TD Wealth

Federal Budget 2018

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Clarifying taxation of private corporations and new trust reporting rules

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On February 27, 2018, Federal Finance Minister Bill Morneau tabled the 2018 Federal Budget. The Budget provides clarity around an array of issues, including the taxation of passive income within private corporations. It introduces measures to close tax "loopholes" involving certain investments, and also advances the federal government's social agenda by addressing gender equality, parental leave, and support for indigenous people and Canadian workers.

Business Income Tax Measures

Passive Investment Income

One of the most anticipated 2018 Federal Budget measures is related to the taxation of passive investment income earned within private corporations. A Canadian-controlled private corporation (CCPC) can benefit from a corporate income tax rate on qualifying active business income that is lower than the general corporate income tax rate. The policy rationale for this lower tax rate is to leave CCPCs with more retained earnings to reinvest in their active businesses. However, those earnings can also be used to finance passive investments. The federal government has described this as an unfair tax advantage not available to the average taxpayer. This issue was the subject of public consultations launched in July 2017.

> The 2018 Budget contains two measures applicable to taxation years that begin after 2018, which propose to limit tax deferral advantages on passive investment income earned inside private corporations.

The first proposed measure will reduce the small business deduction on qualifying business income for CCPCs (and their associated corporations) that is eligible for a lower tax rate based on the amount of passive investment income generated. Under this measure, the small business deduction will be reduced on a "straight-line" accounting method of computing depreciation and amortization for CCPCs having between $50,000 and $150,000 in annual investment income. It is proposed that the small business deduction be reduced by $5 for every $1 of investment income above the $50,000 threshold (equivalent to $1 million in passive investment assets at a 5% return), such that the business limit would be reduced to zero at $150,000 of investment income (equivalent to $3 million in passive investment assets at a 5% return).

Under this proposal, the corporation taxation of investment income remains unchanged — refundable taxes and dividend tax rates will remain the same.

The second measure addresses the refundability of taxes on investment income. Currently, refundable taxes on investment income of private corporations attempts to tax income from passive investments at approximately the top personal income tax rate while that income is retained in the corporation.

The 2018 Budget proposes an updated approach for dealing with the recovery of refundable dividend tax on hand (RDTOH) and the payment of eligible and non-eligible dividends. The new approach involves the creation of eligible and non-eligible notional RDTOH accounts. The budget proposes transitional measures for allocation of existing RDTOH balances for CCPC's between the two new accounts.

If you own a private corporation, talk to your TD advisor about ways to effectively invest the income. Review your tax planning strategies with your tax advisor to help ensure your company is compliant with the new rules.

Artificial Losses Using Equity-Based Financial Arrangements

The 2018 Budget proposes to expand the existing synthetic equity arrangement and securities lending arrangement (SLA) rules with the intention to prevent taxpayers from realizing artificial tax losses through the use of equity-based financial arrangements to circumvent these rules. The proposed amendments to the SLA rules will apply to compensation payments using dividends that are made on or after Budget Day unless the securities lending arrangement was in place before Budget Day, in which case the amendments will apply to dividend compensation payments that are made after September 2018.

Mineral Exploration Tax Credit for Flow-Through Share Investors

The Budget 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.

Personal Income Tax Measures

Registered Disability Savings Plan – Qualifying Plan Holders

Where the capacity of an adult individual to enter into a contract is in doubt, the *Income Tax Act* requires 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. 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. The 2018 Budget proposes to extend the existing 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 Quebec Pension Plan

On November 2, 2017, the Government of Quebec announced that the Quebec Pension Plan (QPP) would be enhanced in a manner similar to the enhancement of the Canada Pension Plan (CPP) that was announced in 2016. To provide consistent income tax treatment of CPP and QPP contributions, the 2018 Budget proposes to amend the *Income Tax Act* 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 the 2019 and subsequent taxation years.

Reporting Requirements for Trusts

To improve the collection of beneficial ownership information with respect to trusts, the 2018 Budget introduces enhanced income tax reporting requirements for certain trusts to provide additional information on an annual basis, applicable for 2021 and subsequent taxation years.

These changes, which include a requirement to disclose trustees, beneficiaries, settlors and protectors of certain trusts, will create a T3 filing requirement for certain trusts that do not currently file a T3 return. Exceptions to the additional reporting requirements include:

- 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).

Medical Expense Tax Credit

The Medical Expense Tax Credit (METC) is a 15% non-refundable tax credit that recognizes the effect of above-average medical and disability related expenses on an individual's ability to pay tax. For 2018, the METC is available for qualifying medical expenses in excess of the lesser of $2,302 and 3% of the individual's net income.

The 2018 Budget proposes to 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). This measure will apply in respect of eligible expenses incurred after 2017.

Final Notes

The 2018 Budget confirms that the federal government will proceed with several previously announced measures. For example, on October 16, 2017 the federal government announced measures to lower the small business tax rate from 10.5% to 10% on January 1, 2018 and to 9% on January 1, 2019.

The Budget also reflects the federal government's commitment to move forward with amendments to improve the certainty of the tax system.

Talk to your TD advisor and your tax advisor about how the Federal Budget proposals may impact your circumstances.