MNP Federal Budget Summary – 2018

ACCOUNTING › CONSULTING › TAX

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FEDERAL BUDGET HIGHLIGHTS

On Tuesday, February 27, 2018, the Honourable Bill Morneau, Minister of Finance tabled his third budget: Equality and Growth for a Strong Middle Class.

Despite a relatively strong economy, the government is projecting sizeable deficits stretching to 2023 (and presumably beyond). The deficit for the current year ending March 31, 2018 is projected to be $19.4 billion.

Given the recent activity around the taxation of private corporations this past year, MNP is pleased to see the government listened to the voices of Canadian business owners. While the tax on split income rules will proceed as drafted, a more practical approach to the passive investment proposals was introduced.

While Budget 2018 states the government will analyze the U.S. tax changes over the next few months, it does not contain any provisions to enhance Canadian tax competitiveness. It will be important for the government to formulate a response in the near term as the U.S. tax changes will have a significant impact on business in Canada.

Below are highlights from Budget 2018.

A. Corporate Tax Measures

CORPORATE TAX RATES

As previously announced, the federal small business rate is 10 percent as of January 1, 2018, and will further decline to 9 percent, effective January 1, 2019. The combined federal and provincial corporate tax rates for calendar 2018 are as follows:

	Small Business Rate		General Rate	
	Rate	**Threshold**	**Non-M&P**	**M&P**
Federal	10.00%	$500,000	15.00%	15.00%
British Columbia	12.00%	$500,000	27.00%	27.00%
Alberta	12.00%	$500,000	27.00%	27.00%
Saskatchewan	12.00%	$600,000	27.00%	25.00%
Manitoba	10.00%	$450,000	27.00%	27.00%
Ontario	13.50%	$500,000	26.50%	25.00%
Quebec	18.00%	$500,000	26.70%	26.70%
New Brunswick	12.62%	$500,000	29.00%	29.00%
Nova Scotia	13.00%	$500,000	31.00%	31.00%
Prince Edward Island	14.50%	$500,000	31.00%	31.00%
Newfoundland and Labrador	13.00%	$500,000	30.00%	30.00%

PASSIVE INVESTMENT INCOME

Budget 2018 proposes two measures, applicable to taxation years that begin after 2018, to limit tax deferral advantages on passive investment income earned inside Canadian Controlled Private Corporations (CCPCs).

1. Business Limit Reduction

A preferential tax rate applies to CCPCs having active business income up to $500,000 (the "business limit"). The business limit is shared amongst associated corporations. 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.

Budget 2018 proposes to 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 by $5 for every $1 of investment income in excess of $50,000, such that the business limit will be eliminated at $150,000 of investment income. As outlined in the table below, a CCPC with $100,000 of investment income would have its business limit reduced to $250,000. Provided the reduced business limit remains above the active business income of the CCPC, all of that income would continue to be taxed at the small business tax rate. A CCPC with $75,000 of business income would have to earn more than $135,000 in passive income before its business limit is reduced below its business income. This feature of the proposed rules recognizes CCPCs with lower amounts of business income generate less retained earnings that can later be used for reinvestment in the business and may have more difficulty accessing capital. CCPCs with business income above the reduced business limit will be taxed on income above the business limit at the general corporate tax rate.

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	NOT AFFECTED				$0
$75,000					$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 the corporation has less than $10 million of taxable capital.
Table courtesy of Budget 2018 - Tax Measures: Supplementary Information

The business limit reduction under this measure will include investment income of any other associated corporations. It will also operate alongside the business limit reduction that applies in respect of taxable capital in excess of $10 million.

Adjusted Aggregate Investment Income

For the purpose of determining the reduction of the business limit of a CCPC, investment income will be measured by a new concept of adjusted aggregate investment income which will be based on aggregate investment income (a concept that is currently used in computing the amount of refundable taxes in respect of a CCPC's 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.

This measure will apply to taxation years that begin after 2018. Certain 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. 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 approximately 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 are refundable at a rate of $38.33 for every $100 of taxable dividends paid to shareholders.

For income tax purposes, dividends paid by corporations are either eligible or non-eligible. Non-eligible dividends are generally paid from a corporation's passive income and income taxed at the small business tax rate, while eligible dividends are generally paid from a corporation's income that has been subject to the general corporate income tax rate.

A corporation receives a refund of taxes paid on investment income (RDTOH) regardless of whether the dividends paid are eligible or non-eligible. When refunds are received as a result of an eligible dividend, this can provide a tax deferral advantage on passive investment income.

To better align the refund of taxes paid on passive income with the payment of dividends sourced from passive income (i.e. non-eligible dividends), 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. This new account (eligible RDTOH) will track refundable taxes paid under Part IV of the Income Tax Act on eligible portfolio dividends. Any taxable dividend (i.e., eligible or non-eligible) will entitle the corporation to a refund from its eligible RDTOH account, subject to the ordering rules.

The current RDTOH account (which will now be referred to as non-eligible RDTOH) will track refundable taxes paid under Part I of the Income Tax Act on investment income, as well as under Part IV on non-eligible portfolio dividends (i.e., dividends that are paid by non-connected corporations as non-eligible dividends). Refunds from this account will be obtained only upon the payment of non-eligible dividends.

The proposed rules track refundable balances through connected corporations, adding them to either the eligible or non-eligible RDTOH account depending upon which account the dividend was paid.

Transitional rules will apply to convert the existing RDTOH pool balances to the eligible and non-eligible RDTOH balances.

These measures will apply to taxation years that begin after 2018.

AT-RISK RULES FOR TIERED PARTNERSHIPS

Budget 2018 proposes to clarify the at-risk rules applicable to partnerships in circumstances where a limited partnership is itself a limited partner of a limited partnership (commonly referred to as tiered-partnership structures). These rules restrict the availability of limited partnership losses to a limited partner that is itself a partnership, effectively reversing a recent Federal Court of Appeal decision which was perceived to be inconsistent with the policies underlying the at-risk rules. These rules apply to taxation years that end on or after Budget Day.

HEALTH & WELFARE TRUSTS

There are currently no explicit rules in the Income Tax Act for Health & Welfare Trusts. These trusts are established by employers to provide health and welfare benefits to their employees. Canada Revenue Agency (CRA) has historically published administrative positions relating to health and welfare trusts, such as what arrangements qualify and how their income is computed.

Budget 2018 proposes to legislate income tax rules for health and welfare trusts by extending the current tax rules for employee life and health trusts. Transitional rules will be added to the Income Tax Act so that existing health and welfare trusts can convert to employee life and health trusts. The government is seeking input from stakeholders on transitional issues, and will subsequently release draft legislation. CRA will no longer apply current administrative positions to existing health and welfare trusts after 2020, or any such new trusts created after Budget Day. Existing health and welfare trusts will be subject to existing trust tax rules if they do not convert to employee life and health trusts.

CLEAN ENERGY EQUIPMENT

Class 43.1 and 43.2 of Schedule II to the Income Tax Regulations provide accelerated capital cost allowance rates (30 percent and 50 percent, respectively on a declining balance) for investments in specified clean energy generation and conservation equipment.

Both classes include eligible equipment that generates or conserves energy by:

- using a renewable energy source;
- using a fuel from waste; or
- making efficient use of fossil fuels.

Class 43.2 was introduced in 2005 and is currently available in respect of property acquired before 2020.

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

B. Personal Tax Measures

PERSONAL TAX RATES

No new personal income tax rate or tax bracket changes were announced in this year's Budget. The government did, however, confirm that it will proceed with the proposed tax on split income measures announced on December 13, 2017.

CANADA WORKERS BENEFIT (CWB) (FORMERLY WORKING INCOME TAX BENEFIT)

Budget 2018 enhances the CWB which is a refundable tax credit paid to low income workers. Currently, the maximum benefit for an individual is $1,192. The amount is clawed back at a rate of 14 percent of income and is eliminated at approximately $21,000 of income. The maximum CWB will be increased to $1,355, with the claw-back rate reduced to 12 percent and is eliminated at approximately $24,000 of income.

For a family, the maximum benefit will increase from $2,165 to $2,335, and is eliminated at approximately $36,500 of income.

The change is effective for 2019 and subsequent taxation years.

MINERAL EXPLORATION TAX CREDIT

Flow-through shares facilitate resource companies in raising capital. The mineral exploration tax credit, equal to 15 percent of specified mineral exploration expenses incurred in Canada and renounced to investors, will be extended to flow through share agreements entered into on or before March 31, 2019. This credit was set to expire on March 31, 2018.

REPORTING REQUIREMENTS FOR TRUSTS

To improve the collection of beneficial ownership information of trusts, Budget 2018 proposes new annual reporting requirements for express trusts that are resident in Canada and to non-resident trusts that are currently required to file a T3 return.

Each trust will be required to report the identity of each trustee, beneficiary and settlor, as well as any person who can exert control over trustee decisions.

The proposals will create a T3 filing requirement for many trusts previously not subject to a filing obligation to the extent the trust did not earn income or make distributions in the year.

Exceptions to the additional annual reporting requirements are proposed for the following:

- Mutual fund trusts, segregated funds and master trusts;
- Trusts governed by registered plans;
- 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 year (assets must be restricted to deposits, government debt and listed securities).

C. International Tax Measures

CROSS-BORDER SURPLUS STRIPPING

Budget 2018 proposes amendments to the cross-border anti-surplus stripping rules to ensure that such rules are not circumvented by taxpayers through the use of partnerships or trusts. The proposed measures will apply to transactions that occur on or after Budget Day. Budget 2018 further indicates that the Income Tax Act's general anti-avoidance rules may be used to challenge transactions that occurred before Budget Day.

FOREIGN AFFILIATES

The foreign accrual property income (FAPI) regime prevents Canadian corporations from earning passive income offshore by taxing the income on a current basis. The income is currently taxed if it's earned from an investment business (essentially earning income from property such as dividends, rents, interest and royalties) unless the business employs more than five full time employees. Some structures have been set up to allow the investment business income to meet the threshold by pooling assets and employees. The parties to the arrangement track their returns based on their assets contributed. Budget 2018 proposes that each party's operations be treated as a separate business and therefore will need to satisfy the six-employee test and other conditions of the investment business exemption.

In addition, other structures have been set up such that Canadian taxpayers do not meet the requisite ownership tests to control the foreign corporation and hence are not required to include FAPI in their income. However, the taxpayers' have used tracking arrangements whereby each taxpayer retains control over its assets and the returns that accrue from those assets. Budget 2018 proposes that a taxpayer is required to include FAPI in their income if the taxpayer's returns are based upon a tracking arrangement. This measure will apply to taxation years of a foreign affiliate that begin on or after Budget Day.

Both of the above proposals appear to apply only in respect of tracking arrangements involving a foreign company that is a foreign affiliate. They therefore do not appear to affect arrangements whereby the Canadian taxpayer's interest in the foreign company is below the 10 percent threshold for foreign affiliate status.

REASSESSMENT PERIOD

Budget 2018 proposes to extend the reassessment period for an additional three years where the reassessment is made as a consequence of a transaction between a taxpayer and a non-arm's length non-resident.

FOREIGN AFFILIATE REPORTING

Budget 2018 proposes to shorten the filing deadline for information returns required to be filed by taxpayers with respect to their interest in foreign affiliates to six months after the taxation year (from 15 months). This measure is applicable to taxation years beginning after 2019.

D. Indirect Tax Measures

INVESTMENT LIMITED PARTNERSHIPS

Budget 2018 proposes changes to the September 8, 2017 draft legislation and regulatory proposals relating to the application of the GST / HST to investment limited partnerships. Specifically, Budget 2018 modifies the September 8, 2017 proposal to:

- Ensure the GST / HST applies to management and administrative services rendered by the general partner on or after September 8, 2017 and not to management and administration services rendered by the general partner before September 8, 2017, unless the general partner charged GST / HST in respect of such services before that date;
- Ensure tat the GST / HST be generally payable on the fair market value of management and administrative services in the period in which these services are rendered; and
- Allow an investment limited partnership to make an election to advance the application of the special HST rules as of January 1, 2018.

TOBACCO TAXATION

The Government proposes that tobacco excise duty taxes be indexed annually on April 1. However, for the current year, excise duty rates will be adjusted on February 28 to account for inflationary adjustments since 2014.

CANNABIS TAXATION

The Government has released an excise duty framework and Budget 2018 contains a new federal excise duty framework for cannabis products to be introduced in the Excise Tax Act. This will be applicable as of the dates cannabis products became legally available for sale. Cannabis cultivators and manufacturers will be required to get a license from the CRA and remit the excise duty.

The measures include both flat rate duties and additional taxes as the product moves from the manufacturer to the provincially licensed distributor and finally to the consumer. The CRA will be providing excise stamps in order to ensure the package is properly marked before its entry into the applicable market. There will also be an amendment to the GST / HST section on basic groceries in the Excise Tax Act to ensure sales of cannabis products will not be treated as such.

HOLDING COMPANY RULES

The Government will be releasing for comment and consultation draft proposals with regard to the holding corporation rule. This rule essentially provides that where a parent corporation incurs expenses relating to shares or indebtedness of a related company conducting a commercial operation, the parent is able to obtain input tax credits on its expenditures provided certain conditions are met.

ABOUT MNP

MNP is a leading national accounting, tax and business consulting firm in Canada. We proudly serve and respond to the needs of our clients in the public, private and not-for-profit sectors. Through partner-led engagements, we provide a collaborative, cost-effective approach to doing business and personalized strategies to help organizations succeed across the country and around the world.

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