2018 Federal Budget Highlights

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Agenda

1. Personal tax changes
2. Support for the Canadian tax system
3. Other business taxation changes
4. Small business taxation changes

Personal tax changes

- **No changes to tax rates, tax brackets, capital gain rate still at 50%**
- Trusts now have to disclose all trustees, beneficiaries and settlors starting in 2021 or face a maximum $2,500 penalty
- Service animals qualify as a medical expense
  - assist in blindness, deafness, severe autism, severe diabetes, severe epilepsy, severe mental impairment (PTSD) or impairment that restricts the person’s arms or legs
  - Cost of animal, food and veterinary care
  - Travel and food/hotel costs to facility that teaches how to handle service animal

Personal tax changes

- Canada Workers Benefit – Refundable tax credit up to $1,355 for single individual with no dependents, $2,335 for families/single parents
- RESPs: Canada Learning Bond will now be automatically given to children by using the Ontario online birthing registration service
- Foreign born Status Indians can claim child benefits from 2005
- Mineral exploration tax credit extended to March 31, 2019

Support for the tax system

- $39 million to assist in sharing of international tax data
- $42 million to fund the court system
- $91 million to combat tax evasion and tax avoidance (to recover $354 million)
- Promises CRA will adapt a "more Client-Centric Approach"
  – "Canadians interacting with the CRA feel like valued clients, not just taxpayers"
  – $206 million for improving CRA's phone system, enhancing the volunteer tax preparer program, strengthening digital services

Other business tax changes

- Continued fast tax write-offs for “Clean Energy”
- Closing “Loopholes”
  - Transactions used by the Big Banks
  - Investments in “tiered” partnerships
  - Non-residents getting tax-free money out of Canada
  - Foreign subsidiaries of Canadian companies abuse of avoiding current taxation
- Canadians that own foreign companies now have to report information within 6 months instead of 15 months starting in 2019
- Response to US tax reform?

Small business tax changes

- Status of the July 2017 Tax Proposals
  - “Income sprinkling” proposals:
    - New legislation introduced December 2017 that took effect January 1, 2018. Splitting income with your family became significantly restricted, with service businesses having more restrictions than other businesses
  - Proposal to block transactions that convert corporate income into capital gains:
    - Completely dropped (for now)
    - Waiting to see if government will improve intergenerational transfers
  - “Passive Income” proposal
    - 73% tax rate on passive income originally proposed with a highly complex system
    - Rules in Federal budget are targeted and “easier” to deal with
- Fall 2017: Small business taxes further reduced to 13.5% for 2018 and 12.5% for 2019

Passive Income Proposal 1

- Goal: Prevent corporations from using excess cash provided by lower taxes to buy investments
- How: Reduce the "Small business deduction" for investment income
- For every $1 over $50,000 of "Adjusted Aggregate Investment Income", your company loses $5 of the $500,000 "small business deduction"
- For $100,000 of investment income, the small business deduction =
  - $500,000 – 5 x ($100,000 - $50,000) = $250,000
  - Therefore, if your company has $100,000 of investment income it can still earn up to $250,000 and pay tax at the small business rate

Passive Income Proposal 1

- “Adjusted Aggregate Investment Income”
  - Investment income but not including
  - capital gains on assets used in your business
  - small business shares with >10% ownership
  - capital loss carry-forward
- Add up all “associated corporations” to determine the amount of “Adjusted Aggregate Investment Income”
- Anti-avoidance rule – can’t give money to a corporation owned by a related person for them to earn the income
- Effective January 1, 2019

Passive Income Proposal 2

- Currently if corporations earn investment income, higher rate of tax is paid upfront but a portion can be recovered by paying taxable dividends to individual shareholders ("RDTOH")
- Corporation recovers $ .3813333 cents of RTDOH per $1 taxable dividend paid to individual shareholder
- Two types of dividends shareholders receive from their corporation
  - **Ineligible** (Higher personal tax rate dividends) : Dividend paid from business income taxed at the lower small business rate + passive income (not including 50% of capital gains and dividends from Canadian public companies)
  - **Eligible** (Lower personal tax rate dividends): Dividends paid from business income taxed at the normal tax rate + dividends from Canadian public corporations
- Current strategy: Payout eligible dividends to get favourable tax rate personally and recover RDTOH at the same time

Passive Income Proposal 2

- Proposal is to create two RDTOH “pools”:
  - Ineligible RDTOH: passive income (not including 50% of capital gains and dividends from Canadian public companies)
  - Eligible RDTOH : dividends form Canadian public corporations
- Eligible RDTOH can be recovered by paying either eligible or ineligible dividends
- Only way to recover Ineligible RDTOH is to pay ineligible dividend
- If you pay Eligible Dividend you can’t recover RDTOH until Ineligible RDTOH is zero
- Transition rule: Lower of current RDTOH and 38 1/3% of “GRIP” goes to Eligible RDTOH
  - Protects public company dividend received previously
- Effective January 1, 2019

Planning Points

- Buy and hold investments and sell incrementally
- Turn passive portfolio into “active” / inventory assets
- Invest more in Canadian public companies to create more Eligible RDTOH over Ineligible RDTOH
- Setup new company to hold exclusively Canadian public company dividends to directly access Eligible RDTOH / (subject to GAAR?)
- Life insurance investments
- Individual Pension Plans
- Generating capital gains before end of year to lower future gain subject to rules (but will generate ineligible RDTOH)

Questions?

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