CALU Special Report

Budget 2019: Government continues its commitment to invest in the middle class

Ottawa—March 19, 2019—Finance Minister Bill Morneau tabled the Liberal Government's 2019 pre-election budget today. This *Special Report* highlights proposed government initiatives and tax proposals of greatest interest to our members and their clients. We extend our thanks to Kevin Wark and Angela Ross, CALU's Tax Advisors, for their work in preparing this summary.

Highlights

- Support for first-time home buyers and related initiatives to expand the housing supply and affordability
- The introduction of an employment training tax benefit and enhancing access to secondary education
- Additional investments in support of the indigenous people of Canada
- Progress in the development of a national pharmacare strategy and related healthcare initiatives
- A continued focus on aggressive tax planning strategies both domestically and internationally

Introduction

On March 19, 2019, Finance Minister Morneau tabled his fourth budget ("Budget 2019"), entitled "Investing in the Middle Class." This pre-election budget contains a number of platforms and spending initiatives designed to buttress the appeal of this government to specific segments of the electorate. In particular, making home ownership more affordable to first-time home buyers, progress on developing a national approach to pharmacare and support of employees wishing to acquire new work skills, will be attractive to a broad range of Canadians.

This CALU *Special Report* reviews the policy frameworks underlying the budget and provides information about tax proposals of greatest interest to CALU members.

The Current Fiscal Situation

Budget 2019 highlights that despite a challenging global environment, Canada's economy remains "sound." Since late 2015, more than 900,000 new jobs have been created, resulting in an unemployment rate that has reached its lowest level in more than four decades. However, with greater world economic uncertainty, combined with lower oil prices and higher interest rates, it is expected that economic growth rates in Canada will soften.

Yet, with the conclusion of new trade agreements in combination with tax relief provided to Canadian businesses through accelerated depreciation on purchases of capital goods, the government forecasts that Canada will continue to be among the leaders for economic growth among the G7 countries in 2019 and 2020.

With this backdrop, the annual federal deficits up to 2023-24 (prior to Budget 2019) are forecast to be significantly lower than what was announced in the 2018 Fall Economic Statement (the "2018 Economic Statement"). However, after taking into account new measures announced in Budget 2019, the federal deficits are forecast to be higher at $19.8 billion in 2019-20 and $19.7 billion in 2020-21 before dropping to levels which are slightly lower than those announced in the 2018 Economic Statement.

Despite the increased deficits, Budget 2019 indicates that the federal debt as a percentage of Canada's gross domestic product (GDP) will decline from 30.8% to 28.6% by 2023-24. It is further noted that much of the increase in the 2019-20 federal deficit is attributable to reduced tax revenues resulting from the accelerated depreciation announced in the 2018 Economic Statement.

Major Budget Themes

Budget 2019 outlines five key themes that will underpin the Government's future priorities:

1. **Investing in the Middle Class**
    - Supporting first-time home buyers
    - Increasing the housing supply through partnerships and targeted investments
    - The introduction of the Canada Training Benefit
    - Moving forward on implementing a national pharmacare strategy
    - Securing retirement benefit of seniors

2. **Building a Better Canada**
    - New infrastructure investing for municipalities
    - A special business write-off for the purchase of electric vehicles
    - Implementation of a national carbon pollution pricing system (the “carbon tax”)
    - Building a nation of innovators and research excellence through a variety of different measures
3. **Advancing Reconciliation with Indigenous Peoples**
    - The government reviewed a number of current initiatives, and announced new initiatives, to support the indigenous peoples and their rights to self-determination and self-government.
4. **Delivering Real Change**
    - The introduction of a national dementia strategy and support for employment of persons with disabilities
    - Support for diversity, culture and the arts
    - Assistance to veterans and their families
    - Enhancing public safety and justice
    - Taking steps to enhance federal governance processes
    - Improving client services at the Canada Revenue Agency
    - Enhancing individual security and access to justice
5. **A Fair Tax System for All**
    - A number of initiatives were announced to improve client services and tax compliance activities undertaken by the Canada Revenue Agency, modify rules relating to stock options, and eliminate certain tax planning strategies as discussed below.

Business Tax Measures

Intergenerational Business Transfers

As part of the 2017 Consultation Paper on the Taxation of Shareholders and Private Corporations (the “Consultation Paper”), the Department of Finance (“Finance”) indicated it would undertake a review of the rules in section 84.1 of the Income Tax Act (Canada) (the “ITA”) which can create punitive tax results on the transfer of shares in a private corporation to a family member.   CALU has made several submissions to Finance (most recently in January 2019) advocating for an exception to those rules on certain transfers to children of the business owner.

Unfortunately, Budget 2019 does not contain specific proposals to address the unfair tax results which can arise under section 84.1. Instead, the Government indicates that it will continue its outreach to business owners in 2019 with the plan to develop new proposals that will "better accommodate intergenerational transfers while protecting the integrity and fairness of the tax system."

CALU will continue its advocacy efforts in support of small business owners who wish to preserve the family-owned business while minimizing unfair negative tax consequences.

Personal Tax Measures

Additional Annuities to be Permitted under Registered Plans

Starting in 2020, Budget 2019 proposes to permit two new types of annuities for registered plans:

- advanced life deferred annuities ("ALDA") will be permitted under RRSPs, RRIFs, DPSPs, PRPPs and defined contribution RPPs; and
- variable payment life annuities ("VPLA") will be permitted under PRPPs and defined contribution RPPs.

In general, an ALDA will be a life annuity that can commence at a time in the future, but no later than the end of the year in which the annuitant attains 85 years of age. In order to qualify as an ALDA, there are a number of conditions that need to be met to ensure that, at the commencement time, equal annual or more frequent payments must be made to the annuitant (subject to limited circumstances where adjustments can be made, including a reduction where a spouse or common-law partner becomes entitled after the death of the annuitant) and that the commencement date cannot extend beyond the end of the year in which the annuitant attains or would have attained 85 years of age.

An ALDA will be both a qualifying annuity purchase and a qualifying investment under the identified registered plans and its value will not be included in the calculation of the minimum amount to be withdrawn from a RRIF, PRPP or defined contribution RPP. However, there will be a lifetime ALDA limit equal to the lesser of: (a) 25% of the property (other than annuities) in the registered plan at the end of the previous year plus amounts used to purchase ALDAs in previous years; and (b) $150,000, indexed to inflation after 2020. ALDAs purchased in excess of the ALDA limit will be subject to a 1% tax on the excess amount for each month in which the excess continues (with provisions to have the tax waived where the excess ALDA occurred as a result of a reasonable error and the excess is returned to the registered plan by the end of the year following the year in which the excess was purchased).

In general, a VPLA will be an annuity that provides payments that will vary based on the investment performance of the underlying annuities fund and on the mortality experience of the annuitants. Plan administrators will be permitted to set up a separate annuities fund under the plan which will receive monies from members' accounts (direct employee/employer contributions will not be permitted). In order to qualify as a VPLA there must be a minimum of 10 participating retired employees and, among other requirements, payments must commence by the later of the end of the year in which the member attains 71 years of age and the end of the year in which the VPLA is acquired.

Survivor rights and taxation of any remaining fund value or guaranteed benefits on death are similar to the treatment of regular registered annuities.

Draft legislation for these rules were not provided with Budget 2019. These will be released at a later date for public comment. As well, to accommodate VPLAs, there will be consultation on potential changes to the federal pension benefits standards legislation. Changes may also be required for provincial pension benefits standards legislation, which will need to be addressed by the individual provinces.

Individual Pension Plans

In order to further combat schemes whereby 100% of the commuted value of a defined benefit RPP is being transferred to an IPP (rather than being subject to the transfer limits applicable to an RRSP or RRIF), Budget 2019 proposes to prohibit IPPs from providing pension benefits in respect of past year employment with an employer other than the IPPs participating employer. Any transfers to an IPP in respect of such prohibited service will be a non-qualifying transfer to be included in the income of the member. This will in many cases significantly limit the commuted value amount that can be transferred to the IPP on a tax-deferred basis.

This measure applies to pensionable service credited under an IPP on or after the Budget Day.

Stock Options

Budget 2019 announces the Government's intention to introduce limits to the benefits under the current stock option tax regime for high-income individuals employed at large, long-established, mature corporations ("large corporations").

Specifically, the amount of stock option grants (based on the fair market value of the underlying shares) that can benefit from the favourable tax treatment will be capped at $200,000 annually for employees of large corporations. Stock options for start-ups and rapidly growing corporations will remain uncapped.

Further details of the measures are expected to be released before the summer of 2019 and any changes will apply on a go-forward basis; i.e., any stock options granted prior to the announcement of legislative proposals will not be subject to these new limitations.

Retirement Income Security

Protecting Pension Plan Benefits

The Government proposes to introduce legislative amendments to the *Companies' Creditors Arrangement Act*, the *Bankruptcy and Insolvency Act*, the *Canada Business Corporations Act* and the *Pension Benefits Standards Act, 1985* to better protect workplace pensions in the event of corporate insolvency. These new measures are intended to make insolvency proceedings fairer, more transparent and more accessible for pensioners and workers. This will be accomplished in part by requiring everyone involved to act in good faith, and by giving courts greater ability to review payments made to executives in the lead up to insolvency.

In addition, changes to corporate law will set higher expectations and better oversight of corporate behaviour. It will be made clear that federally incorporated businesses are able to consider diverse interests, such as those of workers and pensioners, in corporate decision-making. In addition, publicly traded, federally incorporated firms will be required to disclose their policies pertaining to workers and pensioners and executive compensation or explain why such policies are not in place. These firms will also be required to hold and disclose the results of non-binding shareholder votes on executive compensation.

The proposed pension measures will clarify that if a federally regulated plan is wound-up, it must still provide the same pension benefits as when it was ongoing. In addition, allowing defined benefit plans to fully transfer the responsibility to provide pensions to a regulated life insurance company through the purchase of annuities will improve plan sustainability and better protect retirees' pensions from the risk of employer insolvency.

Guaranteed Income Supplement (GIS)

Budget 2019 proposes to introduce legislation that will enhance the GIS earnings exemption beginning with the July 2020 to July 2021 benefit year. The enhancement will:

- Extend eligibility for the earnings exemption to self-employment income.
- Provide a full or partial exemption on up to $15,000 of annual employment and self-employment income for each GIS or Allowance recipient as well as their spouse, specifically by:
  - Increasing the amount of the full exemption from $3,500 to $5,000 per year for each GIS or Allowance recipient as well as their spouse;
  - Introducing a partial exemption of 50%, to apply to up to $10,000 of annual employment and self-employment income beyond the initial $5,000 for each GIS or Allowance recipient as well as their spouse.

Canada Pension Plan (CPP)

A small but significant number of Canadians are currently not receiving their CPP benefit because they applied for the benefit late, or not at all. To ensure all Canadian workers receive the full value of the benefits to which they contributed, Budget 2019 proposes to introduce legislative amendments to proactively enroll Canada Pension Plan contributors who are age 70 or older in 2020 but have not yet applied to receive their retirement benefit.

Home Buyer's Plan

In order to better assist first-time home buyers, Budget 2019 proposes to increase the amount that can be withdrawn from a buyer's RRSP (and the RRSP of a spouse or a common-law partner, if applicable) to facilitate the purchase of the home from $25,000 to $35,000 starting in 2019. As well, the special rules in the ITA to facilitate the acquisition of a more accessible home for a person eligible for the disability tax credit will also increase the amount that can be withdrawn from an RRSP to $35,000 starting in 2019. The rules regarding the repayment of the amount withdrawn remain the same.

Budget 2019 also proposes to extend access to funds in an RRSP to assist with the purchase of a home after the breakdown of a marriage.

In addition, Budget 2019 proposes to introduce the First-Time Home Buyer Incentive (the "Incentive"). In general, the CMHC will administer the Incentive to provide first-time home buyers with a shared equity mortgage of either 10% (for a newly constructed home) or 5% (for a resale home) of the value of the home purchase. The shared equity mortgage will not require monthly mortgage payments and is repayable no later than upon the sale of the home. To be eligible, the buyer is still required to have the minimum down payment for an insured mortgage and must have a household income under $120,000; and the amount of Incentive available is capped such that the amount of Incentive plus the insured mortgage cannot exceed four times the annual household income. It is unclear whether there will be interest payable at any time in respect of this Incentive. More information about the Incentive will be released later this year and it is expected it will be operational in September 2019.

Canada Training Benefit

Budget 2019 proposes a new refundable personal tax credit that can be claimed in connection with tuition fees and associated costs paid to an eligible educational institution (which will not include institutions outside of Canada). The amount that can be claimed by an individual to offset taxes owing (or as a refund) is limited to the lesser of: (a) one-half of the actual amounts paid in respect of the year, and (b) the individual's accumulated notional account under this regime (referred to herein as the "training account").

The amount that can be added to the training account of an individual each year is $250, to a lifetime maximum of $5,000, but only if the individual:

- files a tax return for that year,
- is at least 25 years of age and less than 65 years of age at the end of the year,
- is resident in Canada throughout the year,
- has earnings of $10,000 or more in the year (subject to indexation), and
- has net income for the year that does not exceed the top of the third bracket for the year ($147,667 in 2019).

In order to claim the credit for the year in which tuition and related fees are incurred, the individual must be resident in Canada throughout the year and under 65 years of age. The amoun cannot be claimed again under the Tuition Tax Credit regime. However, any tuition and related fees paid in a year and not claimed under this regime can still be claimed under the Tuition Tax Credit regime.

This measure will start applying in 2019 (i.e., the first year of accumulating the training account is 2019; the first year a claim could be made is 2020).

This refundable tax credit measure is paired with a proposed EI Training Support Benefit which will provide four weeks of income support (at 55% of average weekly earnings) every four years. Small businesses will benefit from an EI Small Business Premium Rebate starting in 2020 to offset the costs of employees taking advantage of this benefit.

Registered Disability Savings Plan

Budget 2019 proposes to remove the time limitation (currently about four years) during which an RDSP can continue while the beneficiary is ineligible for the disability tax credit, and alleviates the requirement to have medical certification that the beneficiary is likely to become eligible for the disability tax credit again in the future. As well, the rules requiring the repayment of government benefits into the RDSP when there is a withdrawal during this period are being modified based on the age of the beneficiary.

This measure will apply after 2020.

Tax-Free Savings Account

Under the current legislation, where a TFSA carries on business (for example, an active investment business), it is the trustee and not the holder who is jointly and severally liable for any Part I tax owing by the TFSA. Budget 2019 proposes to extend the joint and several liability to the holder and limit the joint and several liability of the trustee to the property held in the TFSA and distributions made by the TSFA after a Notice of Assessment is sent.

This measure applies starting in 2019.

Personal Tax Credit for Digital Subscriptions

Budget 2019 proposes a new, temporary non-refundable personal tax credit equal to 15% of amounts paid, capped at $500, for eligible digital new subscriptions offered by a Qualified Canadian Journalism Organization. The tax credit will be available for amounts paid after 2019 and before 2025.

Other Announcements and Measures of Interest

National Pharmacare Strategy

In Budget 2018 the Government announced the creation of the Advisory Council on the Implementation of National Pharmacare (the "Advisory Council"). Over the last year, the Advisory Council has undertaken consultations with Canadians on how best to ensure that all Canadians have affordable access to the prescription drugs, and in early March 2019 the Advisory Council released its initial report.

While the Government awaits the Advisory Council's final report, Budget 2019 indicates it intends to move forward on the three foundational elements outlined in the interim report, as follows:

- The creation of the Canadian Drug Agency, a new national drug agency that will build on existing provincial and territorial successes and take a coordinated approach to assessing effectiveness and negotiating prescription drug prices on behalf of Canadians;
- In partnership with provinces, territories and other stakeholders, the Canadian Drug Agency will assist in the development of a national formulary—a comprehensive, evidence-based list of prescribed drugs. This will provide the basis for a consistent approach to formulary listing and patient access across the country; and
- A national strategy for high-cost drugs for rare diseases to help Canadians get better access to effective treatments. The Government will co-develop a plan to ensure that patients with rare diseases have better and more consistent coverage for life-prolonging treatments.

Tax Services and Compliance Measures

To further support the Canada Revenue Agency's service improvement efforts, Budget 2019 proposes to invest an additional $50 million over five years in two key initiatives:

- The CRA processes more than two million adjustments to T1 returns post-filing and these high volumes mean that not all adjustments are processed on a timely basis. Additional staff will be hired to reduce unnecessary delays in calculating the credits and benefits to which Canadians are entitled.
- In Budget 2016, the Government invested in a pilot program to provide a dedicated telephone support line for tax service providers, giving them access to experienced CRA officers. The Government proposes to make this program permanent, improving service for those taxpayers who work with tax service providers.

As well, to help the CRA stay ahead of non-compliance schemes driven by the use of new, advanced technologies, Budget 2019 also proposes to invest $65.8 million over five years to improve the CRA's information technology systems, including replacing legacy systems, so that the infrastructure used to fight tax evasion and aggressive tax avoidance continues to evolve.

Budget 2019 further proposes to provide the CRA with $50 million over five years to create four new dedicated residential and commercial real estate audit teams in high-risk regions (e.g. British Columbia and Ontario). These teams will ensure that tax provisions regarding real estate are being followed, and in particular:

- Taxpayers report all sales of their principal residences on their tax returns;
- Any capital gain derived from a real-estate sale, where the principal residence tax exemption does not apply, is identified as taxable;
- Money made on real estate flipping is reported as income;
- Commissions earned are reported as taxable income; and
- For Goods and Services Tax/Harmonized Sales Tax (GST/HST) purposes, builders of new residential properties remit the appropriate amount of tax to the CRA.

Strengthening Beneficial Ownership Reporting

In December 2017 the federal, provincial and territorial governments committed to improving corporate transparency so that Canadian authorities can more clearly identify who owns which corporations in Canada. There was also agreement to work together to better harmonize corporate ownership record requirements between jurisdictions. To that end, the *Canada Business Corporations Act* was amended to require federally incorporated corporations to maintain beneficial ownership information starting in the summer of 2019.

In Budget 2019, the Government proposes further amendments to the ITA to make the beneficial ownership information maintained by federally incorporated corporations more readily available to the CRA and law enforcement officials.

What's Not in the Budget?

Budget 2019 does not contain any new tax measures relating to the following areas:

- Tax treatment of exempt life insurance policies
- Rules governing the capital dividend account
- Individual or corporate tax rates
- Tax treatment of capital gains
- Taxation of group life and health benefits
- Modifications to the tax on split income (TOSI) or passive investment rules

However, Budget 2019 did indicate that the government still plans to move ahead with the following:

- Measures announced in the 2018 Economic Statement to provide for the accelerated capital cost allowance
- Measures announced in Budget 2018 to implement enhanced reporting requirements for certain trusts to provide additional information on an annual basis starting in 2021

- Measures announced in Budget 2018 to facilitate the conversion of Health and Welfare Trusts to Employee Life and Health Trusts
- Measures announced in Budget 2016 on information reporting requirements for certain dispositions of an interest in a life insurance policy governed by subsection 148(7) of the ITA)

Budget 2019 also reaffirms the Government's commitment to move forward as required with technical amendments to improve the certainty of the tax system.

CALU will continue to monitor and report on the implementation of the budget measures and will make submissions to Finance on those proposals of importance to our members.

On behalf of its members and its partner organization, Advocis, CALU represents the interests of more than 13,000 advisors on advanced planning issues to protect the financial futures of millions of Canadians. CALU's 650 industry leading members include insurance and financial advisors as well as accounting, tax, legal and actuarial experts. These professionals provide expert advice that Canadians rely on to invest in their businesses and live a more secure and prosperous life.

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