

Federal Budget 2019: Putting the Middle Class in Focus

March 2019



Introduction

With an election just around the corner, the federal government has delivered the 2019 Federal Budget; *Investing in the Middle Class*, with a wide variety of measures directed at home affordability, education, health and infrastructure. In keeping with the government's previous budget theme to create a "fair tax system", new measures geared to help new home buyers, Registered Disability Savings Plan beneficiaries, and farmers and fishers have been proposed. In addition, tax benefits for Individual Pension Plan holders and stock option recipients are getting an overhaul.

Personal Income Tax Measures

Home Buyers' Plan (HBP)

To provide first-time home buyers with greater access to their RRSPs to purchase or build a home, the Budget proposes to increase the HBP withdrawal limit to \$35,000 from \$25,000. As a result, a couple will potentially be able to withdraw \$70,000 from their RRSPs to purchase or build their first home.

This increase will apply to the 2019 and subsequent calendar years with respect to withdrawals made after March 19, 2019.

The Budget 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. These measures will apply to HBP withdrawals made after 2019.

Carrying on Business in a Tax-Free Savings Account (TFSA)

A TFSA allows Canadians to earn tax-free investment income on a wide range of investments. However, when it comes to income from a business carried on by the TFSA, the TFSA is liable to pay tax on that income at the top personal tax rate. Further, under the current rules, the trustee of a TFSA (i.e., a financial institution) is liable along with the TFSA for the tax payable while the holder of the TFSA is not.

This can result in difficulty for the financial institution when there are insufficient assets within the TFSA to pay any tax liability. For example, the TFSA holder may have withdrawn the assets or transferred them to another financial institution. The Budget proposes joint and several liability for tax payable on income from carrying on a business in a TFSA be extended to the TFSA holder, in addition to the trustee. This measure will apply to the 2019 and subsequent taxation years.

Disability Tax Credit (DTC) and Registered Disability Savings Plans (RDSP)

An RDSP plan holder may elect to extend the period for which an RDSP remains open should a beneficiary become ineligible for the DTC. To qualify for an extension, a medical practitioner must certify in writing that the nature of the beneficiary's condition makes it likely that they will be eligible for the DTC in the foreseeable future.

The Budget proposes to remove the time limitation that an RDSP may remain open after a beneficiary becomes ineligible for the DTC, and to eliminate the requirement for medical certification as described above.

This measure will generally apply after 2020.

Canada Pension Plan Automatic Enrolment

To ensure that all Canadian workers eligible for the Canada Pension Plan (CPP) receive the full benefits to which they are entitled, the Budget proposes to introduce legislation to proactively enroll CPP contributors who are age 70 or older in 2020, if they have not already done so.

Change in tax treatment of multi-unit residential properties

Under the *Income Tax Act* a taxpayer is deemed to have disposed of and reacquired a property when he or she converts the property from an income-producing use (e.g., a rental property) to a personal use (e.g., a residential property) or vice-versa. Under current tax rules, a taxpayer cannot elect out of the deemed disposition that arises on a change affecting only part of a property.

To improve consistency of tax treatment for owners of multi-unit residential properties, such as a duplex, the Budget proposes to allow taxpayers to elect that the deemed disposition that normally arises on a change in use of part of a property, not apply. This measure will apply to changes in use of property on or after March 19, 2019.

Additional types of annuities allowed under registered plans

An annuity provides a stream of periodic payments to an individual (the annuitant), 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 for their retirement savings, the Budget proposes to permit two new types of annuities for certain registered plans:

- advanced life deferred annuities will be permitted under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) and defined contribution registered pension plan (RPP). An advanced life deferred annuity allows payments to be deferred to the end of the year in which the annuitant turns 85. Certain requirements must be met to qualify as advanced life deferred annuity; and
- variable payment life annuities will be permitted under a PRPP and defined contribution RPP.

A variable payment life annuity will provide payments that are based on investment performance of the underlying funds in addition to the mortality experience of the annuitants. The measures will apply to the 2020 and subsequent taxation years.

Individual Pension Plans (IPP)

The 2019 Federal Budget is proposing new rules for certain contributions to an IPP.

An IPP is a defined benefit registered pension plan established by an incorporated company for the benefit of one person, typically an executive or owner. Currently, when an individual terminates membership in another defined benefit registered pension plan, the income tax rules allow a tax-deferred transfer of the value of the member's accrued plan benefits via:

- a transfer of the full commuted value to another defined benefit plan sponsored by another employer; or
- subject to a prescribed transfer limit (normally about 50% of the member's commuted value), a transfer of a portion of the commuted value to the member's registered retirement savings plan or a similar registered plan.

The 2019 Budget points to planning that has been undertaken to circumvent the latter transfer limits and proposes to prohibit IPPs from providing retirement benefits for past years of employment that were pensionable service under a defined benefit plan of an employer other than the IPP's participating employer. Instead, any assets transferred to an IPP for such benefits will be included in the income of the member for income tax purposes. This measure applies to pensionable service credited under an IPP on or after March 19, 2019.

Employee Stock Options

In the 2019 Budget, the federal government is announcing its intent to limit the use of the current employee stock option tax regime. Employee stock options provide employees with the right to acquire shares of their employer at a designated price, thereby providing remuneration linked to the company's future success. The stock options can help small growing companies, such as startups, to attract and retain talent.

To support this objective, the tax rules provide employee stock options with preferential personal income tax treatment in the form of a stock option deduction resulting in taxation at a rate equal to 50% of the normal rate of personal taxation.

To address this, the Government intends to limit the employee stock option deduction for high-income individuals employed at large, long-established firms.

The aim is:

1. to make the employee stock option tax regime fairer and more equitable for Canadians, and
2. to ensure that start-ups and emerging Canadian businesses that are creating jobs continue to grow and expand.

The Budget proposes a \$200,000 annual cap on employee stock option grants (based on the fair market value of the underlying shares) receiving beneficial tax treatment for employees of large established firms. The Budget states that the vast majority of employees receiving employee stock option benefits will be unaffected.

Meanwhile, for start-ups and rapidly growing Canadian businesses, employee stock option benefits will remain uncapped. Further details will be released by the federal Department of Finance before the summer of 2019. Any changes would apply on a go-forward basis only — not to employee stock options granted prior to the announcement of legislative proposals to implement the changes.

Canada Training Credit

The 2019 Budget is introducing the new Canada Training Credit, a refundable tax credit aimed at providing financial support to help cover up to one-half of eligible tuition and fees associated with training. Eligible individuals will accumulate \$250 each year in a notional account. In order to accumulate the amount of \$250 in respect of a year, an individual must:

- file a tax return for the year;
- be at least 25 years old and less than 65 years old at the end of the year;
- be resident in Canada throughout the year;
- have earnings (including income from employment, self-employment, Maternity and Parental Employment Insurance benefits or benefits paid under the *Income Tax Act* respecting parental insurance, the taxable part of scholarship income, and the tax-exempt part of earnings of status Indians and emergency service volunteers) of \$10,000 or more in the year; and
- have individual net income for the year that does not exceed the top of the third tax bracket for the year (\$147,667 in 2019).

The amount of a credit that can be claimed for a taxation year will be equal to the lesser of one-half of the eligible tuition and fees paid in respect of the taxation year and the individual's notional account balance for the taxation year (based on amounts used or accumulated in respect of previous years).

Individuals will be able to accumulate credits to a lifetime maximum of \$5,000. Any unused balance will expire at the end of the year in which an individual turns 65.

The annual accumulation to the notional account will start based on eligibility in the 2019 taxation year and the credit available to be claimed in the 2020 taxation year.

Business Income Tax Measures

Helping farmers and fishers

Canadian farmers and fishers have been seeking government assistance in facilitating the ability to pass their businesses on to their children. The federal government has promised it will continue to reach out throughout 2019 to develop new proposals to better accommodate intergenerational transfers of these businesses.

Currently, there is some financial assistance through the tax system. Income from an active business carried on in Canada by a Canadian-controlled private corporation (CCPC) is eligible for a reduced rate of taxation under the small business deduction rules in the *Income Tax Act*, on such income, up to \$500,000.

The *Income Tax Act* contains various rules that are intended to prevent inappropriate multiplication of this \$500,000 limit.

However, certain income of a CCPC's farming or fishing business that arises from their sales to arm's length purchasers is excluded from specified corporate income. The Budget proposes to eliminate this exclusion to provide greater flexibility to farming and fishing businesses.

Accelerated Capital Cost Allowance (CCA)

The Budget confirms the government's intention to proceed with three CCA acceleration measures announced in the Fall Economic Statement on November 21st 2018:

- Full expensing for the cost of manufacturing and processing machinery and equipment on a temporary basis
- Full expensing for the cost of specified clean energy equipment on a temporary basis
- A temporary accelerated investment incentive

An immediate write-off of the cost of M&P manufacturing equipment (previously qualifying for a temporary accelerated

CCA rate of 50% on a declining-balance basis) and specified clean energy equipment (previously qualifying for either an accelerated 30% or 50% CCA rate, both on a declining-balance basis) is available under these proposals for acquisitions after the 20th of November 2018 if the property becomes available for use prior to 2024.

A reduced first-year write-off of 75% of the cost will be available for property that becomes available for use in 2024 or 2025, and a 55% first-year write-off will apply for property that becomes available for use in 2026 or 2027.

The proposals also include an accelerated investment incentive that provides for a temporary enhanced CCA deduction of up to three times the normal first-year CCA deduction for other capital assets subject to the CCA regime, with a few exceptions. This measure applies to property that would otherwise be subject to the current half-year rule acquired after November 20, 2018 and available for use before 2024. The enhanced allowance is reduced to two times the normal first-year CCA in the 2024-2027 period.

Closing tax loopholes

As part of the Government's ongoing aim to create greater fairness in the tax system, the Budget proposes tax measures to close some specific loopholes. These measures include:

- preventing the use by mutual fund trusts from allocating capital gains or income to their redeeming unit-holders, when the use of that method inappropriately defers tax or converts fully taxable ordinary income into capital gains (which are taxed at a lower rate). This measure will apply to taxation years of mutual fund trusts that begin on or after March 19, 2019;
- improving existing rules meant to prevent taxpayers from using derivative transactions to convert fully taxable ordinary income into capital gains (taxed at a lower rate).

