RBC Wealth Management Services

2018 Federal Budget

Key tax measures
that may have a direct impact on you

2018 Federal Budget – February 27, 2018

A summary of the key tax measures that may have a direct impact on you

Federal Minister of Finance, Bill Morneau, delivered the Liberal Government's budget on February 27, 2018. Many of the budget's tax measures are aimed at tightening perceived loopholes or inequalities in various aspects of the tax system. Several measures have been proposed relating to Canada's international taxation rules, which aim to broaden and protect Canada's tax base and reinforce the Government's commitments to address global tax evasion.

Prior to implementing any strategies, individuals should consult with a qualified tax advisor, legal professional or other applicable professional.

While it has been the long-standing practice of the Canada Revenue Agency (CRA) to allow taxpayers to file their tax returns based on proposed legislation, a taxpayer remains potentially liable for taxes under current law in the event that a budget proposal is not ultimately passed. Therefore, if proposed legislation does not become law, it is possible that the CRA may assess or re-assess your tax return based on existing legislation. It is recommended that you consult a qualified tax advisor to assist you in assessing the costs and benefits of proceeding with specific budget proposals as they relate to you.

PERSONAL TAX CHANGES

Reporting Requirements for Trusts

Currently, there is no requirement for a trust to report the identity of all its beneficiaries to government authorities. To improve the collection of beneficial ownership information with respect to trusts and to help the CRA assess the tax liability for trusts and its beneficiaries, the budget proposes new annual reporting requirements for certain trusts.

The new reporting requirements 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.

The new reporting requirements will require certain trusts to file an annual T3 return where currently there is no requirement to do so. For example, currently, a trust that does not earn income or does not make a distribution in a year will generally not have to file a T3 return.

Trusts subject to the new reporting requirements will also be required to report the identity of:

- all trustees;
- beneficiaries of the trust;
- settlors of the trust; and
- each person who has the ability (through the trust terms or a related agreement) to exert control over trustee decisions regarding the appointment of income or capital of the trust.

Exceptions to the additional reporting requirements are proposed for a number of types of trusts, including:

- mutual fund trusts and segregated funds;
- trusts governed by registered plans (e.g., DPSPs, PRPPs, RDSPs, RESPs, RPPs, RRIFs, RRSPs, and TFSAs);
- graduated rate estates and qualified disability trusts;
- trusts that qualify as non-profit organizations or registered charities;
- trusts that have been in existence for less than three months; and

- trusts that hold less than $50,000 in assets throughout the taxation year (provided, their holdings are confined to deposits, government debt obligations and listed securities).

The budget proposes new penalties for the failure to file a T3 return, including a required beneficial ownership schedule, where the schedule is required. The penalty will be equal to $25 for each day late, with a minimum penalty of $100 and a maximum penalty of $2,500. An additional penalty may apply if failure to file the return was made knowingly, or due to gross negligence. The additional penalty will be equal to 5% of the maximum fair market value of property held during the relevant year by the trust, with a minimum penalty of $2,500.

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

New Employment Insurance Parental Sharing Benefit

EI maternity and parental benefits are available to help parents care for their children. EI parental benefits are available to both parents, allowing either parent to take time off work. Generally, it is the mother who takes on the primary caregiving responsibilities.

To support greater gender equality in the home and in the workplace, the budget proposes to introduce a new EI Parental Sharing Benefit, expected to be available in June 2019. The proposed benefit will be available to eligible two-parent families, including adoptive and same-sex couples. The new benefit is modelled after the program currently available in Quebec.

Under the current standard programs, in addition to a maximum of 15 weeks of EI maternity leave benefits, parents can choose to receive:

- up to 35 weeks of EI parental leave at a benefit rate of 55% of average weekly earnings paid over a period of 12 months, or
- up to 61 weeks of EI parental leave at a benefit rate of 33% of average weekly earnings paid over a period of 18 months.

If one parent decides to take all the weeks available under the current EI parental benefits program there are no weeks available to the other parent.

When both parents agree to share parental leave, the proposed new EI parental benefits will provide additional weeks of leave on a "use it or lose it" basis. For example, in addition to maternity leave, where the second parent agrees to take a minimum of five weeks of EI parental leave, and they have opted to take the standard payment over 12 months, the proposed new benefit would increase EI parental leave by up to five weeks. This increases the total leave to 40 weeks. Alternatively, where parents have opted for payment over 18 months, the second parent would be able to take up to eight weeks of additional parental leave for a total of 69 weeks.

In cases where the second parent opts not to take any weeks of the EI parental benefits, the standard leave durations of 35 weeks and 61 weeks will apply.

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 ("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 can be a lengthy and expensive process. There is currently a temporary federal measure that allows a qualifying family member (i.e., a parent, spouse or common-law partner) to be the plan holder of the individual's RDSP where the individual's capacity to enter into a contract is in doubt and they do not have a legal representative. The measure is set to expire at the end of 2018. The budget proposes to extend this temporary measure 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.

Canada Workers Benefit

The Working Income Tax Benefit is a refundable tax credit that supplements the earnings of low-income workers and provides work incentives for low-income earners. The budget proposes to rename the program to the Canada Workers Benefit (CWB). In addition, to provide increased support and further improve work incentives, the budget proposes to increase the amount of the benefit 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), starting in 2019. 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. Individuals who are eligible for the Disability Tax Credit (DTC) may also receive a CWB disability supplement.

In circumstances where an individual does not claim the benefit, the budget proposes to allow the CRA to determine if the individual is eligible for the CWB and assess their return as if the benefit had been claimed.

This measure will apply to the 2019 and subsequent taxation years and indexation of CWB amounts will apply after the 2019 taxation year.

Medical Expense Tax Credit – Eligible Expenses

The Medical Expense Tax Credit (METC) is a 15% non-refundable tax credit. The budget proposes to expand the METC to recognize costs incurred with respect to animals that are specifically trained to help individuals cope with severe mental impairment, for example, a psychiatric dog trained to assist with post-traumatic stress disorder. Expenses will not be eligible if they are in respect of an animal that only provides comfort or emotional support and has not been specially trained to perform tasks such as guiding a disoriented patient, searching a home of a patient with severe anxiety before they enter and applying compression to a patient experiencing night terrors.

This measure will apply in respect of eligible expenses incurred after 2017.

Enhancing the Wage Earner Protection Program

To better support workers, the budget proposes to increase the maximum payment under the Wage Earner Protection Program from four to seven weeks of Employment Insurance (EI) insurable earnings. The Government also proposes changes to make eligibility for the program more equitable for workers who are owed wages, vacation, severance or termination pay when their employer files for bankruptcy or enters receivership.

Child Benefits

The budget proposes to amend the Act to provide legislative authority for the Government to share taxpayer information related to the Canada Child Benefit with the provinces and territories, as of July 1, 2018, solely for the purpose of administering their social assistance payment regimes.

The budget proposes that foreign-born status Indians residing legally in Canada who are neither Canadian citizens nor permanent residents are made retroactively eligible for the former Canada Child Tax Benefit, the National Child Benefit supplement and the Universal Child Care Benefit, where all other eligibility requirements are met. This amendment applies from the 2005 taxation year to June 30, 2016.

Charitable Donations to Universities Outside Canada

An individual may claim the charitable donation tax credit or deduction for donations made to registered charities and other “qualified donees”, including universities outside Canada. As part of the current charity registration process, qualifying universities outside Canada are required to be listed in the Income Tax Regulations (“Regulations”) as well as on the Government of Canada’s website. To streamline the registration process, the budget proposes to remove the requirement that universities outside Canada be prescribed in the Regulations as of February 27, 2018.

Deductibility of Employee Contributions to the Enhanced Portion of the Quebec Pension Plan

To provide consistent income tax treatment of CPP and QPP contributions, the budget proposes 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. Legislation had previously been amended to provide for the deductibility of the enhanced CPP contributions commencing in 2019. The enhanced portion of employee CPP and QPP contributions will be deductible for Quebec income tax purposes for the 2019 and subsequent taxation years.

Mineral Exploration Credit

The budget proposes 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.

BUSINESS TAX CHANGES

Passive Investment Income

In July 2017, the Government announced that it was considering approaches that will improve the fairness and neutrality of the tax system, such that savings held within corporations are taxed in a manner that is equivalent to savings held directly by individuals. The Government sought feedback from the public regarding this issue.

Taking into account the feedback received from the July 2017 consultation, the Government proposes two measures to limit the tax deferral advantage associated with earning passive investment income inside private corporations:

- **Small Business Limit:** The tax rate for qualifying active business income of small CCPCs is 10% for 2018 and 9% as of 2019. This preferential tax rate applies on up to $500,000 of qualifying active business income. This $500,000 limit, known as the business limit, is reduced on a straight-line basis for a CCPC and its associated corporations having between $10 million and $15 million of total taxable capital employed in Canada. Any active business income earned above the business limit is taxed at the general corporate tax rate of 15%.

  The budget proposes to introduce a measure that will reduce the business limit for CCPCs that have significant income from passive investments. Under this measure, the business limit will be reduced on a straight-line basis for CCPCs having between $50,000 and $150,000 of investment income.

  The new business limit reduction will be calculated as the greater of the reduction based on taxable capital and the reduction based on passive investment income.

- **Refundability of Taxes on Investment Income:** The current tax regime relating to refundable taxes on investment income of private corporations seeks to tax income from passive investments at a rate that is approximately equal to the top personal income tax rate while that income is retained in the corporation. Some or all of these taxes are added to the corporation's refundable dividend tax on hand (RDTOH) account and refundable at a rate of $38.33 for every $100 of taxable dividends paid to its shareholders. This refund is available regardless of whether eligible or non-eligible dividends are paid to the shareholder.

  The budget proposes two RDTOH accounts: "eligible RDTOH" and "non-eligible RDTOH". The "eligible RDTOH" account will be created to track the RDTOH that arises from eligible dividends received by a corporation, so that the corporation will still be able to obtain a refund of the RDTOH upon payment of eligible dividends. The non-eligible RDTOH account will track any other refundable taxes paid by the corporation. In most cases, this amount will be refunded where a corporation pays non-eligible dividends.

These measures are applicable to taxation years beginning after 2018.

Health and Welfare Trusts

A Health and Welfare Trust is a trust set up by an employer for the purpose of providing health and welfare benefits to its employees. The tax treatment of such a trust is not set out explicitly in the Act. Instead, the CRA has published administrative positions regarding the requirements for qualifying as a Health and Welfare Trust along with rules relating to contributions to, and the computation of taxable income of, such a trust. The Act does, however, contain rules relating to Employee Life and Health Trusts. These trusts also provide health benefits for employees. These set of rules are very similar to the CRA's administrative positions for Health and Welfare Trusts; however, there are certain differences. For example, a Health and Welfare Trust does not limit the number of key employees who can be beneficiaries of this trust, whereas an Employee Life and Health Trust does. In order to provide more certainty for taxpayers, the budget proposes that only one set of rules apply to these arrangements. The CRA will no longer apply their administrative positions with respect to Health and Welfare Trusts after the end of 2020. Existing Health and Welfare Trusts will be required to either convert to an Employee Life and Health Trust by December 31, 2020 or wind up. Trusts that do not convert (or wind up) to an Employee Life and Health Trust will be subject to the normal income tax rules for trusts.

The CRA will also not apply their administrative positions to new Health and Welfare Trusts established after February 27, 2018. New trusts will be required to satisfy the Employee Life and Health Trust rules. To facilitate the conversion of existing Health and Welfare Trusts to Employee Life and Health Trusts, transitional rules will be added to the Act following a consultation period.

INTERNATIONAL TAX CHANGES

Cross-Border Surplus Stripping Using Partnerships and Trusts

The existing cross-border surplus stripping rules seek to prevent a non-resident shareholder from entering into transactions that provide the ability to extract free of tax, the surplus from a Canadian corporation in excess of the paid-up capital (PUC) of its shares or to artificially increase the PUC. However, some non-resident taxpayers have entered into transactions (internal reorganizations) involving trusts and partnerships, which are not expressly addressed by the current rules, which may result in the ability to extract tax-free surplus from a Canadian corporation.

The budget proposes to amend the existing provisions to introduce measures that will prevent such planning by adding comprehensive "look-through" rules for partnerships and trusts.

These measures will apply to transactions that occur on or after February 27, 2018. Transactions that occurred before February 27, 2018 may be challenged by the CRA using the general anti-avoidance rule.

Reporting and Reassessments Relating to Foreign Affiliates

A foreign affiliate ("FA") of a taxpayer resident in Canada is a non-resident corporation in which the taxpayer has a significant interest.

Generally, taxpayers are required to file an information return each year in respect of each of their FAs in the year. These information returns are not due until 15 months after the end of the taxpayer's taxation year. The budget proposes to require the information returns to be filed within six months after the end of the taxpayer's taxation year. This measure will apply to taxation years that begin after 2019.

Due to the complexity of audits that involve FAs, the budget also proposes to extend the reassessment period for a taxpayer by three years in respect of income arising in connection with a FA of the taxpayer. This measure will apply to taxation years that begin on or after February 27, 2018.

Sharing of Information for Criminal Matters

Canada has entered into 93 tax treaties and 23 Tax Information Exchange Agreements, and is one of 117 parties to the Convention on Mutual Administrative Assistance in Tax Matters. In addition, Canada has entered into numerous mutual legal assistance agreements. These international instruments facilitate the administration and enforcement of the tax and other laws of both Canada and its international partners. The government will be proposing various legislative amendments to allow for the sharing of information internationally for the investigation, prosecution and suppression of serious criminal offences, both tax-related and non-tax-related. The government's intention is that any such amendments will come into force upon the granting of Royal Assent to the enacting legislation.

PREVIOUSLY ANNOUNCED MEASURES

The budget confirms the Government's intention to proceed with a number of previously announced tax and related measures, as modified to take into account consultations and deliberations since their release, including:

- Measures released on December 13, 2017 that address income splitting using a private corporation;
- The lowering of the small business tax rate from 10.5% to 10%, effective January 1, 2018 and to 9% effective January 1, 2019; and
- The measure announced in Budget 2016 on information reporting requirements for certain dispositions of an interest in a life insurance policy.

Please contact us for more information about the topics discussed in this article.

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