2018 Federal Budget Special Report

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2018 FEDERAL BUDGET OVERVIEW:

Budget 2018 Prioritizes Economic Equality, Opportunity & Diversity

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ECONOMY BY THE NUMBERS

- Income tax revenues are projected to increase to $208.6 billion. This includes personal, corporate and non-resident tax revenue
- Net debt is projected to be $736.7 billion in 2017-2018, and growing to $831.5 billion by 2022-2023
- GDP growth is expected to change little from Budget 2017, ranging from 1.6 percent in 2019 to 1.8 percent in 2022
- Nominal GDP growth is projected to range from 3.5 percent in 2019 to 3.8 percent in 2022
- Inflation is projected to average 1.9 percent, no change from Budget 2017
- The Canadian to US dollar exchange rate is expected to average 79.6 US cents/C$
- Crude oil prices will average US $57 per barrel
- The three-month treasury bill rate will average 1.9 percent
- The ten-year government bond rate will average 2.7 percent
- The unemployment rate will average 6.1 percent

The theme of the 2018 Federal Budget announced February 27 is focused on Equality and Growth, and carries forward the 2017 theme of “a Strong Middle Class”. There are five key areas this budget addresses:

Growth of our economy with a strong emphasis on empowering our Canadian workforce in all of its diversity; with particular attention to gender equality. According to the 2018 budget, there is a 31% gap in the median income between men and women. The Government will be introducing legislation to close this gap.

Progress in the Innovation and Skills Plan with a focus on recognizing, supporting, and funding research within Canada. This budget proposes to provide $2.6 billion over five years to support innovation in Canada. This is a continuation of the Innovation and Skills Plan announced in the 2017 budget.

Budget 2018 also introduces a Women Entrepreneurship Strategy to further encourage women in positions of leadership. This includes additional funding through organizations such as Business Development Canada (BDC) and Export Development Canada (EDC) to the tune of over $1.4 billion over three years.

Advancement for a sustainable future both inside and outside of our borders, tackles topics such as environment, gender equality, national pharmacare, and enhancements to security in a digital environment.

Reconciliation with Indigenous peoples through investments in infrastructure and skills training. This budget projects a total of $4.1 billion over 6 years, including 2017.

Equality within the Canadian workforce is also a priority, with particular attention paid to gender gaps between men and women is a lens the Government has used throughout this document with regards to proposed and implemented legislation within the four key areas: growth, progress, advancement, and reconciliation.

This budget has definitely taken an ‘issues based’ approach with very little change to legislation.

This 2018 budget overview addresses tax measures for individuals and businesses such as:

- Working Income Tax Benefit (rebranded as the Canada Workers Benefit), effective for the 2019 tax year
- Psychiatric service dogs, effective after 2017
- Deductibility of QPP enhanced contributions, effective for tax year 2019
- Retroactive eligibility for Child Benefits, effective retroactively to July 2016
- New reporting requirements and penalties for trusts, effective 2021
- Passive investment income taxation for small business, proposed to begin after 2018

Started in the 2017 budget, and expanded upon throughout the year, this budget does continue to focus on closing tax preferences extended to small business corporations. Passive investments, in particular, have been addressed in this budget, through two proposed measures. The Government has indicated that less than 3 percent of Canadian Controlled Private Corporations will be affected, and these measures will target corporate owners whose household income is in the top 1 percent of income distribution.

SPECIFIC TAX MEASURES: PERSONAL

Working Income Tax Benefit

Effective for Tax Year 2019

The Working Income Tax Benefit will be renamed as the Canada Workers Benefit.

As previously announced, the benefit will be enhanced for 2019 to compensate for increased costs for Canada Pension Plan contributions starting in 2019.

For 2019, the benefit will be 26% (increased from 25%) of earned income over $3,000 (unchanged). The maximum benefit will be increased to $1,355 (from $1,042 for 2017, $1,059 for 2018) for single taxpayers and $2,335 (from $1,892 for 2017, $2,165 for 2018) for couples and single parents. The clawback rate will be 12% (decreased from 15% for 2017; 14% for 2018) for income over $12,820 (up from $11,838 for 2017) for singles and $17,025 (up from $16,348 for 2017).

In addition, for disabled taxpayers, the new Canada Workers Benefit will be increased to $700 (up from $521 in 2017). This benefit is reduced at a rate of 12% when only one partner is disabled (down from 15%) and 6% when both partners are disabled. The clawback begins at $24,111 for one disabled taxpayer (up from $18,785 in 2017) and $36,483 when both spouses are disabled (up from $28,975).

Provinces can change the amounts applicable to their province (as is currently done in AB, BC, QC, and NU).

The budget also proposes to allow CRA to include the benefit in the assessment for taxpayers who qualify but do not apply for the benefit by completing Schedule 6 when they file their tax returns. To implement this and certain other tax measures, the budget proposes to require designated educational institutions be required to report to the CRA prescribed information regarding the enrolment of students (number of months of full- and part-time attendance). Currently this information is provided to students on Form T2202A, but these forms are not provided directly to the CRA.

Medical Expenses: Psychiatric Service Dogs

Effective for expenses incurred after 2017

For 2018 and subsequent tax years, the costs 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 will be allowed as a medical expense. Expenses related to dogs not specifically trained for this purpose will not be allowable as a medical expense.

RDSP (Registered Disability Savings Plan) Qualifying Plan Holders

This is an extension of an existing measure

The current rule that allows a family member to be a plan holder for a disabled RDSP beneficiary who is not competent is being extended to the end of 2023. (the previous rule expires at the end of 2018). A family member who becomes a qualified plan holder before this rule expires could continue to be a qualified plan holder after 2023.

Deductibility of QPP Enhanced Contributions

Effective 2019 taxation year

To ensure that QPP contributions and CPP contributions are treated the same way, the budget proposed to amend the *Income Tax Act* to allow taxpayers who pay additional contributions on the enhanced portion of QPP (equivalent to the enhanced CPP contributions planned for 2019) be allowed to deduct those contributions.

Retroactive Eligibility for Child Benefits

Effective retroactive to July 2016

The budget proposes that foreign-born status Indians legally residing in Canada who are neither Canadian citizens nor permanent residents be eligible for the following benefits, retroactive to their inception if they otherwise qualify:

- Universal Child Care Benefit (UCCB)
- Canada Child Benefit (CCB)
- National Child Benefit supplement

Sharing of Information

This is a continuation of existing policies

The budget proposes to amend the Income Tax Act to authorize the sharing of information with respect to the Canada Child Benefit with provinces for the sole purpose of administering social assistance programs. The change is required as of July 2018 as the National Child Benefit supplement is no longer payable after that date.

Mineral Exploration Tax Credit for Flow-Through Shares

This is an extension of an existing policy

The budget proposes to extend the eligibility for the mineral exploration tax credit which currently expires March 31, 2018, to flow-through share agreements entered into on or before March 31, 2019. This will allow deductions for such expenditures through to the end of 2020.

New Reporting Requirements for Trusts

Effective for 2021 and subsequent taxation years

Certain trusts (including some trusts that are not currently required to file a T3 return, will be required to report

- the identity of all trustees, beneficiaries and settlors of the trust
- the identity of each person who has the ability to exert control over trustee decisions regarding the appointment of income or capital of the trust

Electronic Processing of T3 Returns

The budget also proposes to provide funding, over a five-year period to develop an electronic platform for processing of T3 returns.

Penalties for Trust Returns

Effective for 2021 and subsequent taxation years

The budget proposes the following penalties:

- Late filing: $25 per day (minimum $100; maximum $2,500)
- Additional late filing penalty: 5% of fair market value of trust assets (minimum $2,500) where the failure to file the trust return was made knowingly or due to gross negligence

SPECIFIC TAX MEASURES: FOR BUSINESS

Passive Investment Income

Proposed for taxation years after 2018

As promised, Budget 2018 proposes to limit the tax deferral advantages on passive investment income earned inside private corporations on taxation years that begin after 2018 through two measures. Previously announced measures include the reduction of the tax rate for qualifying active business income of CCPCs. The current rate of 10.5% will be reduced to 10% for 2018 and then again reduced in 2019 to 9%.

The first measure results in a reduction of the $500,000 small business deduction limit based on passive income of greater than $50,000 and less than $150,000 as shown in the table below.

Active business income qualifying for the small business tax rate under new business limit ($)

Business Income	Investment Income				
	50,000	75,000	100,000	125,000	150,000
50,000	NOT AFFECTED				0
75,000					0
100,000					0
200,000				125,000	0
300,000			250,000	125,000	0
400,000		375,000	250,000	125,000	0
500,000		375,000	250,000	125,000	0

Note: Assumes that the corporation has less than $10 million of taxable capital.

Source: Budget Document

Active business income qualifying for the small business tax rate under new business limit for illustrative passive assets ($)

Business Income	Passive Assets				
	1,000,000(*)/ 2,500,000(**)	1,500,000(*)/ 3,750,000(**)	2,000,000(*)/ 5,000,000(**)	2,500,000(*)/ 6,250,000(**)	3,000,000(*)/ 7,500,000(**)
50,000	NOT AFFECTED				0
75,000					0
100,000					0
200,000				125,000	0
300,000			250,000	125,000	0
400,000		375,000	250,000	125,000	0
500,000		375,000	250,000	125,000	0

Note: Assumes that the corporation has less than $10 million of taxable capital.
(*) Assuming a five-per-cent rate of return. (**) Assuming a two-per-cent rate of return.

Source: Budget Document

Canadian controlled private corporations (CCPC) with active business income more than the reduced limit will be taxed at general rates, currently 15%. The small business deduction reduction is in conjunction with existing reductions for CCPCs with more than $10 million in taxable capital. Thus, the reduction is the greater of passive income or the taxable capital methods.

Adjusted Aggregate Investment Income

Adjusted Aggregate Investment Income is defined as:

Aggregate investment income less taxable capital gains (and losses) will be excluded to the extent they arise from the disposition of;

- a property that is used principally in an active business carried on primarily in Canada by the CCPC or by a related CCPC
- or a share of another CCPC that relates to the CCPC, where, in general terms, all or substantially all of the fair market value of the assets of the other CCPC is attributable directly or indirectly to assets that are used principally in an active business carried on primarily in Canada, and certain other conditions are met
- net capital losses carried over from other taxation years will be excluded
- dividends from non-connected corporations will be added
- income from savings in a life insurance policy that is not an exempt policy will be added, to the extent it is not otherwise included in aggregate investment income

Taxable income exceeding the Adjusted Small Business Deduction will be taxed at General Rates (GRIP).

The second measure relates to Refundable Dividend Tax on Hand (RDTOH) for CCPC's. The creation of a second RDTOH pool – "Eligible RDTOH" applies only to eligible portfolio dividends received by CCPC resulting in Part IV tax. The current RDTOH pool is renamed "Non-Eligible RDTOH" and applies to refundable Part I tax and non-eligible portfolio dividends. The current method for connected corporations remains however, the allocation will no longer be applied to Part IV RDTOH but will follow the pool paid from by the connected corporation.

For a CCPC the allocation of an existing RDTOH pool will be the lesser of its existing RDTOH balance and an amount equal to 38 1/3 percent of the balance of its general rate income pool, if any, will be allocated to its eligible RDTOH account. For any other private corporation, the entire corporation's existing RDTOH balance will be allocated to its eligible RDTOH account. RDTOH refunds will first apply to the non-eligible RDTOH account then to the eligible RDTOH account.

There will be no grandfathering provisions for existing passive assets regardless of their value.

There will be a new anti-avoidance rule to prevent the deferral of these measures through the creation of a short taxation year.

Health and Welfare Trusts **Effective 2021**

Health and Welfare Trusts will soon be required to transition to the existing Employee Life and Health Trust category. This will ensure that only one set of rules applies instead of the current set of rules for each type of health trust.

OTHER NEWS

SALES AND EXCISE TAX MEASURES

GST/HST and Investment Limited Partnerships

The draft legislation that was presented on September 8, 2017 relating to the application of GST/HST to investment limited partnerships is confirmed to proceed with changes. The GST/HST will now apply to management and administrative services rendered by the partner only after September 8, 2017 and not before that date. The GST/HST will be payable on the fair market value of management and administrative services in the period they were rendered.

An investment limited partnership will also be allowed to make an election to advance the application of the special HST rules as of January 1, 2018.

Tobacco Taxation **Effective the day after Budget Day**

Currently the rates of excise tax on tabacco products increase every five years. The next increase is scheduled for December 1, 2019. The 2018 budget proposes to adjust the increases on an annual basis and will take effect on April 1 of every year starting in 2019. The excise duty rates are proposed to increase an additional $1 per carton of 200 cigarettes with this budget.

As of February 27, inventories of cigarettes held by manufacturers, importers, wholesalers and retailers will be subject to an inventory tax that must be filed by April 30, 2018. This inventory tax consists of $0.011468 per cigarette.

Cannabis Taxation **Proposed to be effective when available for sale for non-medical purposes**

As part of the *Excise Act*, 2001 the 2018 Budget proposes a new framework for cannabis products. A cannabis license from the Canada Revnue Agency will be required for all cannabis manufacturers and cultivators. They will be required to remit excise duty where applicable.

There will be a flat rate duty at the time of packaging and an *ad valorem** rate at the time of delivery. Those licensed to sell cannabis will be required to pay duty at the higher of the flat rate or *ad valorem* rate. Any sales of cannabis that would be considered as basic groceries will be subject to the GST/HST of other cannabis products.

An agreement for the first two years after legalization with most provincial and territorial governments states that they will receive 75 percent of the taxation revenues from a combined $1 per gram/10 percent excise duty rate and the federal government will receive the remaining 25 percent.

Excise Duty Rates for Cannabis Products

Cannabis Plant Product	Federal Rates *Higher of the Two Rates Apply*		Additional Rates in Respect of a Province/Territory *Higher of the Two Rates Apply*	
	Federal Flat Rate	Federal Ad Valorem Rate	PT Additional Flat Rate	PT Ad Valorem Additional Rate
Flower	$0.25 / gram	2.5 per cent of the dutiable amount of a cannabis product packaged by a cannabis licensee to a purchaser.	$0.75 / gram	7.5 per cent of the dutiable amount of a cannabis product packaged by a cannabis licensee to a purchaser.
Trim	$0.075 / gram		$0.225 / gram	
Seed	$0.25 / seed		$0.75 / seed	
Seedling	$0.25 / seedling		$0.75 / seedling	

Source: Budget Document

The Canada Revenue Agency will issue excise stamps and accept applications for cannabis licenses before the legalization date.

**ad valorem is a tax based on the value of the goods or transaction*

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