2019 Federal Budget

Finance Minister Bill Morneau delivered the Liberal Government's fourth budget on March 19, 2019 (Budget Day) titled Investing in the Middle Class. The Budget anticipates a deficit of $14.9 billion for 2018-2019 and projects a deficit of $19.8 billion in 2019-2020. There is currently no plan to balance the budget.

The major spending announcements in the budget include amounts for indigenous services for water quality, child welfare, education and other support programs. Also included is a program in which the Canada Mortgage and Housing Corporation will co-own up to 10% of a residence acquired by a first time home buyer. Tax credits of up to $5,000 are also available for the purchase of a zero emission vehicle.

Other measures include increased funding for the Canada Revenue Agency to identify tax avoidance and evasion transactions and making Canadian corporate ownership more transparent.

Budget 2019 also discusses reviewing the tax implications of transferring Canadian businesses to other family members. Currently, it is often more beneficial for a family owned business to sell to an unrelated purchaser than to a family member. Hopefully this inequality is addressed.

The tax changes announced in Budget 2019 include an increase in the amount of money that can be withdrawn from an RRSP under the Home Buyers' Plan, limiting the stock option deduction for certain employers, fast write-offs for zero emission vehicles and increasing access to the Scientific Research and Experimental Development tax credits.

Details of the key tax highlights of the budget are as follows.

Personal Income Tax Measures

Canada Training Credit

Budget 2019 proposes to introduce the Canada Training Credit, a refundable tax credit, which is paid dollar for dollar, to provide financial support to cover up to half of the eligible tuition and fees for eligible individuals over 25 years old. Eligible individual will be able to accumulate $250 each year in a notional account, if an individual meets the following criteria:

- Files a tax return for the year
- Is at least 25 years old and less than 65 years old
- Is a resident of Canada
- Has earned income of at least $10,000 and does not exceed the top of the 3rd tax bracket for the year

The amount that can be claimed will be equal to the lesser of half of the eligible tuition and fees paid in the year and the individuals notional account balance. Individuals will be able to accumulate a maximum of $5,000 over their entire lifetime, and will expire at the end of the year when an individual turns 65.

To be eligible to use the Canada Training Credit, the educational institution must be located in Canada, and be either a university, college, or an institution providing occupational-skills courses that is certified by the Ministry.

This measure will apply to 2019 and subsequent taxation years. The notional account will start to accumulate for the 2019 taxation year and the credit will be claimable in the 2020 taxation year.

Home Buyers' Plan

Budget 2019 proposes to increase the Home Buyer's Plan withdrawal limit from $25,000 to $35,000. This would allow couples to potentially withdraw $70,000 from their RRSP's to purchase their first home. This increase will apply to the 2019 and subsequent years.

Budget 2019 also extends access to the Home Buyers' Plan after the breakdown of a marriage.

Change in use Rules for Multi-Unit Residential Properties

A change in use of a property from income producing use to personal use (or vice versa) results in a deemed disposition of the property at its fair market value. Currently, when there is a change in use of a property either to an income-producing use, or from an income-producing use to a principal residence, the taxpayer may elect for this deemed disposition does not apply.

Similarly, there is a deemed disposition when *part* of a multi-unit property is converted between these uses (for example, one unit of a duplex is converted to personal use). However, there is no election available to eliminate the deemed disposition. Budget 2019 proposes to allow taxpayers to elect out of the deemed disposition on a partial change in use to improve the consistency of the tax treatment. This measure will apply to changes of use that occur on or after Budget Day.

Registered Disability Savings Plan – Cessation of Eligibility for the Disability Tax Credit (DTC)

Currently, when a beneficiary of an RDSP ceases to be eligible for the DTC, no contributions may be made to, and no Canada Disability Savings Grants and Canada Disability Savings Bonds may be paid into, the RDSP. The income tax rules generally require that the RDSP be closed by the end of the year following the first full year throughout which the beneficiary is not eligible for the DTC.

Budget 2019 proposes to remove the time limitation on the period that an RDSP may remain open after a beneficiary becomes ineligible for the DTC and to eliminate the requirement for medical certification that the beneficiary is likely to become eligible for the DTC in the future in order for the plan to remain open. The RDSP will be subject to specific rules throughout which the beneficiary is no longer eligible for the DTC.

This measure will apply after 2020. An RDSP issuer will not, however, be required to close an RDSP on or after Budget Day and before 2021 solely because the RDSP beneficiary is no longer eligible for the DTC.

Permitting Additional Types of Annuities under Registered Plans

Budget 2019 proposes to permit two new types of annuities under the tax rules for certain registered plans:

- advanced life deferred annuities will be permitted under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) and defined contribution registered pension plan (RPP); and
- variable payment life annuities will be permitted under a PRPP and defined contribution RPP.

The measures will apply to the 2020 and subsequent taxation years.

Tax Measures for Kinship Care Providers

Canada Workers Benefit

The Canada Workers Benefit is a refundable tax credit that supplements the earnings of low-income workers and improves work incentives for low-income Canadians. A higher benefit amount is provided to eligible families (couples and single parents) than to single individuals without dependants. There is a concern that the receipt of assistance under various provincial kinship assistance provisions may preclude the ability to claim the Canada Workers Benefit.

Budget 2019 proposes to amend the *Income Tax Act* to clarify that an individual may be considered to be the parent of a child in their care for the purpose of the Canada Workers Benefit, regardless of whether they receive financial assistance from a government under a kinship care program. Kinship care providers will thus be eligible for the Canada Workers Benefit amount available for families, provided all other eligibility requirements are met.

This measure will apply for the 2009 and subsequent taxation years.

Tax Treatment of Financial Assistance Payments

Currently, social assistance payments made on the basis of a means, needs or income test are not taxable but must be included in income for the purposes of determining entitlement to income-tested benefits and credits.

Budget 2019 also proposes to amend the *Income Tax Act* to clarify that financial assistance payments received by care providers under a kinship care program are neither taxable, nor included in income for the purposes of determining entitlement to income-tested benefits and credits.

This measure will apply for the 2009 and subsequent taxation years.

Donations of Cultural Property

The Government of Canada provides certain enhanced tax incentives to encourage donations of cultural property to certain designated institutions and public authorities in Canada, in order to ensure that such property remains in Canada for the benefit of Canadians. To qualify for the incentives, a donated property must be of "outstanding significance" or "national importance".

Budget 2019 proposes to amend the *Income Tax Act* and the *Cultural Property Export and Import Act* to remove the requirement that property be of "national importance" in order to qualify for the enhanced tax incentives for donations of cultural property. No changes are proposed that would affect the export of cultural property.

This measure will apply in respect of donations made on or after Budget Day.

Medical Expense Tax Credit

The medical expense tax credit is a 15-per-cent non-refundable tax credit that recognizes the effect of above-average medical or disability-related expenses on an individual's ability to pay tax. For 2019, the medical expense tax credit is available for qualifying medical expenses in excess of the lesser of $2,352 and three per cent of the individual's net income.

Budget 2019 proposes to amend the *Income Tax Act* to reflect the current regulations for accessing cannabis for medical purposes.

This measure will apply to expenses incurred on or after October 17, 2018.

Contributions to a Specified Multi-Employer Plan for Older Members

Currently, unlike other defined benefit RPPs, employers are not prevented by the pension tax rules from making contributions to a specified multi-employer plan (SMEP) in respect of workers over age 71 or those receiving a pension from the plan, if such contributions are required by the plan. Budget 2019 proposes to amend the tax rules to prohibit contributions to a SMEP in respect of a member after the end of the year the member attains 71 years of age and to a defined benefit provision of a SMEP if the member is receiving a pension from the plan (except under a qualifying phased retirement program). The proposed changes will ensure that employers do not make pension contributions on behalf of older SMEP members in these situations from which they cannot benefit.

To provide SMEP sponsors and employers with a flexible transition period, this measure will apply in respect of SMEP contributions made pursuant to collective bargaining agreements entered into after 2019, in relation to contributions made after the date the agreement is entered into.

Pensionable Service Under an Individual Pension Plan

An individual pension plan (IPP) is a defined benefit registered pension plan that provide businesses with a mechanism to provide lifetime retirement benefits to owner-managers in respect of their employment.

When an individual terminates membership in a defined benefit registered pension plan, the income tax rules allow for a tax-deferred transfer of all or a portion of the commuted value of the member's accrued benefits in one of two ways:

- a transfer of the full commuted value to another defined benefit plan sponsored by another employer; or
- subject to a prescribed transfer limit (normally about 50 per cent of the member's commuted value), a transfer of a portion of the commuted value to the member's registered retirement savings plan or similar registered plan.

Planning is being undertaken that seeks to circumvent these prescribed transfer limits, by establishing an IPP sponsored by a newly incorporated private corporation controlled by an individual who has terminated employment with their former employer. This planning seeks to obtain a 100-per-cent transfer of assets to the new IPP instead of the restricted transfer of assets to the individual's registered retirement savings plan.

To prevent this planning, Budget 2019 proposes to prohibit IPPs from providing retirement benefits in respect of past years of employment that were pensionable service under a defined benefit plan of an employer other than the IPP's participating employer (or its predecessor employer). Any assets transferred from a former employer's defined benefit plan to an IPP that relate to benefits provided in respect of prohibited service will be considered to be a non-qualifying transfer that is required to be included in the income of the member for income tax purposes.

This measure applies to pensionable service credited under an IPP on or after Budget Day.

Mutual Funds: Allocation to Redeemers Methodology

Mutual fund trusts are commonly used vehicles for the pooling and investment of funds. In particular, if a mutual fund trust's capital gains or ordinary income for the year are allocated to its unitholders, the mutual fund trust will be entitled to a deduction for such allocated amounts in computing its income. When a mutual fund trust disposes of investments to fund a redemption of its units, any accrued gain on the investments is realized by the trust and is subject to tax, and may be taxed again in the hands of the unitholder who disposes of units at a redemption price that reflects this accrued gain. Mutual fund trusts have access to a capital gains refund mechanism which provides a refund to the mutual fund trust in respect of tax that the mutual fund trust has paid on its capital gains attributable to redeeming unitholders.

Budget 2019 proposes to introduce new rules that would deny a mutual fund trust a deduction where they have entered into certain tax avoidance or deferral transactions with respect to unit redemptions.

This measure will apply to taxation years of mutual fund trusts that begin on or after Budget Day.

Carrying on Business in a Tax-Free Savings Account

The tax-free savings account (TFSA) is a registered account that allows Canadians to earn tax-free investment income on a wide range of investments. However, a TFSA is liable to pay tax under Part I of the *Income Tax Act* (at the top personal tax rate) on income from a business carried on by the TFSA or from non-qualified investments.

Under the current rules, the trustee of a TFSA (i.e., a financial institution) is jointly and severally liable with the TFSA for Part I tax while the holder of the TFSA is not. Budget 2019 proposes that the joint and several liability for tax owing on income from carrying on a business in a TFSA be extended to the TFSA holder. The joint and several liability of a trustee of a TFSA at any time in respect of business income earned by a TFSA will be limited to the property held in the TFSA at that time plus the amount of all distributions of property from the TFSA on or after the date that the notice of assessment is sent.

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

Electronic Delivery of Requirements for Information

The Canada Revenue Agency (CRA) may issue a requirement for information to oblige a person to provide information or documents for the purposes of the administration and enforcement of various Acts. In many cases, the CRA must send requirements for information by registered mail, certified mail or personal service and is not permitted to send those requirements electronically.

To improve the efficiency of the requirement-for-information process and to reduce administration and compliance costs, Budget 2019 proposes to allow the CRA to send requirements for information electronically to banks and credit.

This measure will apply as of January 1, 2020.

Business Income Tax Measures

Support for Canadian Journalism

Budget 2019 proposes to introduce three new tax measures to support Canadian journalism:

- Allowing journalism organizations to register as qualified donees on or after January 1, 2020 (subject to certain criteria);
- A refundable labour tax credit for qualifying journalism organizations; and
- A non-refundable personal tax credit for subscriptions to Canadian digital news. This credit will be available in respect of eligible amounts paid after 2019 and before 2025.

These measures are intended to provide support to Canadian journalism organizations producing original news.

Business Investment in Zero-Emission Vehicles

Budget 2019 proposes adding two new CCA classes for zero-emission vehicles with an enhanced CCA rate of 100%. The two new classes will be as follows:

- **Class 54 –** would include zero emission vehicles that would otherwise be included in class 10 or 10.1. For passenger vehicles (that would otherwise be included in class 10.1), the limit in the addition to the CCA class will be $55,000 (as opposed to the $30,000 limit currently imposed on class 10.1);
- **Class 55 –** would include zero emission vehicles that would otherwise be included in class 16 (taxis and rental cars).

This new accelerated CCA rate would be available for vehicles acquired on or after Budget Day and will be gradually phased out from 2024-2028.

Small Business Deduction – Farming and Fishing

Currently, “specified corporate income” of a Canadian Controlled Private Corporation (CCPC) can have a disqualifying effect on the eligibility for the small business deduction. However, certain income of a CCPC’s farming or fishing business that arises from sales to farming or fishing cooperative corporation are excluded from specified corporate income.

Budget 2019 proposes to eliminate the requirement that farming or fishing business sales have to be to a farming or fishing cooperative corporation in order to be excluded from specified corporate income. The proposed exclusion from specified corporate income would apply to all sales from a farming or fishing business to any arm’s length purchaser corporation.

This measure will apply to taxation years that begin after March 21, 2016 (the date the specified corporate income rules were introduced).

Character Conversion Transactions

Character conversion transactions are securities that covert regular income to lower taxed capital gains. Budget 2019 proposes to limit certain exceptions to this rule that apply to derivatives. This measure will apply to transactions entered into on or after Budget Day.

Canadian-Belgian Co-productions – Canadian Film or Video Production Tax Credit

Budget 2019 proposes measures to allow joint projects of producers from Canada and Belgium to qualify for the Canadian film or video production tax credit. This measure will apply as of March 12, 2018.

Scientific Research and Experimental Development (SR&ED) Program

Currently, under the SRED tax incentive program, qualifying expenditures are eligible for an investment tax credit. For CCPC's, a fully refundable enhanced tax credit at a rate of 35 per cent is available on up to $3 million of qualifying expenditures annually. This $3 million expenditure limit for a taxation year is gradually phased out based on two factors, which apply on the basis of an associated group:

- The expenditure limit is reduced where taxable income for the previous taxation year is between $500,000 and $800,000; and
- The expenditure limit is also reduced where taxable capital employed in Canada for the previous taxation year is between $10 million and $50 million.

Budget 2019 proposes to repeal the above reduction of expenditure limit based on the previous taxation year's taxable income. As a result, the expenditure limit will only be subject to reduction based on the previous taxation year's taxable capital employed in Canada. This measure will apply to taxation years that end on or after Budget Day.

International Tax Measures

Transfer Pricing Measures

In the tax context, "transfer pricing" refers to the prices, and other terms and conditions, used in transactions occurring across international borders by persons who are not dealing at arm's length. These transactions may involve the intra-group purchase or sale of goods, services, intra-group financing arrangements or loan guarantees. International organizations often arrange their affairs such that income is taxed in low tax jurisdictions through various favourable business arrangements.

Many countries, including Canada, have agreed to adopt the “arm’s length principle” for measuring transfer pricing transactions. This means that related businesses should transact with each other using the same policies as they would with unrelated businesses.

In Canada, the arm’s length principle is reflected in the transfer pricing rules contained the *Income Tax Act*. Under the transfer pricing rules, where the transaction does not reflect arm’s length terms and conditions, the quantum or nature of amounts related to the transaction or series between the participants is adjusted to reflect arm’s length terms and conditions.

Budget 2019 proposes two measures with respect to the transfer pricing.

Order of Application of the Transfer Pricing Rules

To provide greater certainty in the application of the income tax rules, Budget 2019 proposes that the transfer pricing rules will apply prior to the other portions of the Income Tax Act. This measure could impact the calculations of penalties for instance.

This measure will apply to taxation years that begin on or after Budget Day.

Applicable Reassessment Period

An extended three-year reassessment period exists in respect of a reassessment made as a consequence of a transaction involving a taxpayer and a non-resident with whom the taxpayer does not deal at arm’s length. This is intended to apply in the transfer pricing context. Due to a technical issue, “transaction” used in the transfer pricing rules does not apply for the purposes of the rule establishing this extended reassessment period.

Budget 2019 proposes to amend the Income Tax Act to correct that technicality.

This measure will apply to taxation years for which the normal reassessment period ends on or after Budget Day.

Foreign Affiliate Dumping

Foreign affiliate Dumping is where a Corporation Resident in Canada (CRIC) invests in a foreign corporation affiliated with it. When these rules apply the ability of the CRIC to pay tax free amounts to its parent will be reduced. These rules currently only apply to CRIC's controlled by foreign corporations.

These rules are being expanded to include CRIC's controlled by non-resident individuals, trusts and certain groups.

This measure will apply to transactions and events that occur on or after Budget Day

Sales and Excise Tax Measures

GST/HST on Health Services and Devices

The budget proposes the following extensions of GST/HST relief:

- Supplies and imports of human ova, and imports of human *in vitro* embryos, made after Budget Day will be zero-rated for GST/HST;
- Foot care devices will be zero-rated for GST/HST when ordered by licensed podiatrists and chiropodists, after Budget Day; and
- Multidisciplinary health care services will be GST/HST exempt, such as by a team of licensed health care professionals, when those same services are GST/HST exempt when supplies separately, and when all or substantially all of the service is provided by health professionals acting within the scope of their respective profession.

Taxation of Cannabis Products

New classes of cannabis products will be subject to excise duty, following their upcoming legalization and regulation. These classes of products are edible cannabis, cannabis extracts (including cannabis oils) and cannabis topical. They will be subject to excise duties at a flat rate applied on the quantity of total tetrahydricannabinol (THC) contained in the final product. The duties will be imposed at the time of packaging of a product, and become payable when delivered to a non-cannabis licensee, such as a provincial wholesaler, retailer or individual customer.

The current excise duty regime for fresh cannabis, dried cannabis, seeds and seedlings will be unaffected by this change. The proposed changes to the excise duty framework will come into effect on May 1, 2019.

Previously Announced Measures

Budget 2019 confirms the Government's intentions to proceed with the following previously announced tax measures:

- Income tax measures announced on November 21, 2018 in the Fall Economic Statement to:
  - provide for the Accelerated Investment Incentive,
  - allow the full cost of machinery and equipment used in the manufacturing and processing of goods, and the full cost of specified clean energy equipment, to be written off immediately, and
  - extend the 15-per-cent mineral exploration tax credit for an additional five years,
- The income tax measures announced in Budget 2016 on information-reporting requirements for certain dispositions of an interest in a life insurance policy.
- Measures confirmed in Budget 2016 relating to the Goods and Services Tax/Harmonized Sales Tax joint venture election;
- The income tax measures announced in Budget 2018 to implement enhanced reporting requirements for certain trusts to provide additional information on an annual basis; and
- Regulatory proposals released on September 17, 2018 relating to the taxation of cannabis.