2018 Federal Budget Commentary (excerpts only)

BUSINESS INCOME TAX MEASURES

Passive Investment Income Earned by Private Corporations

The Budget proposes to introduce measures to reduce perceived tax advantages where a private corporation earns passive income. The announcement that such measures were going to be introduced was first made on July 18, 2017, along with other substantive measures intended to reduce the ability of taxpayers to sprinkle income among family members. The Budget proposals bear little resemblance to the measures initially announced.

The Budget proposes two sets of new provisions. One set is intended to reduce the $500,000 business limit otherwise available to a group of associated Canadian-controlled private corporations (CCPCs) where the group earns a significant amount of passive income. The second set reduces, but does not eliminate, the ability of a corporation to obtain refunds of refundable dividend tax on hand (RDTOH) by paying eligible dividends as compared to non-eligible dividends.

$500,000 Business Limit Reduction

The business limit of an associated group of CCPCs is already reduced where the group's "taxable capital employed in Canada" exceeds $10,000,000.

The proposed provisions will reduce the group's business limit on a straight line basis where the group earns "adjusted aggregate investment income" between $50,000 and $150,000. The reduction will be $5 for every $1 of investment income. Consequently, a group's business limit will be reduced to zero (5 × $100,000 = $500,000) in a particular year if its adjusted aggregate investment income is $150,000 or more.

This reduction to the business limit is based on income for the year that ended in the preceding calendar year.
This proposal will apply to taxation years that commence after 2018 with no grandfathering of passive income earned on existing investments. Consequently, all future investment earnings will be included in this annual test, regardless of when the applicable investments were accumulated.

Anti-avoidance measures will discourage transactions designed to delay or avoid the new rules.

Changes to RDTOH

Currently, a dividend refund is available to a corporation at the rate of 38 1/3 per cent of taxable dividends paid to the extent that there is an available balance of RDTOH at the corporation's year-end. The taxable dividends paid can be either non-eligible dividends or eligible dividends. There is a tax advantage where eligible dividends are paid.

The Budget proposes to introduce measures that will generally allow a CCPC to recoup RDTOH only on the payment of non-eligible dividends. An exception will apply to RDTOH arising on the payment of Part IV tax on eligible portfolio dividends. Such RDTOH can be recouped on the payment of eligible dividends.

To accomplish this, the Budget proposes to create an "eligible RDTOH" account and a "non-eligible RDTOH" account. As indicated above, eligible RDTOH will include only Part IV tax paid on the receipt of eligible portfolio dividends. All other RDTOH will be included in the non-eligible RDTOH account.

This measure will apply to taxation years that commence after 2018. An anti-avoidance measure will prevent the deferral of the new measures by creating a short taxation year.

Income Sprinkling Measures

Overview

The Budget confirms that Finance will proceed with the implementation of the December 13, 2017, draft proposals that address income sprinkling involving private corporations.

The Tax on Split Income (TOSI) regime that existed prior to 2018 (commonly referred to as the "kiddie tax" rules), impacted only Canadian-resident minors. It essentially taxed at the top marginal rate certain types of income that they earned. The December 13, 2017, draft legislative proposals represent a major broadening of the old TOSI rules and will become effective as of January 1, 2018.

The proposed TOSI rules can apply to any Canadian resident, regardless of age. Further, types of income in addition to those under the old rules described above could be caught. The TOSI rules will not apply to the arm's-length sale of qualified small business corporation shares (QSBC shares) that are eligible for the lifetime capital gains exemption even if the lifetime capital gains exemption is not claimed. The taxation of capital gains from the non-arm's length sale of private company shares by a minor will remained. Further, the ability of adults to sell QSBC shares to non-arm's-length parties without triggering the TOSI will remain intact. Several exclusions from TOSI must be considered in order to determine if the tax applies. No adult of any age is subject to TOSI on income from an unrelated business. Also, the proposals introduce some "bright line" tests as well as a general reasonableness test that could operate to exclude an individual from the new TOSI rules. These tests are not mutually exclusive and vary based on the age of the individual in question.

An adult of any age will not be subject to TOSI on income derived from an "excluded business", i.e., one in which the individual is actively engaged on a "regular, continuous and substantial basis" in the taxation year in which the income amount is received, or in any five previous taxation years that need not be consecutive. Income derived by adults over the age of 24 from "excluded shares" is not subject to TOSI. To meet the definition of an excluded share, several conditions must be met.

- The individual in question must directly own at least 10 per cent of the votes and value of the corporation.
- The corporation must earn less than 90 per cent of its income from the provision of services.
- The corporation cannot be a professional corporation, such as those carried on by medical doctors, dentists, accountants, lawyers, chiropractors and veterinarians.
- All or substantially all of the corporation's income cannot be derived from a related business in respect of the individual.

If taxpayers restructure their corporations in order to meet the excluded share definition by the end of 2018, this exception will be available to them for the entire 2018 taxation year If income earned by the spouse of a business owner aged 65 or more would not be subject to TOSI had the business owner earned it directly, then the spouse's income would not be subject to TOSI. There is no requirement that the spouse be aged 65 or over for this exclusion to be met.

There are various exclusions for inherited property.

Taxable capital gains arising from the deemed disposition on the death of an individual as well as income derived from property acquired on the breakdown of a marriage or common-law partnership are also excluded from TOSI.
If none of the above exclusions from the TOSI rules apply, the reasonableness tests must be considered. This is because only income in excess of a "reasonable return" will be subject to TOSI.

For adults over the age of 24, a reasonable return will take into account various factors, including labour contributions, property contributions, risk assumed, historical payments, and any other relevant factors. As these factors do not include any thresholds in terms of hours worked or amounts contributed, there is a high degree of subjectivity with this test.
For adults between the ages of 18 and 24, what is considered to be a reasonable return is more precisely defined, but greatly limited. Only capital contributed will be considered.

PERSONAL INCOME TAX MEASURES

Canada Workers Benefit (CWB)

The Budget enhances the existing Working Income Tax Benefit and renames it as the Canada Workers Benefit, effective for 2019 and subsequent years. The CWB will be 26 per cent of "earned income" in excess of $3,000 to a maximum of $1,355 for single taxpayers without dependents and $2,335 for families (couples and single parents

Employment Insurance Parental Sharing Benefit

The Budget proposes a new five-week Employment Insurance Parental Sharing Benefit, effective June 2019. This benefit will be available as a top-up in situations where both parents agree to share parental leave. It will be available to eligible two-parent families, including same sex-couples and adoptive parents. This new benefit is intended to provide greater flexibility, particularly for mothers, to return to work sooner.

Apprenticeship Incentive Grant for Women

Current legislation provides for the Apprenticeship Completion Grant which is a one-time taxable cash grant of $2,000 to a registered apprentice who has completed their apprenticeship training and obtains their journeyperson certification. The Budget proposes a new Apprenticeship Incentive Grant for Women. Under this program, women in male-dominated Red Seal trades will be able to receive $3,000 per year for each of their first two years of training.

TRUSTS

Reporting Requirements

The Budget proposes extensive new reporting requirements for most family trusts, effective for returns required to be filed for 2021 and subsequent taxation years. These requirements could impose an obligation to file a return where none currently exists, such as where the trust earned no income in the year. The trust will be required to report the identity of all trustees, beneficiaries and settlors of the trust. In addition, the identity of each person who has the ability to exert control, through the trust terms or a related agreement, over trustee decisions in respect of the appointment of income or capital must be disclosed.

The reporting requirements will apply to Canadian-resident express trusts and to non-resident trusts currently required to file a Canadian return. This would include most personal “family” trusts used in tax planning. The following trusts are excluded from the requirements:

- Lawyers’ general trust accounts
- Graduated rate estates (generally the first 36 months of a deceased individual’s estate)
- Qualified disability trusts
- Trusts in existence for less than three months
- Trusts that hold less than $50,000 in assets throughout these new reporting requirements are designed to provide better beneficial ownership information.

The Budget also introduces penalties for failure to file a trust return where the new reporting requirements apply. The penalty will be $25 per day late with a minimum of $100 and a maximum of $2,500.