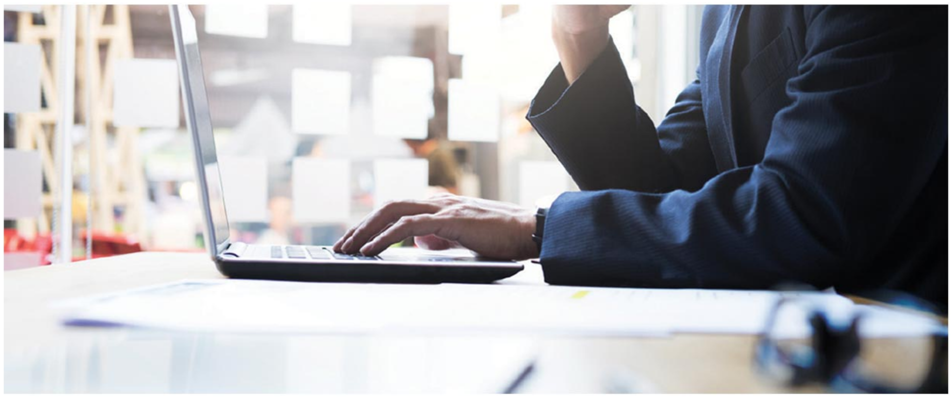
NetWorth



2018 Federal Budget Review

On February 27, Finance Minister Bill Morneau unveiled the Liberal government's third Federal Budget entitled "Equality + Growth: A Strong Middle Class" which continues with many of the themes of previous budgets, including an undertaking of a gender-based analysis in developing any budget proposals.

Consistent with previous years, the Budget highlights innovation, gender equality – including the introduction of a new EI Parental Sharing Benefit – and tax fairness and integrity. With regards to the latter items, the Budget outlined the government's continued focus on eliminating perceived unfair tax advantages for some and introduced measures to improve the efficiency, certainty and fairness of the tax system. In addition, the government has taken further steps in this Budget to strengthen the Canada Revenue Agency's (CRA) ability to crack down on tax evasion and combat tax avoidance, particularly as it relates to international transactions.

From a personal and small business tax perspective, which is the focus of this review, the Budget did not propose any changes to personal or corporate tax rates. Notably, as expected, the government introduced important changes to the tax treatment of passive income earned in Canadian private corporations. However, these changes to private corporations and their shareholders are simpler and more targeted than originally envisioned in the government's July 2017 consultation paper and subsequent announcements. The personal tax measures proposed in the Budget were minor in comparison, consisting primarily of slight tweaks to certain existing tax credits.

The most significant income tax measures affecting individuals and Canadian private companies are summarized below. Note that the measures introduced are only proposals at this stage and may not ultimately be enacted into law. Readers are cautioned to consult with their tax advisors for specific advice on how they may be affected by these proposals.

Let's connect

Brooks Barks Wealth Advisory
River Center 475 2nd Ave S., 3rd Floor
Saskatoon, SK
S7K 1P4

Tel.: 306-343-3694
Toll Free: 1-800-667-2633
Fax: 306-653-7227

www.bbwa.ca

Continued

Summary of Personal Income Tax Proposals

The most significant personal tax proposals from the 2018 Federal Budget include the following:

- strengthening the existing Working Income Tax Benefit (WITB), which is a refundable tax credit that supplements the earnings of low-income workers. The renamed "Canada Workers Benefit" will be more generous and also more accessible;
- expanding the medical expense tax credit to include certain additional expenses after 2017 in respect of a specially trained animal to assist patients with severe medical impairments;
- extending (to 2023) the existing temporary federal measure which allows a qualifying family member to be the plan holder of an RDSP for an individual with capacity issues;
- further extending the eligibility for the mineral exploration tax credit for an additional year, to flow-through share agreements entered into on or before March 31, 2019; and
- providing a federal tax deduction for employee contributions to the enhanced portion of the Quebec Pension Plan, effective for the 2019 and subsequent taxation years.

Proposals Affecting Canadian Private Companies

Holding Passive Investments Inside a Private Corporation

A much anticipated tax measure expected in the 2018 Federal Budget was the release of detailed draft legislation affecting private corporations holding passive investments. Proposed measures, first introduced as part of a more comprehensive consultation paper released in July 2017, seek to limit the tax deferral advantage that can be achieved if after-tax profits of an active business are retained within a private corporation.

Active business income earned by private corporations is taxed at corporate income tax rates that are generally lower than personal income tax rates. In addition, a Canadian-controlled private corporation (CCPC) can benefit from a reduced corporate income tax rate (achieved through a small business deduction) on qualifying active business income that is lower than the general corporate income tax rate. Where funds invested passively within a private corporation have been financed with retained earnings that have been taxed at preferential corporate active business income tax rates, owners of the corporation can benefit from a tax deferral advantage relative to a situation where the corporation distributes its retained earnings and the owners invest personally in passive investments.

As part of these initial July 2017 proposals, complex measures were contemplated to alter the taxation of corporate passive income and the refundable tax system under current tax legislation. In the course of consultations, the government heard that its proposals could be very complex and would add significant administrative burdens to Canadian businesses. In response to these concerns, the government introduced two new measures in the Budget to limit tax deferral advantages from holding passive investments in a corporation, but in a more targeted and simpler manner than was originally proposed, as follows:

Business Limit Reduction

As noted above, small businesses benefit from a reduced federal corporate income tax rate of 10 per cent – a preference relative to the general federal corporate income tax rate of 15 per cent – on the first $500,000 per year of qualifying active business income of a CCPC (which is shared amongst associated CCPCs). Access to the lower tax rate is phased out on a straight-line basis for associated CCPCs having between $10 million and $15 million of aggregate taxable capital employed in Canada.

The first measure proposed in the Budget seeks to limit the ability of businesses with significant passive investments to benefit from this preferential small business tax rate. Rather than remove or alter access to the refundable taxes (on passive income earned in a CCPC) as originally proposed in July 2017, the alternative proposed approach outlined in the Budget will gradually reduce access to the small business tax rate for corporations that have significant passive investment income. As such, the Budget introduces an additional eligibility mechanism for the small business deduction, based on the level of the corporation's passive investment income.

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 lower small business tax rate will be gradually reduced. Specifically, the Budget proposes that the small business deduction limit be reduced by $5 for every $1 of aggregate investment income above the $50,000 threshold, such that the business limit (of $500,000) would be reduced to zero at $150,000 of investment income.

The $500,000 business limit reduction under this new measure will operate alongside the business limit reduction that applies in respect of taxable capital outlined above. In particular, the reduction in a corporation's business limit will be the greater of the reduction under this new measure and the existing reduction based on taxable capital.

For the purpose of determining the reduction of the business limit under this additional method, 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. Notably, dividends from non-connected corporations will be added whereas capital gains realized from the sale of active investments, investment income incidental to the business, and net capital losses applied from other taxation years will not be taken into account in the measurement of passive investment income for purposes of this calculation.

Continued

Limiting Access to Refundable Taxes

The second proposed measure will limit perceived tax advantages that some CCPCs can currently obtain by accessing refundable taxes on the distribution of certain dividends. The tax system is designed to tax passive investment income earned by private corporations at a higher rate than active business income, roughly equivalent to the top personal income tax rate, and to refund a portion of that tax when investment income is paid out to shareholders as a divided taxed personally.

Currently, however, any taxable dividends paid by a private corporation triggers a refund of taxes paid on investment income, regardless of the source of that dividend (i.e., whether derived from investment income or lower-taxed active business income). This means that larger CCPCs can pay out lower-taxed (eligible) dividends from their pool of active income taxed at the lower general corporate rate, and still claim a refund of taxes paid on their investment income distributed. As these amounts distributed are intended to be taxed at higher personal tax rates, a tax deferral advantage can arise.

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 the refundable tax will only be available where a private corporation pays (higher-taxed) non-eligible dividends. However, an exception will be provided in respect of refundable tax that arises from eligible portfolio dividends received by a corporation.

The two measures outlined above will apply to taxation years that begin after 2018 and anti-avoidance rules will apply to prevent transactions designed to avoid these measures. Transitional rules are proposed for existing refundable tax balances and tracking of separate refundable tax accounts will be required once implemented.

Other Notable Measures

Trusts – Expanded Reporting Requirements (Beneficial Ownership)

The Budget proposes to introduce enhanced income tax reporting requirements for certain trusts to provide additional information on an annual basis, effective for the 2021 and subsequent tax years. The new reporting requirements will impose an obligation on certain trusts to file a T3 return where one does not currently exist, and to report the identity of all trustees, beneficiaries and settlors of the trust. The new reporting requirements will apply to "express trusts" (i.e. generally a trust created with the settlor's express intent) that are resident in Canada and to non-resident trusts that are currently required to file a T3 return, with certain exceptions proposed for specific types of trusts.

Health and Welfare Trusts

Health and Welfare Trusts (HWT) and Employee Life and Health Trusts (ELHTs) are both arrangements established by employers for the purpose of providing health benefits to their employees. With the aim of providing more certainty for taxpayers and greater consistency in the tax treatment of these plans, 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 HWTs after the end of 2020 and transitional rules will be introduced to facilitate the conversion of HWTs to ELHTs.

Please see our "2018 Federal Budget Review" for more information on these and other budget proposals. For guidance in your particular situation, please consult with your tax advisor.

Appointing an Executor

In some Wills, the appointment of an executor is conditional upon a survivorship period, for example, thirty days. In many circumstances, this may be legally problematic since it leaves the deceased's body, and the estate assets, without an authorized executor to make decisions and act. Immediately upon death, it is necessary for someone to make decisions and make burial arrangements. If there is no authorized executor (due to the survivorship period), it may be necessary for someone to apply to court to be granted that authority. Such a proceeding is costly and time consuming. It is also necessary within a short time after death for someone to have authority to pay the funeral expenses and other estate expenses from estate assets. It is necessary for someone to have the authority to retain a lawyer to commence the probate process and to communicate with next of kin regarding all matters – burial and financial. Therefore, the appointment of the executor in a Will should not be subject to a survivorship period.

Continued

Did You Know?

Intestacy, which means dying without a valid Will, should be avoided. Regardless of the level of wealth, on an intestacy, the administration and distribution of an estate brings with it long delays, increased court costs, additional legal fees, tax inefficiency, and, grief for heirs and loved ones.

In British Columbia, Nova Scotia and Ontario, the actual distribution of an intestate estate may not be made until a prescribed time has passed from date of death. For example, the Ontario Succession Law Reform Act, section 26, states that no distribution shall be made on an intestacy until after one year from the death of the intestate. The British Columbia Wills Estates and Succession Act, section 155, provides for a hold period of 210 days from date of receipt of the Representation Grant (which may take a few months from date of death to obtain). However, with written consent from the beneficiaries (where there is a Will), or, with written consent from heirs (on an intestacy), or, with court approval on an intestacy, a distribution can be made prior to the expiration of the 210 days from date of the Representation Grant. The Nova Scotia Probate Act, subsection 70(2), states that the personal representative shall distribute at the expiry of 12 months."

While the Ontario and Nova Scotia hold period is expressly one year from date of death, the British Columbia hold period is 210 from date of Representation Grant (subject to consents, as discussed above). Obtaining the Representation Grant is a process that can take several months, so, in addition to the 210 days, the wait period can be as long (or longer) than a year, particularly in circumstances involving an intestacy. Thus in general terms, in these three provinces there is a statutory hold period for approximately a year, on an intestacy. This means that no distribution of assets can take place until the hold period expires. It may or may not be a coincidence that in these three provinces the probate tax rate is highest among all the provinces in Canada. The hold period therefore allows the respective provincial governments more time to scrutinize and assess (and perhaps reassess) the probate tax owning by the intestate estate.

BMO Wealth Management
BMO Nesbitt Burns

BrooksBarks
Wealth Advisory