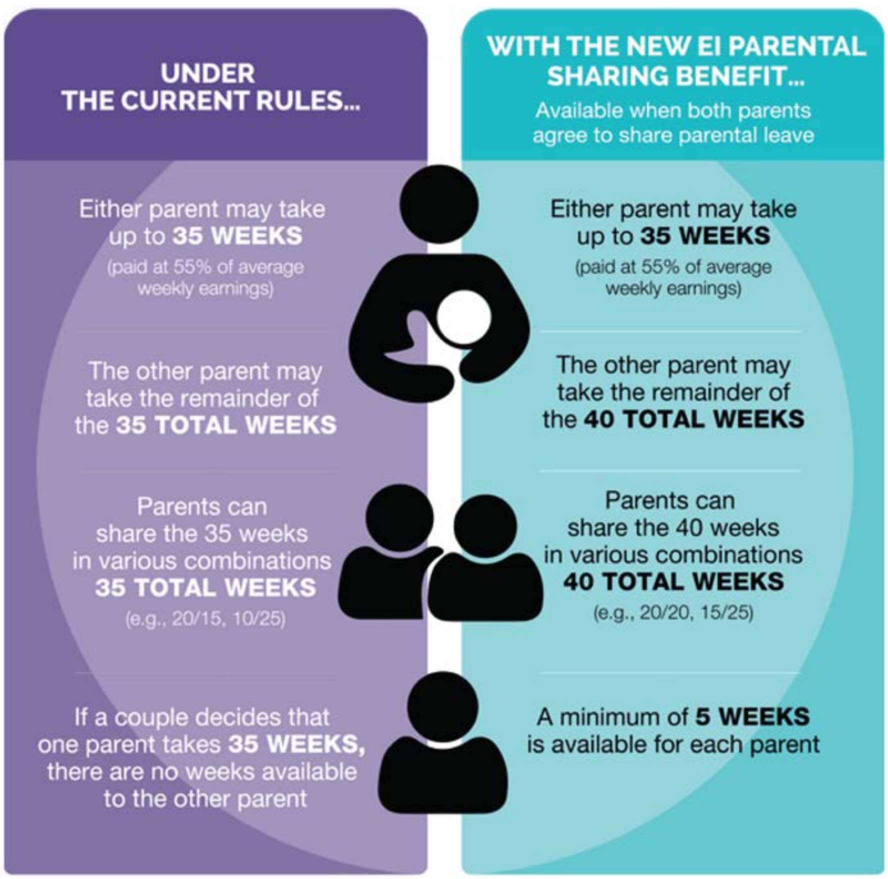
Other Measures

8. Employment insurance

Budget 2018 proposes some changes applicable to employment insurance (EI), amongst others:

a) New Parental Sharing Benefit

Budget is proposing a new EI Parental Sharing Benefit to support greater gender equality in the home and the workplace by providing an additional five weeks of benefits when both parents agree to share parental leave.



b) Improving Working While on Claim

The Government proposes to introduce amendments to the Employment Insurance Act to make the current EI Working While on Claim pilot rules permanent.

The Government will extend Working While on Claim provisions to maternity and sickness benefits so that mothers and those dealing with an illness or injury have greater flexibility to stage their return to work and keep more of their EI benefits

c) Helping Workers in Seasonal Industries

The Government will also work with key provinces to help workers in seasonal industries most affected by fluctuations in eligibility for EI from year to year and who are unable to find alternative employment in between seasons. This will take the form of both short-term support starting in 2017–18, as well as pilot projects that will be developed and implemented in partnership with provinces over the next two years.

9. Advisory Council on the Implementation of National Pharmacare

As part of Budget 2018, the Government is announcing the creation of an Advisory Council on the Implementation of National Pharmacare. Dr. Eric Hoskins, who recently served as the Minister of Health of Ontario, has been appointed to chair this initiative. He and board members will begin a national dialogue that will include working closely with experts from all relevant fields as well as with national, provincial, territorial and Indigenous leaders. The Advisory Council will report to the federal Minister of Health and the Minister of Finance and will conduct an economic and social assessment of domestic and international models, and will recommend options on how to move forward together on this important subject.

Measure that were not modified

Please note that notwithstanding certain rumors, the capital gains rate inclusion remains unchanged at 50%.