TAXBULLETIN
WILKINSON TAX GROUP

Finance Minister Bill Morneau delivered the Liberal Government's third budget on February 27, 2018 ("Budget Day") titled Equity and Growth. The Budget anticipates a deficit of $19.4 billion for 2018-2019 and projects that by 2023 the deficit will drop to $12.3 billion.

The major spending announcements in the budget include amounts for gender equality provisions, indigenous communities and investments in science and innovations.

The tax changes again did not include an increase in the capital gains inclusions rate or the taxation of stock option benefits. Clarifications on plans for the taxation of corporate passive income which are to be effective for taxation years after 2018 were provided. The budget does not include any previously unannounced changes to personal or corporation tax rates or changes enhancing asset tax write-off rates in reaction to recent US tax reform announcements.

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

Personal Income Tax Measures

Canada Workers Benefit

The Working Income Tax Benefit is a refundable tax credit that supplements the earnings of low-income workers and improves work incentives for low income Canadians. Budget 2018 proposes to rename the program to the Canada Workers Benefit and to enhance the credit.

For 2019 the amount of the benefit will increase the maximum benefit to $1,355 for single individuals without dependants and to $2,335 for families (couples and single parents) from $1,192 and $2,165 respectively. The benefit will be reduced by 12 per cent 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 may also receive a Canada Workers Benefit disability supplement. Budget 2018 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. This measure will apply to the 2019 and subsequent taxation years. Indexation of amounts relating to the Canada Workers Benefit will continue to apply after the 2019 taxation year.

Budget 2018 also proposes to allow the CRA, in circumstances where an individual does not claim the new Canada Workers Benefit, to determine if the individual is eligible to receive the benefit and assess their return as if the benefit had been claimed.

To assist in the administration of the Canada Workers Benefit, Budget 2018 also proposes that designated educational institutions in Canada be required to report, to the CRA, prescribed information pertaining to students' enrolment, effective for months of enrolment after 2018. This reporting will also assist the CRA in the administration of existing measures, such as the Lifelong Learning Plan and the exemption for scholarship, fellowship and bursary income.

Medical Expense Tax Credit – Eligible Expenditures

The METC currently provides tax relief in respect of certain expenses incurred for an animal specially trained to assist a patient in coping with the following impairments: blindness; profound deafness; severe autism; severe diabetes; severe epilepsy; or a severe and prolonged impairment that markedly restricts the use of the patient's arms or legs.

Budget 2018 will expand the METC to recognize such expenses where they are incurred in respect of an animal specially trained to perform tasks for a patient with a severe mental impairment in order to assist them in coping with their impairment (e.g., a psychiatric service dog trained to assist with post-traumatic stress disorder). For example, these tasks may include guiding a disoriented patient, searching the home of a patient with severe anxiety before they enter and applying compression to a patient experiencing night terrors. Expenses will not be eligible if they are in respect of an animal that provides comfort or emotional support but that has not been specially trained to perform tasks as described above. 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 ITArequires 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.

Budget 2018 notes that establishing a legal guardian or other representative can be a lengthy and expensive process that can have significant repercussions for individuals. Some provinces and territories have instituted streamlined processes that allow for the appointment of a trusted person to manage resources on behalf of an adult who lacks contractual capacity, or have indicated that their system already provides sufficient flexibility to address this concern. Others require more time to develop such a process.

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; however, Budget 2018 will extend the temporary measure by five years, to the end of 2023.

Deductibility of Employee Contributions to the Enhanced Portion of the Quebec Pension Plan (QPP)

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

As part of the CPP enhancement, the ITA was amended to provide a tax deduction for employee contributions (as well as the "employee" share of contributions by self-employed persons) to the enhanced portion of the CPP. A tax credit will continue to be provided on employee contributions to the base CPP (i.e., the existing CPP). Contributions to the enhanced portion of the CPP will begin in 2019 and will be fully phased in by 2025.

To provide consistent income tax treatment of the enhanced CPP and QPP contributions, Budget 2018 proposes to amend the ITA 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. This measure will apply to taxation years after 2018.

Child Benefits

Foreign-born status Indians who are neither Canadian citizens nor permanent residents under the Immigration and Refugee Protection Act may legally reside in Canada and be eligible for certain programs and services offered by federal, provincial and territorial governments, such as the Goods and Services Tax/Harmonized Sales Tax credit, the Working Income Tax Benefit, Old Age Security and Employment Insurance.

Under the Canada Child Benefit, as announced in Budget 2016, foreign-born status Indians residing legally in Canada who are neither Canadian citizens nor permanent residents are eligible for the benefit, where all other eligibility requirements are met. However, these individuals were not eligible under the previous system of child benefits.

Budget 2018 proposes that such individuals be made retroactively eligible for the Canada Child Tax Benefit, the National Child Benefit supplement and the Universal Child Care Benefit, where all other eligibility requirements are met applicable from the 2005 taxation year to June 30, 2016.

Budget 2018 will amend the ITA to provide legislative authority for the government to share with the provinces and territories taxpayer information related to the Canada Child Benefit, as of July 1, 2018, solely for the purpose of administering their social assistance payment regimes. Also, taxpayer information related to the National Child Benefit supplement in respect of prior benefit years will continue to be shared after June 2018.

Mineral Exploration Tax Credit for Flow-Through Share Investors

Budget 2018 will 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.

Charities

Municipalities as Eligible Donees

The registration of a charity may be revoked at the request of the charity or because the charity has not complied with its registration requirements. In either case, the ITA imposes a 100-per-cent revocation tax on the charity based on the total net value of its assets. In order to ensure that a revoked charity's accumulated property stays within the charitable sector, a charity can reduce the amount of revocation tax by making qualifying expenditures, including gifts to "eligible donees".

Budget 2018 proposes to amend the ITA to allow transfers of property to municipalities to be considered qualifying expenditures for the purposes of the revocation tax, subject to the approval of the Minister of National Revenue on a case-by-case basis. In situations where a suitable recipient cannot be found to keep a property in the charitable sector, this change will allow the property to be transferred to a municipality for the benefit of the community. This measure will apply to transfers made on or after February 27, 2018.

Universities Outside Canada

In 2011, the ITA was amended so that certain categories of qualified donees, including universities outside Canada, are now required to register with the CRA, and to meet certain receipting and record-keeping conditions. Once these qualified donees are registered, public notification is provided by listing them on the Government of Canada's website. To simplify the administration of these rules and streamline the registration process for universities outside Canada as qualified donees, Budget 2018 will remove the requirement that universities outside Canada also be prescribed in the Income Tax Regulations effective February 27, 2018.

Reporting Requirements for Trusts

A trust that does not earn income or make distributions in a year is generally not required to file an annual T3 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.
Consequently, Budget 2018 proposes to require that certain trusts provide additional information on an annual basis. The new reporting requirements will impose an obligation on certain trusts to file a T3 return where one does not currently exist. The Government states that this information would be used to help CRA assess the tax liability for trusts and its beneficiaries.

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 (as opposed to a resulting or constructive trust, or certain trusts deemed to arise under the provisions of a statute).

Exceptions to the additional reporting requirements will be available for: mutual fund trusts, segregated funds and master trusts; trusts governed by registered plans (i.e., DPSPs, RRSPs, TFSAs, etc.); lawyers' general trust accounts; graduated rate estates and qualified disability trusts; trusts that qualify as non-profit organizations or registered charities; and trusts that have been in existence for less than three months or that hold less than $50,000 in assets throughout the taxation year (provided, in the latter case, that their holdings are confined to deposits, government debt obligations and listed securities).

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 (through the trust terms or a related agreement) to exert control over trustee decisions regarding the appointment of income or capital of the trust (e.g., a protector).

Budget 2018 proposes to provide funding of $79 million over a five year period and $15 million on an ongoing basis to CRA in order to support the development of an electronic platform for processing T3 returns.

Budget 2018 will also introduce new penalties for a failure to file a T3 return, including a required beneficial ownership schedule, in circumstances where the schedule is required. The penalty will be equal to $25 for each day of delinquency, with a minimum penalty of $100 and a maximum penalty of $2,500. If a failure to file the return was made knowingly, or due to gross negligence, an additional penalty will apply equal to 5% of the maximum FMV of property held during the relevant year by the trust, with a minimum penalty of $2,500. As well, existing penalties will also continue to apply.

These proposed new reporting requirements and penalties will apply to T3 returns required to be filed for taxation years after 2020.

Business Income Tax Measures

Tax Planning Using Private Corporations

In the 2017 federal budget the government identified a number of perceived issues regarding tax planning strategies using private corporations and a formal announcement was made in July 2017. These strategies include:

Sprinkling Income
Strategies that reduce income taxes by allocating certain corporate distributions (e.g., dividends or capital gains) to lower income family members instead of higher income family members.

Holding a Passive Investment Portfolio Inside a Private Corporation
It can be financially advantageous for owners of private corporations to keep profits in a corporation to invest rather than distributing the profits to shareholders to invest. This is mainly due to the fact that corporate income tax rates, which are generally much lower than personal rates, facilitate accumulation of earnings that can be invested in a passive portfolio.

Converting a Private Corporation's Regular Income into Capital Gains
Capital gains are taxed at a rate that is half of other forms of income. There are a number of strategies that can be utilized in specific circumstances to take advantage of this disparity by arranging distributions to be taxed as capital gains.

In response to the significant criticism of the original proposals capital gains provisions were cancelled in November and the several new exemptions to the proposed income sprinkling rules were announced in December. Our Tax Bulletin on January 11 discussed the government's amendments to the income sprinkling rules. Budget 2018 confirms the Government's intention to move forward with these rules.

Furthermore, Budget 2018 finally provides the proposed provisions to address the corporate passive investment income. These proposals bear little resemblance to the initial alternatives proposed by the government in July 2017 which would have potentially imposed an overall tax rate of 73% on corporate passive income. Fortunately, it is our opinion that the two proposals in Budget 2018 will generally be less onerous and complex than those original proposals.

(1) Business Limit Reduction

The Government has previously proposed to reduce the tax rate for qualifying active business income of small Canadian Controlled Private Corporations (CCPCs) from 10.5 per cent to 10 per cent for 2018 and to 9 per cent as of 2019 on the $500,000 of business income. The tax rate for Ontario CCPCs in 2019 is scheduled to be 13.5% compared to 26.5% for corporations that do not qualify for this Small Business Deduction (SBD).

There is a requirement to allocate the business limit among corporations under common control (associated corporations). The business limit is also reduced on a straight-line basis for a CCPC and its associated corporations having between $10 million and $15 million of total capital employed in Canada.

Budget 2018 proposes to also reduce the business limit for CCPCs (and their associated corporations) 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 in investment income. The measure will affect CCPCs only to the extent that their business income exceeds the reduced business limit (see table below). For example, a CCPC with $100,000 of investment income would have its business limit reduced to $250,000.

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.

It is expected that about three per cent of CCPCs claiming the small business deduction will be affected by the measure. The intent of this measure is that it will affect companies that invest in lower risk investments less than those that invest in higher risk investments.

The investment income that is used in the calculation will:

- Not include capital gains (and losses) from the disposition of property used principally in an active business carried on primarily in Canada by the CCPC or by a related CCPC or from the disposition of a share of a connected active Small Business Corporation;
- Not include net capital losses carried over from other taxation years;
- Include certain dividends from non-connected corporations; and
- Include income from savings in a life insurance policy that is not an exempt policy, to the extent it is not otherwise included in aggregate investment income.

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.

(2) Refundable Tax 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 approximately the top personal income tax rate while that income is retained in the corporation. In order to avoid punitive rates some or all of these taxes are refundable when dividends are paid to the corporation's shareholders.

The amount of tax available for refund is tracked through the corporation's refundable dividend tax on hand (RDTOH) account. The taxes are refundable at a rate of $38.33 for every $100 of taxable dividends paid to shareholders. The personal tax on the dividend may be higher or lower than the dividend refund depending on the income of the shareholder.

For income tax purposes, dividends paid by corporations are either "eligible" or "non-eligible". Non-eligible dividends are presumed to have been paid from a corporation's small business or from passive investment income. Eligible dividends are presumed to have been paid from a corporation's active business income that has been subject to the general corporate tax rate and other eligible dividends received by the corporation. To offset the higher amount of corporate tax that was paid to generate eligible dividends, the personal tax rate on eligible dividends is less than the tax rate on ineligible dividends.

The dividend refund received by a corporation from the payment of an eligible dividend is currently the same as the refund generated by 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 that will track the refundable taxes generated from portfolio dividends. The current RDTOH account will only generate refunds when non-eligible dividends are paid.

A private corporation will be required to obtain a refund from its non-eligible RDTOH account before it can obtain a refund from its eligible RDTOH account.

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.

A corporation's existing RDTOH balance will be allocated as follows:

- For a CCPC, the lesser of its existing RDTOH balance and an amount equal to 38⅓ per cent of the balance of its general rate income pool will be allocated to its eligible RDTOH account. Any remaining balance will be allocated to its non-eligible RDTOH account.
- For any other corporation, all of the corporation's existing RDTOH balance will be allocated to its eligible RDTOH account.

Tax Support for Clean Energy

Capital Cost Allowance (CCA) classes 43.1 and 43.2 provide accelerated CCA rates for certain clean energy generation and conservation equipment. Class 43.2 was introduced in 2005 for property that would otherwise be included in Class 43.1 for property acquired before 2020 and provides more favourable depreciation rates. Budget 2018 proposes to extend eligibility for Class 43.1 for property acquired before 2025.

Artificial Losses Using Equity-Based Financial Arrangements

Synthetic Equity Arrangements

In the 2015 federal budget, the Government introduced rules to capture certain "synthetic equity arrangements" that sought to circumvent rules intended to deny the inter-corporate dividend deduction to a shareholder where the main reason for the arrangement was to enable the shareholder to receive a dividend on a share and transfer the economic exposure to someone else.

In some situations, these rules are still being circumvented. Budget 2018 proposes to add further clarification to the synthetic equity arrangement rules in order to prevent these situations. The proposed amendments will apply to dividends that are paid, or become payable, on or after Budget Day.

Securities Lending Arrangements

The Government has become aware of certain other sophisticated equity-based financial arrangements, such as security lending and repurchase arrangements, in a manner that attempts to achieve the same unintended tax benefit that was targeted by the synthetic equity arrangement rules.

Budget 2018 proposes an amendment to broaden the “securities lending arrangement” definition in the Income Tax Act, and to clarify certain interactions of rules relating to these arrangements in order to eliminate these types of arrangements. The proposed rules will apply to dividend compensation payments on or after Budget Day. For arrangements that were already in place before the Budget Day, the amendments will apply to payments that are made after September 2018.

Stop-Loss Rule on Share Repurchase Transactions

The Income Tax Act generally permits a corporation to deduct dividends received on a share of a corporation resident in Canada in computing its taxable income. This inter-corporate dividend deduction is available for dividends actually received; it is also available for dividends that are deemed to have been received on a share, which can arise on a repurchase of the share. The deduction is intended to limit the imposition of multiple levels of corporate taxation on earnings distributed from one corporation to another.

To prevent abuses of this inter-corporate dividend deduction mechanism, dividend stop-loss rules have been introduced that reduce, in specific cases, the amount of a tax loss otherwise realized by a corporation on a disposition of shares.

Canadian financial institutions have previously relied on exceptions to these stop-loss rules pertaining to shares held as mark-to-market property to realize artificial tax losses on certain share repurchase transactions. Budget 2011 previously expanded the stop-loss rules to address this issue, but the formula did not fully capture the elimination of the artificial losses.

Budget 2018 proposes to amend provisions of the Income Tax Act to reduce the tax loss realized on a share repurchase by the amount of deemed dividend eligible for the inter-corporate dividend deduction for share repurchases that occur on or after Budget Day.

At-Risk Rules for Tiered Partnerships

Limited partners of a partnership may deduct losses of the partnership allocated to them only to the extent of their “at-risk amount” in respect of the partnership. This amount is generally a measure of the limited partner’s invested capital that is at risk in the partnership, and is increased by unpaid income allocated from the partnership. Losses incurred in excess of the partner’s at-risk amount are not deductible, but are available for carry-forward. When a limited partner disposes of their partnership interest any undeducted limited partnership losses are added to the adjusted cost base of the partnership unit.

A recent Federal Court of Appeal decision has limited the application of the at-risk rules where the limited partner is another partnership. Budget 2018 proposes to clarify the application of the at-risk rules in situations where a partnership is a limited partner of another partnership, restricting the amount of losses that can be allocated to the upper-tier partners from the limited partnership to the at-risk amount 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.

Health and Welfare Trusts

A Health and Welfare Trust is a trust established by an employer for the purpose of providing health and welfare benefits to its employee. There are currently no provisions in the Income Tax Act that deal with this type of trust, and as a result the tax treatment has relied on a number of administrative positions issued by the Canada Revenue Agency (CRA). Employee Life and Health Trust rules were added to the Income Tax Act in 2010, however these provisions only deal with certain issues and not the administrative Health and Welfare Trust regime.

Budget 2018 proposes that only one set of rules relate to such arrangements and that Health and Welfare Trusts will need to convert to Employee Life and Health Trusts. After the end of 2020, the CRA administrative positions will no longer apply to Health and Welfare Trusts, and any that have not converted will be subject to normal rules for trusts.

Transitional rules will be added to the Income Tax Act to facilitate the transition, and stakeholders have been invited to submit comments by June 29, 2018 on transitional issues.

International Tax Measures

Cross Border Surplus Stripping Using Partnerships and Trusts

The Income Tax Act contains a rule that is intended to prevent a non-resident shareholder from entering into transactions to extract free of tax (or "strip") a Canadian corporation's surplus in excess of the tax Paid Up Capital (PUC) of its shares, or to artificially increase the PUC of such shares. Some taxpayers have attempted to avoid this rule by involving a partnership or trust in certain transactions.

Budget 2018 proposes to amend these provisions to add comprehensive "look-through" rules for such entities. These rules will allocate the assets, liabilities and transactions of a partnership or trust to its members or beneficiaries, as the case may be, based on the relative fair market value of their interests.

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

Foreign Affiliates

A foreign affiliate of a taxpayer resident in Canada is a non-resident corporation in which the taxpayer has a significant interest. A controlled foreign affiliate of a taxpayer is generally a foreign affiliate in which the taxpayer has, or participates in, a controlling interest. Where a controlled foreign affiliate earns passive income, that income will be taxed in the hands of a Canadian shareholder when earned even if it is not distributed.

The foreign affiliate rules are extremely complicated and contain many deeming rules that convert otherwise active income into passive or provide exceptions to those rules.

Budget 2018 provides several revisions to the existing legislation including:

- Limiting the exceptions for certain investment businesses that utilize “tracking arrangements” to avoid these rules;
- Extending the minimum capital requirements required to rely on the exemption for regulated financial institutions; and
- Extend the reassessment period by three years from income from foreign affiliates; and
- Reducing the time period to file an information return for foreign affiliated to 6 months from fifteen months.

Other International Tax Measures

Other provisions affecting international tax include:

- Extending the reassessment period where requirements for information requests or compliance orders are being contested and where losses involving non-arm’s length non-residents are carried back; and
- Increase the ability of the CRA to utilize information from criminal investigations in other countries.

Sales and Excise Tax Measures

GST/HST and Investment Limited Partnerships

Budget 2018 confirms the Government’s intention to changes proposed in September 2017 which would result in the application of GST/HST on management and administrative services provided to a limited partnership by the general partner. GST/HST would apply to services rendered on or after September 8, 2017, with an election to advance the application of the special HST rules as of January 1, 2018.

Tobacco Taxation

Budget 2018 proposes to advance the existing inflationary adjustments for tobacco excise duty rates to occur on an annual basis on April 1 of every year, starting in 2019, as opposed to every five years.

Cannabis Taxation

Budget 2018 proposes a new federal excise duty framework for cannabis products. The duty will generally apply to all products available for legal purchase. Cannabis cultivators and manufacturers will be required to obtain a cannabis license 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.

Consultations on the GST/HST Holding Corporation Rules

The current "holding corporation rule" generally allows a parent corporation to claim input tax credits to recover GST/HST paid on expenses that can reasonably be regarded as being in relation to shares or indebtedness of a related commercial operating corporation. The Government intends to consult on certain aspects of the holding corporation rule.

Previously Announced Measures

Budget 2018 confirms the Government's intention to proceed with several previously announced measures including:

- The Goods and Services Tax/Harmonized Sales Tax joint venture election;
- Technical amendments relating to a division of a corporation under foreign laws;
- The establishment of a tax-exempt Memorial Grant for First Responders (the Community Heroes benefit);
- Additional tax relief for Canadian armed forces personnel and police officers; and
- Indexing of the Canada Child Benefit amounts as of July 1, 2018 instead of July 1, 2020.