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TAXSTRATEGY

Federal Budget Roundup

NO STRESS

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For some reason, the lead time to the release of this year's Federal Budget seemed to really make me anxious. Since the summer of 2017 when Finance dropped the would be bomb on private corporations, I feel like I have been constantly looking over my shoulder to find out when the next hit might come. And with the government pulling back on a couple of their would-be proposals, I'm just waiting for the other shoe to drop.

And so, March 19, 2019 came and went, and I find myself asking "So, where is that shoe?" Now, I'm not much of a betting person, but I would have put money down that the feds would have at least introduced revised legislation to curb the ability to strip money out of a company at capital gains rates

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(commonly referred to as a strip), rather than at higher dividend rates. And I would have lost that bet. In fact, the 2019 Federal Budget was quite benign. So, all that stress that came with days of fretting and weeks of running around implementing tax reorganization before March 19 were all for naught.

I've highlighted some of the more notable measures that I thought you might be interested in (please note that this is not an exhaustive summary of all proposals).

Business measures

No changes were announced to the corporate tax rates; however, a few notable proposals were introduced at the business level.

SR&ED

Currently, Canadian-controlled private corporations (known as CCPCs) or associated groups, are entitled to enhanced federal tax credits (35 per cent vs

15 per cent) on up to \$3,000,000 of current scientific research & experimental development (SR&ED) incurred for the tax year (the "expenditure limit"). This enhanced credit is available where taxable income in the previous year was \$500,000 or less. Moreover, there is a grind down to the expenditure limit of \$10.00 for every dollar of taxable income in the previous year in excess of \$500,000. This means that the expenditure limit is ground down to zero if taxable income exceeds \$800,000.

Additionally, the enhanced credit is eroded if the company's (or the associated group's) taxable capital (i.e., the aggregate of equity and debt) exceeds \$10 million (and is eventually eliminated where taxable capital exceeds \$50 million).

The budget proposes to remove this erosion as it relates to the taxable income of a company, but not in respect of taxable capital. This measure will apply for taxation years that ended on or after March 19, 2019.

Small Business Deduction – Farming and Fishing

A CCPC is entitled to pay the small business federal rate of tax of 9 per cent on its first \$500,000 of income from an active business carried on in Canada. Any non-eligible income is taxed at the federal rate of 15 per cent. Since 2016,

specified corporate income (SCI), however, is not eligible for the 9 per cent rate – this is income derived from the provision of services or property to other private corporations in which the CCPC or others hold a direct or indirect interest. Yet, sales to a farming or fishing cooperative corporation was excluded from the definition of SCI.

Budget 2019 proposes to broaden this exclusion to include the sale of farming products or fishing catches to any arm's length corporation (and not just to a farming or fishing cooperative corporation). This measure will apply for taxation years beginning after March 21, 2019.

Mutual Funds

Character Conversion Transactions – Converting Income to Capital Gains

The only measure introduced in the budget which attempts to target the conversion of income to capital gains focused on the mutual fund industry. Back in 2013, the government attempted to combat investment platforms that allowed investors to realize capital gains instead of income from underlying investments through the use of derivatives, by treating gains from derivative forward agreements as income. Since then, the mutual fund industry has developed structures to allow investors to acquire and sell a reference portfolio of investments on closing, such that the gain was not considered to be “derived” from another portfolio (this allows investors to rely on an exception to the 2013 rules to “commercial transactions”, where the economic return was based on the actual property being purchased or sold in the future).

Budget 2019 proposes to deny the commercial transaction exception where it is reasonable to conclude that one of the main purposes of the series of transactions is to convert into a capital gain any income that would have been earned on the security during the period that the security is subject to a forward agreement. This new rule applies to transactions or agreements entered into on or after March 19, 2019. Moreover, starting in 2020, this rule will also apply to agreements entered into prior to March 19, 2019.

Denial of Deduction

The budget also proposes to deny mutual funds a deduction in respect of an allocation made to a unit-holder on a redemption of a unit that is greater than the capital gain that would be otherwise realized by the unit-holder on the redemption, where the allocated amount is a capital gain and the unit-holder's redemption proceeds are reduced by the allocation. This measure is aimed at denying the deferral available to mutual funds where it allocates its realized gain to a redeeming unit-holder (to be taxed in their hands) while claiming a deduction.

The deduction is also denied where an allocation of ordinary income is made to a unit-holder on a redemption, and the unit-holder's redemption proceeds are reduced by the allocation.

Canadian Film or Video Production Tax Credit

For those film buffs out there, retroactive to March 12, 2018, Canada/Belgium productions will now qualify for the 25 per cent refundable tax credit available to qualified corporations that incur

qualified labour expenditures in connection with an eligible Canadian film or video production.

Personal Measures

Employee Stock Options

Perhaps the most substantive change in the budget was in the realm of employee stock options. Under the current rules, where an employee receives stock in their employer corporation, under certain conditions, the taxable employment benefit (the amount of the fair market value of such stock in excess of the exercise price paid by the employee under the option) can be deferred until such time as the shares are actually sold by the employee. Moreover, in certain circumstances, the deferred tax will be eligible for a 50 per cent deduction on such income so that the net tax rate is equivalent to capital gains treatment.

This has been a big advantage for employees. A few years ago, the government attempted to curb the benefits of this program by capping the deferral, but such attempt was eventually abandoned. Now, Budget 2018 has again focused on this rule and has indicated the government's intention to limit this preferential treatment by announcing that an annual cap of \$200,000 will be set for the fair market value of the shares subject to the option in the year of grant.

Moreover, this measure is intended to apply only to employees of “large, long-established, mature firms” and that employees of start-up and rapidly growing businesses would be exempt from this cap. Huh? So where is the line drawn? How

many years makes a business a long-established one (or even a mature one). The budget did not specifically answer these questions but stated that further details would be released before the summer. No implementation date was announced in the budget, although budget did indicate that the new measures would not apply to options granted before the announcement of legislative proposals to implement any new regime. In short, if you think this could affect you, then get your options in place ASAP.

RRSP Home Buyer's Plan (HBP)

Under this current plan, which I have written about previously, a first-time home buyer can borrow up to \$25,000 from their RRSP to help finance the purchase or construction of their first home (doubled to \$50,000 for spouses purchasing together).

Budget 2019 proposes to increase the maximum withdrawal per individual to \$35,000, effective for withdrawals made after March 19, 2019 (which means an increase to \$70,000 for couples). And speaking of marital harmony, the budget also modifies the rules to better accommodate a situation where there is a marital breakdown. Specifically, the individual must be living separate and apart from their spouse or common-law partner for a period of at least 90 days. The individual will be eligible to make an HBP withdrawal if the spouses live separately and apart at the time of the withdrawal, and began to live separately and apart in the year of withdrawal or at any

time in the four preceding years. However, if an individual is living in a home owned by a new spouse, they will not be able to use the HBP. This new measure is effective after 2019.

Registered Disability Savings Plan (RDSP)

Budget 2018 proposes to relax the rules for 2021 onwards with respect to RDSP such that the life of the RDSPs will be able to extend indefinitely (rather than having to collapse ahead after an individual is no longer eligible for the disability tax credit) without any certification by a medical practitioner (previously such certificate would only be able to extend the life of the RDSP by years). A tax deferred transfer of a deceased individual's RRSP or RRIF to a RDSP of a financially dependent child or grandchild will be permitted as long as the transfer occurs by the end of the fourth calendar year following the first full year the child or grandchild no longer qualifies for the disability tax credit.

Individual Pension Plans (IPP)

New rules were introduced in the budget to combat certain planning using IPPs to circumvent the RRSP contribution limits (a greater amount can be transferred from an IPP where employment is terminated). Essentially, new shell companies would be formed with IPP by the former plan member. As such, the budget proposes that IPPs not be able to provide retirement benefits in respect of years of service under a defined-benefit plan of other than the company that established the

IPP. Assets transferred from a former employee's defined benefit plan to an IPP that relate to such service will be required to be included in the income for tax purposes of the former plan member.

Change in Use Rules for Multi-Unit Residential Properties

Where the use of an entire property is converted from personal use to income-earning, or vice versa, if an income-earning property becomes your principal residence, you can elect to not have the deemed disposition rules to occur until such time as the property is sold. However, this election is not available where only part of the property is converted. Budget 2019 proposes to extend the availability of this election to situations where only part of the property undergoes a change in use, when such change occurs on or after March 19, 2019.

Tax-Free Savings Account (TFSA)

Currently, the trustees of a TFSA (i.e., a financial institution) is jointly and severable liable with the TFSA for tax on income from a business carried on by the TFSA or from non-qualified investments. The budget proposes to extend such liability to the holder of the TFSA.

Miscellaneous

Zero emission cars – a new, temporary enhanced first year CCA rate of 100 per cent was introduced for zero-emission vehicles.

Support for Canadian journalism – effective January 1, 2020, Qualified Canadian Jour-

Journalism Organizations will be allowed to register for tax-exempt status as qualified donees that can issue charitable receipts. The activities must relate exclusively to journalism, be controlled by arm's length persons, in addition to other conditions. Retroactive to January 1, 2019, certain organizations will be eligible for a 25 per cent refundable tax credit on remuneration paid to eligible newsroom employees (capped at \$55,000 per year per employee).

Canada Training Credit – a new credit was introduced to provide financial support for professional development and training for working Canadians age 25 to 65. One can accumulate \$250 per year in a notional

account to cover eligible training costs (starting in 2019) and claim the credit starting for the 2020 taxation year.

Digital Subscriptions Tax Credit – a 15 per cent non-refundable tax credit on up to \$500 costs for eligible digital subscriptions per year (resulting in a maximum credit of \$75 annual credit) is available for amounts paid to a Qualified Canadian Journalism Organization for a subscription to digital form content of such organization, provided that such organization is primarily engaged in producing written content (i.e. a subscription with a broadcaster will not qualify). This credit is available for amounts paid after 2019 and before 2025.

Medical Expense Tax Credit— Cannabis – amounts paid for cannabis products may be eligible for a medical expense tax credit where the product is purchased for medical purposes.

Excise Tax – Cannabis - Edible cannabis, cannabis extracts and cannabis topicals will be subject to an excise tax based on the quantity of THC contained in the final product, equivalent to \$0.01 per milligram of total THC, effective May 1, 2019.

The initiative to develop new proposals for more efficient transfers continues. Budget 2019 specifically mentions Canadian farmers and fishers, but also added that this initiative may also apply to other types of business owners. □