ORDRE DES COMPTABLES PROFESSIONNELS AGRÉÉS DU QUÉBEC

2018 FEDERAL BUDGET SUMMARY

February 27

PSB BOISJOLI

TABLE OF CONTENTS

Introduction
Personal Income Tax Measures
Business Income Tax Measures
International Taxation
Sales and Excise Tax Measures
Proposed Consultations on Tax Measures
Previously Announced Measures
Other Measures
Appendix
Notice to users

INTRODUCTION

Finance Minister Bill Morneau today tabled Budget 2018 on February 27. This budget includes few personal income tax measures, precision on passive investment income and no measures to facilitate transfer of family businesses.

Here are the highlights of the 2018 budget.

PERSONAL INCOME TAX MEASURES

Canada Workers Benefit

Enhancement

The budget proposes to rename the Working Income Tax Benefit program to the Canada Workers Benefit. It also proposes that, for 2019, the amount of the benefit be equal to 26 per cent 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). 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.

In the appendix are presented two charts showing the proposed enhancement of the Canada Workers Benefit in 2019 for a single individual without dependants and the same for families.

The budget also 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. The reduction rate of the supplement will be decreased to 12 per cent to match the proposed rate for the basic benefit, and to 6 per cent where both partners in a family are eligible for the supplement.

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.

It is important to note that thresholds will be modified for Québec residents.

Improving Access

If an individual does not claim the benefit, they currently cannot obtain it even if they would otherwise qualify.

The budget proposes to allow the Canada Revenue Agency (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.

This measure will apply in respect of income tax returns for 2019 and subsequent taxation years.

Medical Expense Tax Credit – Eligible Expenditures

The budget proposes to expand the medical expense tax credit 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).

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 and there is no 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.

The budget proposes to extend the temporary measure by five years, 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.

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

The budget will 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. In this regard, the Government of Québec announced on November 21, 2017 that the enhanced portion of employee CPP and QPP contributions will be deductible for Québec income tax purposes.

Since contributions to the enhanced portion of the QPP will begin to be phased in starting in

2019, this measure will apply to the 2019 and subsequent taxation years.

Child Benefits

Retroactive Eligibility of Foreign-Born Status Indians

The budget proposes that foreign-born status Indians residing legally in Canada who are neither Canadian citizens nor permanent residents 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.

This amendment applies from the 2005 taxation year to June 30, 2016.

Charities – Miscellaneous Technical Issues

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 *Income Tax Act* (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."

In some circumstances, a charity may not be able to locate an eligible donee that is willing or able to assume ownership of one or more of its assets.

The budget proposes 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.

This measure will apply to transfers made on or after February 27, 2018.

Universities Outside Canada

Canadians may claim the charitable donation tax credit or deduction for donations made to registered charities and other "qualified donees," including universities outside Canada.

In 2011, the ITA was amended so that universities outside Canada are required to register with the CRA and to meet certain receipting and record-keeping conditions.

However, the budget proposes to remove the requirement that universities outside Canada be prescribed in the *Income Tax Regulations*.

This measure will apply as of February 27, 2018.

Mineral Exploration Tax Credit for Flow-Through Share Investors

The Government proposes to 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. Under the existing "look-back" rule, funds raised in one calendar year with the benefit of the credit can be spent on eligible exploration up to the end of the following calendar year. Therefore, for example, funds raised with the credit during the first three months of 2019 can support eligible exploration until the end of 2020.

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 of income. 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.

The budget 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. This information would be used to help the 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.

Exceptions to the additional reporting requirements are proposed for the following types of trusts:

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

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

Penalties

The budget proposes to 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. The additional penalty will be equal to five per cent of the maximum fair market value of property held during the relevant year by the trust, with a minimum penalty of $2,500. As well, existing penalties will continue to apply.

The new penalties will apply in respect of returns required to be filed for the 2021 and subsequent taxation years.

BUSINESS INCOME TAX MEASURES

Passive Investment Income

The budget proposes two measures, applicable to taxation years that begin after 2018, to limit tax deferral advantages on passive investment income earned inside private corporations.

Business Limit

The budget proposes to reduce the business limit for CCPCs (and their associated corporations) that have significant income from passive investments.

Under the proposal, if a corporation and its associated corporations earn more than $50,000 of passive investment income in a given year, the amount of income eligible for the small business tax rate would be gradually reduced.

It is proposed that the small business deduction limit be reduced by $5 for every $1 of investment income above the $50,000 threshold. Thus, the business limit would be reduced to zero at $150,000 of investment income.

The business limit reduction under this measure will operate alongside the business limit reduction that applies in respect of taxable capital in excess of $10 million. The reduction in a corporation's business limit will be the greater of the reduction under this measure and the existing reduction based on taxable capital.

Business Limit – 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" 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.

Adjusted aggregate investment income will not include income that is incidental to an active business.

Refundability of Taxes on Investment Income

The second measure will limit tax advantages that larger CCPCs can obtain by accessing refundable taxes on the distribution of certain dividends.

In practice, however, any taxable dividends paid by a private corporation can trigger a refund of taxes paid on investment income, regardless of the source of that dividend (i.e., whether coming from investment income or lower-taxed active business income).

To better align the refund of taxes paid on passive income with the payment of dividends sourced from passive income, the budget proposes that a refund of RDTOH be available only in cases where a private corporation pays non-eligible dividends. Thus, no RDTOH refund will be available regarding eligible dividends. However, an exception will be provided in respect of RDTOH that arises from eligible portfolio dividends received by a corporation, the corporation will then 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 ITA 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.
> The current RDTOH account (which will now be referred to as non-eligible RDTOH) will track refundable taxes paid under Part I of the ITA 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.

RDTOH Recapture – Connected Corporations

Under this measure, the corporation receiving a dividend from a connected corporation will continue to pay an amount of Part IV tax equal to the refund obtained by the payor corporation. This amount, however, will be added to the RDTOH account of the recipient corporation that matches the RDTOH (eligible or non-eligible) account from which the payor corporation obtained its refund.

RDTOH Refunds – Ordering Rule

Upon the payment of a non-eligible dividend, a private corporation will be required to obtain a refund from its non-eligible RDTOH account before it obtains a refund from its eligible RDTOH account.

Application – First taxation year beginning after 2018

An 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, if any, 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

Under the capital cost allowance regime, Classes 43.1 and 43.2 of Schedule II to the *Income Tax Regulations* provide accelerated capital cost allowance rates (30 per cent and 50 per cent, respectively, on a declining-balance basis) for investments in specified clean energy generation and conservation equipment.

The budget proposes to extend eligibility for Class 43.2 by five years so that it is available in respect of property acquired before 2025.

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 employees. The tax treatment of such a trust is not explicitly set out in the ITA. Since 1966, 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 *Employee Life and Health Trust* rules were added to the ITA in 2010. The *Employee Life and Health Trust* rules in the ITA are very similar to the CRA's administrative positions for *Health and Welfare Trusts.* However, the *Employee Life and Health Trust* legislation explicitly deals with certain issues that are not dealt with in the administrative *Health and Welfare Trust* regime.

In order to provide more certainty for taxpayers and greater consistency in the tax treatment of such arrangements, the budget proposes that only one set of rules apply to these arrangements. As such, the CRA will no longer apply their administrative positions with respect to *Health and Welfare Trusts* after the end of 2020. To facilitate the conversion of existing *Health and Welfare Trusts* to *Employee Life and Health Trusts*, transitional rules will be added to the ITA. 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. In addition, the CRA will not apply its administrative positions with respect to *Health and Welfare Trusts* to trusts established after February 27, 2018 and will announce transitional administrative guidance relating to winding up existing *Health and Welfare Trusts*.

Stakeholders are invited to submit comments on transitional issues, both administrative and legislative, to facilitate the discontinuation of the *Health and Welfare Trust* regime. Following the consultation, the Government intends to release draft legislative proposals and transitional administrative guidance.

INTERNATIONAL TAXATION

Cross-Border Surplus Stripping using Partnerships and Trusts

To ensure that the underlying purposes of the cross-border anti-surplus-stripping rule, and the corresponding corporate immigration rule, cannot be frustrated by transactions involving partnerships or trusts, the budget 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 February 27, 2018.

Transactions that occur before February 27, 2018 may be challenged using the general anti-avoidance rule.

Foreign Affiliates

The budget proposes modifications to certain rules related to foreign affiliates.

Investment Businesses

The investment business definition applies on a business-by-business basis. Accordingly, to the extent that a single foreign affiliate carries on multiple businesses, each such business would have to meet the six employees test in order to ensure that it is not an investment business.

Certain taxpayers whose foreign investment activities would not warrant more than five full-time employees have engaged in tax planning with other taxpayers in similar circumstances seeking to meet the six employees test.

The budget proposes to introduce a rule for the purposes of the investment business definition so that, where income attributable to specific activities carried out by a foreign affiliate accrues to the benefit of a specific taxpayer under a tracking arrangement, those activities carried out to earn such income will be deemed to be a separate business carried on by the affiliate. Each separate business of the affiliate will therefore need to satisfy each relevant condition in the investment business definition, including the six employees test, in order for the affiliate's income from that business to be excluded from foreign accrual property income (FAPI).

This measure will apply to taxation years of a taxpayer's foreign affiliate that begin on or after February 27, 2018.

Controlled Foreign Affiliate Status

The budget proposes to deem a foreign affiliate of a taxpayer to be a controlled foreign affiliate of the taxpayer if FAPI attributable to activities of the foreign affiliate accrues to the benefit of the taxpayer under a tracking arrangement. This measure is intended to ensure that each taxpayer involved in such a tracking arrangement – no matter how large the group – is subject to accrual taxation in respect of FAPI attributable to that taxpayer.

This measure will apply to taxation years of a taxpayer's foreign affiliate that begin on or after February 27, 2018.

Trading or Dealing in Indebtedness – Regulated Foreign Financial Institutions

To ensure consistency with the investment business rules, the budget proposes to add a similar minimum capital requirement to the trading or dealing in indebtedness rules.

This measure will apply to taxation years of a taxpayer's foreign affiliate that begin on or after February 27, 2018.

Reassessments

The budget proposes to extend the reassessment period for a taxpayer by three years in respect of income arising in connection with a foreign affiliate of the taxpayer.

This measure will apply to taxation years of a taxpayer that begin on or after February 27, 2018.

Reporting Requirements

The budget proposes to bring the information return deadline in respect of a taxpayer's foreign affiliates in line with the taxpayer's income tax return deadline by requiring the information returns to be filed within six months (currently 15 months) after the end of the taxpayer's taxation year.

This measure will apply to taxation years of a taxpayer that begin after 2019.

Reassessment Period – Requirements for Information and Compliance Orders

The budget proposes to amend the ITA to introduce a "stop-the-clock" rule for requirements for information generally and for compliance orders. This rule will extend the reassessment period of a taxpayer by the period of time during which the requirement or compliance order is contested.

This measure will apply in respect of challenges instituted after Royal Assent to the enacting legislation.

Reassessment Period – Non-Resident Non-Arm's Length Persons

The budget proposes to provide the CRA with an additional three years to reassess a prior taxation year of a taxpayer, to the extent the reassessment relates to the adjustment of the loss carryback, where:

- a reassessment of a taxation year is made as a consequence of a transaction involving a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's length;
- the reassessment reduces the taxpayer's loss for the taxation year that is available for carryback;
- and all or any portion of that loss had in fact been carried back to the prior taxation year.

SALES AND EXCISE TAX MEASURES

GST/HST and Investment Limited Partnerships

The budget confirms the Government's intention to proceed with the proposals announced September 8, 2017 with the following changes.

First, the budget proposes to modify the September 8, 2017 proposal so that 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 administrative 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. The budget also proposes that 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.

Second, the budget proposes to 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 budget proposes to advance the existing inflationary adjustments for tobacco excise duty rates to occur on an annual basis rather than every five years.

The budget also proposes to increase the excise duty rates by an additional $1 per carton of 200 cigarettes, along with corresponding increases to the excise duty rates on other tobacco products.

Inventories of cigarettes held by manufacturers, importers, wholesalers and retailers at the end of February 27, 2018, will be subject to an inventory tax of $0.011468 per cigarette (subject to certain exemptions).

Taxpayers will have until April 30, 2018 to file returns and pay the cigarette inventory tax.

Cannabis Taxation

The budget proposes a new federal excise duty framework for cannabis products to be introduced as part of the *Excise Act, 2001*. The duty will generally apply to all products available for legal purchase, which at the outset of legalization will include fresh and dried cannabis, cannabis oils, and seeds and seedlings for home cultivation. Cannabis cultivators and manufacturers will be required to obtain a cannabis licence 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.

PROPOSED CONSULTATIONS ON TAX MEASURES

Consultations on the GST/HST Holding Corporation Rules

A Goods and Services Tax/Harmonized Sales Tax (GST/HST) rule, commonly referred to as the “holding corporation rule,” generally allows a parent corporation to claim input tax credits to recover GST/HST paid in respect of expenses that relate to another corporation.

The Government intends to consult on certain aspects of the holding corporation rule, particularly with respect to the limitation of the rule to corporations and the required degree of relationship between the parent corporation and the commercial operating corporation.

Consultation documents and draft legislative proposals regarding these issues will be released for public comment in the near future.

PREVIOUSLY ANNOUNCED MEASURES

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

- Measures confirmed in Budget 2016 relating to the Goods and Services Tax/Harmonized Sales Tax joint venture election;
- Income tax measures announced in Budget 2016 expanding tax support for electrical vehicle charging stations and electrical energy storage equipment;
- The income tax measure announced in Budget 2016 on information-reporting requirements for certain dispositions of an interest in a life insurance policy;
- Technical income tax legislative amendments released on September 16, 2016, relating to a division of a corporation under foreign laws, and to the requirements to qualify as a prescribed share;
- The income tax measure announced in Budget 2017 to support the establishment of a tax-exempt Memorial Grant for First Responders (the Community Heroes benefit);
- The income tax measure announced on May 18, 2017 for additional tax relief for Canadian armed forces personnel and police officers;
- Remaining legislative and regulatory proposals released on September 8, 2017 relating to the Goods and Services Tax/Harmonized Sales Tax;

> The income tax measure announced on October 16, 2017 to lower the small business tax rate from 10.5 per cent to 10 per cent, effective January 1, 2018, and to 9 per cent, effective January 1, 2019, which was included in a Notice of Ways and Means Motion tabled on October 24, 2017 along with related amendments to the gross-up amount and dividend tax credit for taxable dividends;
> The income tax measure announced on October 24, 2017 in the Fall Economic Statement to provide for the indexing of the Canada Child Benefit amounts as of July 1, 2018 instead of July 1, 2020; and
> Income tax measures released on December 13, 2017 to address income sprinkling.

The budget also reaffirms the Government's commitment to move forward as required with technical amendments to improve the certainty of the tax system.

OTHER MEASURES

To make Canada's tax system more fair:

> The Government proposes to improve existing anti-avoidance rules meant to prevent a small group of taxpayers, typically Canadian banks and other financial institutions, from gaining a tax advantage by creating artificial losses that can be used against other income through the use of sophisticated financial instruments and structured share repurchase transactions.
> The Government also proposes to clarify the application of certain rules for limited partnerships in order to prevent taxpayers from obtaining unintended tax advantages through the use of complex partnership structures.

APPENDIX

Chart 1 shows the proposed enhancement of the Canada Workers Benefit in 2019 for a single individual without dependants and Chart 2 shows the same for families.

Chart 1

Enhanced Canada Workers Benefit — 2019 Taxation Year (Single Individuals without Dependants)

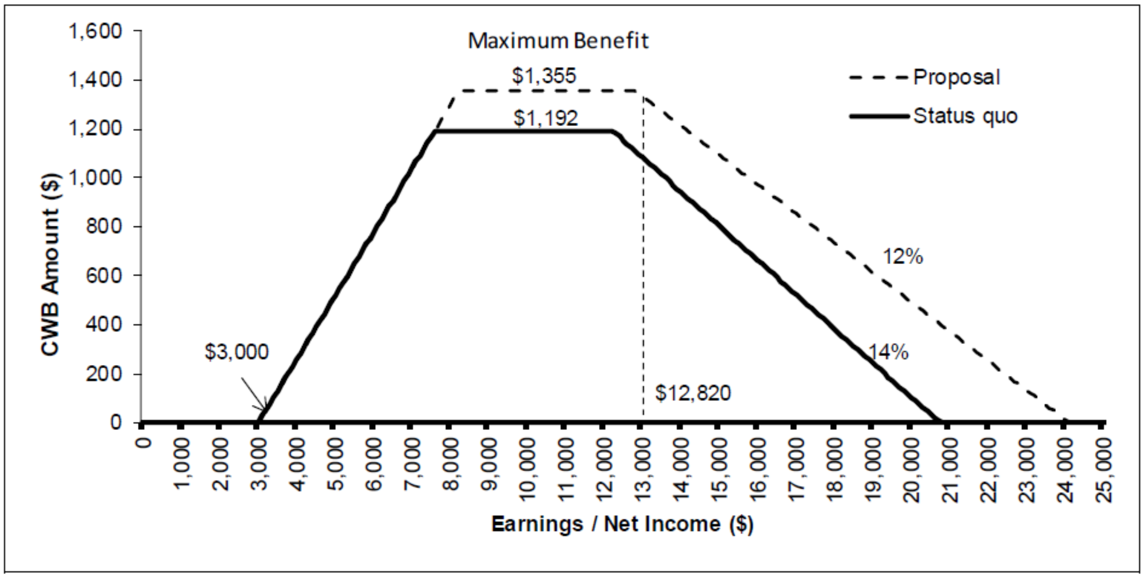
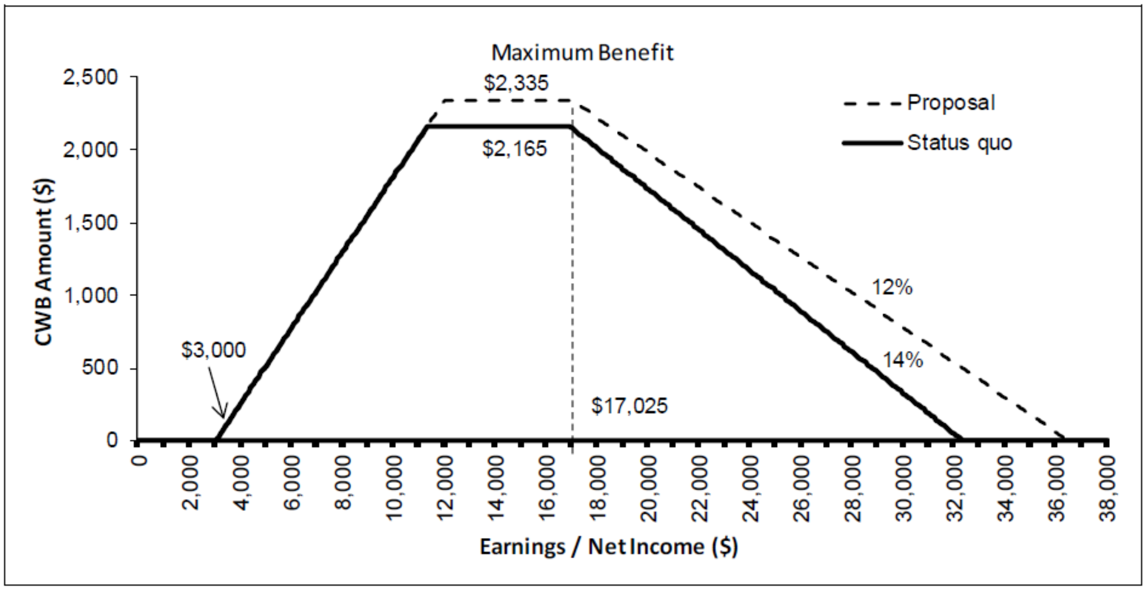


Chart 2

Enhanced Canada Workers Benefit — 2019 Taxation Year (Single Parents and Couples)



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