NetWorth

2019 Federal Budget Review

On March 19, Finance Minister Bill Morneau unveiled the Liberal Government's fourth Federal Budget entitled "Investing in the Middle Class". The key themes of the Budget include housing, training, pharmacare, secure retirement and tax fairness and integrity.

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. Notable personal tax measures proposed in the Budget include the introduction of additional annuity options for registered plans, restrictions on certain transfers of commuted pension values to Individual Pension Plans, and a proposed future annual cap of $200,000 on employee stock option grants that would receive the current tax-preferred treatment.

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.

Summary of Personal Income Tax Proposals

Canada Training Credit

In order to encourage Canadians to enhance their skills to succeed in today's marketplace, Budget 2019 proposes to introduce the Canada Training Credit to address barriers to professional development for working Canadians. This new refundable tax credit aims to

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provide financial support to help cover up to half of eligible tuition and fees associated with training. Eligible individuals between the ages of 25 to 64 can accumulate $250 each year in a notional account, to a lifetime limit of $5,000, which can be accessed for this purpose. The annual accumulation to the notional account will start based on eligibility in respect of the 2019 taxation year and the credit will be available to be claimed for expenses in respect of the 2020 taxation year.

Home Buyers' Plan (HBP) Enhancements

In order to provide first-time home buyers with greater access to their RRSPs to purchase or build a home, Budget 2019 proposes to increase the HBP withdrawal limit to $35,000 from $25,000. Budget 2019 also proposes to extend access to the HBP in order to help Canadians maintain homeownership after the breakdown of a marriage or common-law partnership. This measure will apply to HBP withdrawals made after 2019, whereas the increase in the HBP withdrawal limit will apply to the 2019 and subsequent calendar years in respect of withdrawals made after Budget Day.

Registered Plans – Annuities

The tax rules allow funds from certain registered plans to be used to purchase an annuity to provide income in retirement, subject to specified conditions. In exchange for a lump-sum amount of funds, an annuity provides a stream of periodic payments to an individual (i.e., the annuitant), generally for a fixed term, for the life of the annuitant or for the joint lives of the annuitant and the annuitant's spouse or common-law partner.

To provide Canadians with greater flexibility in managing their retirement savings, Budget 2019 proposes to permit two new types of annuities under the tax rules for certain registered plans. Firstly, an advanced life deferred annuity (ALDA) will be introduced, which will be a life annuity, the commencement of which may be deferred until the end of the year in which the annuitant attains 85 years of age. Secondly, the Budget proposes to allow pooled registered pension plans and defined contribution registered pension plans to provide a variable payment life annuity (VPLA) directly from the plan. A VLPA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants. These measures will apply to the 2020 and subsequent taxation years.

Registered Disability Savings Plans (RDSP)

Budget 2019 proposes to i) remove the time limitation on the period that an RDSP may remain open after a beneficiary becomes ineligible for the Disability Tax Credit and ii) to eliminate the requirement for medical certification that the beneficiary is likely to become eligible for the DTC in the future in order for the plan to remain open.

Budget 2019 also proposes to exempt RDSPs from seizure in bankruptcy, with the exception of contributions made in the 12 months before the filing.

Employee Stock Options

Current tax rules provide employee stock options with preferential personal income tax treatment in the form of a stock option deduction. This effectively results in the income tax benefit realized being taxed at a rate equal to one half of the normal personal tax rate applicable to other forms of employment income, effectively resulting in the same preferential tax rate as capital gains.

In the 2019 Budget, the Government noted that it does not believe that employee stock options should be used as a tax-preferred method of compensation for employees of large, mature companies. In light of this policy rationale, the Government intends to move forward with changes to limit the benefit of the employee stock option deduction for high-income individuals employed at large, long-established, mature firms.

Specifically, the Government intends to apply a $200,000 annual cap on employee stock option grants (based on the fair market value of the underlying shares) that may receive the current tax-preferred treatment for employees of large, long-established, mature firms. However, for start-ups and rapidly growing Canadian businesses, it is intended that the current tax-preferred treatment of employee stock option benefits would remain uncapped.

The Budget did not outline the distinction between the types of firms identified above, however the Government stated that further details of this measure will be released before the summer of 2019. The Budget commentary also indicated that any changes would apply on a go-forward basis only and would not apply to employee stock options granted prior to the announcement of legislative proposals to implement any new regime.

Proposals Affecting Canadian Businesses

Support for Canadian Journalism

To provide support for Canadian journalism, the Budget proposes to introduce three new tax measures:

- allowing journalism organizations to register as qualified donees;
- a refundable labour tax credit for qualifying journalism organizations; and
- a temporary non-refundable tax credit for subscriptions to Canadian digital news.

Scientific Research and Experimental Development Program (SR&ED)

Under the SR&ED tax incentive program, qualifying expenditures are fully deductible in the year they are incurred and potentially eligible for an investment tax credit. The rate and level of refundability of the credit vary depending on the characteristics of the business, including its legal status and its size.

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However, the Budget proposes to repeal the use of taxable income as a factor in determining the phase-out of the annual expenditure limit for a Canadian Controlled Private Company (CCPC) for the purpose of the enhanced SR&ED tax credit. As a result, small CCPCs with taxable capital of up to $10 million will benefit from unreduced access to the enhanced refundable SR&ED credit regardless of their taxable income.

This measure will apply to taxation years that end on or after Budget Day.

Inter-generational Transfers of Businesses

The Government confirmed in the Budget documents that it will continue to reach out to farmers, fishers and other business owners throughout 2019 to develop new proposals to better accommodate intergenerational transfers of businesses while protecting the integrity and fairness of the tax system.

Other Notable Proposals

Integrity Measures

In each of its previous three budgets, the Government has introduced tax measures intended to maintain the integrity of Canada's tax system as well as to ensure tax rules function as intended and do not result in unfair tax advantages. Budget 2019 continues this approach by proposing further integrity measures that are intended to:

- Prevent the use by mutual fund trusts of a method of allocating capital gains or income to their redeeming unitholders where the use of that method inappropriately defers tax or converts fully taxable ordinary income into capital gains taxed at a lower rate;
- Improve existing rules meant to prevent taxpayers from using derivative transactions to convert fully taxable ordinary income into capital gains taxed at a lower rate;
- Ensure fairness by extending the joint and several liability for tax owing on income from carrying on a business in a TFSA, to the TFSA holder; and
- Stop the use of individual pension plans to avoid the prescribed transfer limits.

Charitable Giving

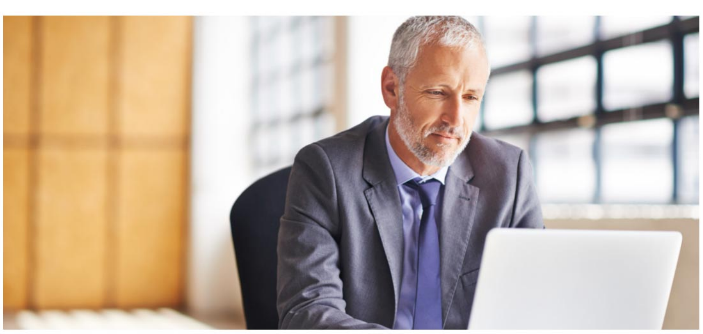
Donations of Cultural Property

Budget 2019 proposes to amend the Income Tax Act and the Cultural Property Export and Import Act to remove the requirement that property be of "national importance" in order to qualify for the enhanced tax incentives for donations of cultural property, effective for donations made on or after Budget Day.

Please see our "2019 Federal Budget Review" for more information on these and other budget proposals. For guidance in your particular situation, please consult with your tax advisor.

Planning For Your Income Tax Refund

For many Canadians spring signals the arrival of their income tax refund from the Canada Revenue Agency (the "CRA") or Revenu Québec ("RQ"), if you also file your taxes in Quebec. If you're receiving a tax refund based on your 2018 income tax return, it may be worthwhile meeting with your BMO financial professional to discuss how you can maximize the use of these funds, such as repaying non-deductible debt, or catching up on your Registered Retirement Savings Plan ("RRSP"), Tax-Free Savings Account ("TFSA"), or Registered Education Savings Plan ("RESP") contributions.



Notice of Assessment

The CRA's stated goal is to issue a Notice of Assessment, including any applicable refund, within two weeks of receiving an electronically filed tax return, or eight weeks after receiving a paper filed return. To check the status of your federal tax refund, you can use the My Account or MyCRA service, or call CRA's Telerefund phone service. However, the CRA suggests waiting eight weeks after filing your return before calling to obtain an update on the status of your refund.

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If you also filed a Quebec personal tax return, note that Revenu Québec generally processes paper returns in four to six weeks, but electronically filed returns may be processed within 14 business days. However, RQ advises to wait at least four weeks after filing your return before contacting them about the status of your refund.

From a tax perspective, ensure that you take the time to review your Notice of Assessment with your tax advisor to determine if the CRA or RQ made any adjustments to your filed tax return. It is important to review the Assessment once available to understand any changes, since there are specific time limits to object or dispute an Assessment.

Use your tax refund wisely

If you receive an income tax refund, consider the following strategies in order to maximize the benefit of your refund to your overall wealth planning:

Make a contribution to your RRSP/TFSA – If you have unused RRSP contribution room, build your retirement savings by making an RRSP contribution. By making your 2019 RRSP contribution now, instead of waiting until the deadline next year, it will allow you to benefit from several more months of tax-deferred growth. The maximum RRSP contribution limit for 2019 is $26,500. Alternatively, topping up your TFSA contribution now will also enable you to grow your money tax-free for a longer period of time. The annual TFSA contribution limit was increased for 2019 to $6,000.

Manage credit card debt – Pay down credit card debt, beginning with those cards that carry the highest interest rate. Going forward, consider using a credit card with a low interest rate for purchases, and try to pay more than the minimum payment due, if not the balance in full, every month.

Make a lump sum mortgage payment – If you have a mortgage, check the terms of your mortgage and consider using your tax refund to make a lump sum payment. Applied directly to your principal, a lump sum payment could save you significant money in interest costs over the life of your mortgage.

Build an emergency fund – Having money set aside in case of an emergency is not only a good financial strategy, but also helps you sleep easier at night. A good rule of thumb is to have at least three months' salary saved as a safety net. If you feel your job might be at risk, or if you are self-employed, six months is a better cushion. Your emergency fund should be easily accessible and it should be kept separate from your day-to-day bank account; perhaps in a high-interest savings account or in a TFSA.

Save for your child's education – A post-secondary education is becoming increasingly expensive. Contributing to a RESP can help alleviate some of the pressure that all parents feel when planning for their children's future education. Consider opening or contributing to an RESP using your income tax refund. A $2,500 contribution to an RESP can earn a $500 Canada Education Savings Grant ("CESG") from the federal government. By maximizing your contributions every year you could earn up to $7,200 in lifetime CESGs for each of your children.

Your BMO financial professional can help you plan for the tax efficiency of your investment assets and help you use your tax refund to your benefit. Please contact them if you have any questions about the planning tips discussed above.

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