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Canadian tax alert

2019-2020 federal budget highlights

March 19, 2019

The Minister of Finance, Bill Morneau, presented the 2019-2020 federal budget in the House of Commons this afternoon. Key themes include growing the economy, implementing national pharmacare, investing in the middle class, and gender equality. In comparison to previous budgets, innovation appears to be less of a focus.

In the Fall Economic Statement, the government announced an accelerated investment incentive and the immediate write-off of manufacturing and processing machinery and equipment as well as clean energy equipment in response to the recent US tax reform. This budget does not provide any additional measures to respond to this development.

The budget announces an investment of $1 billion in training support through employment insurance (EI). This new EI training support benefit will provide up to four weeks of income support, every four years, at 55% of a person’s average weekly earnings.

The government continues to introduce measures to close tax loopholes. Furthermore, the budget proposes to invest an additional $150.8 million over five years to build on previous investments to support the Canada Revenue Agency (CRA) in its efforts to prevent tax evasion and improve tax compliance.

Of note, the budget does not include further measures to address recommendations from the Organisation for Economic Co-operation and Development's base erosion and profit shifting project, particularly with respect to interest deductibility and anti-hybrid measures.

A summary of the economic and tax highlights contained in the budget is provided below.

Fiscal/economic outlook

The deficit for 2018-2019 is estimated to be $14.9 billion and a deficit of $19.8 billion is predicted for 2019-2020. The deficit is projected to decline gradually, reaching $9.8 billion by 2023-2024.

The federal debt-to-GDP ratio is estimated to be 30.7% for 2019-2020. This ratio is expected to decline to 28.6% in 2023-2024.

GDP is expected to grow by 1.8% in 2019 and by 1.6% in 2020.

The CPI inflation rate is estimated to be 1.9% for 2019 and will remain stable over the next few years.

The unemployment rate for 2019 is estimated to be 5.7% and is expected to remain stable in the coming years.

Personal tax measures

- The budget proposes to introduce a $200,000 annual cap on employee stock option grants (based on the fair market value of the underlying shares) that may receive preferential tax treatment for employees of large, long-established, mature firms. More details of this measure will be released before this summer.

- A new refundable Canada training tax credit is proposed to provide financial support to help cover up to half of eligible tuition and fees associated with training. Eligible individuals will accumulate $250 each year in a notional account, to a maximum of $5,000 over a lifetime. The amount of credit that can be claimed for a taxation year will be equal to the lesser of 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. This measure will apply to the 2019 and subsequent taxation years.

- The budget proposes to increase the registered retirement savings plan (RRSP) withdrawal limit for the Home Buyers' Plan from $25,000 to $35,000, applicable to 2019 and subsequent calendar years in respect of withdrawals made after March 19, 2019.

- The budget also proposes to extend access to the Home Buyers' Plan after the breakdown of a marriage or common-law partnership for RRSP withdrawals made after 2019.

- Budget 2019 proposes to address inconsistencies in the change in use rules for owners of multi-unit residential properties in comparison to owners of single-unit residential properties, by allowing a taxpayer 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 that occur on or after March 19, 2019.

- For certain registered plans, two new types of annuities are proposed, applicable to 2020 and subsequent years:
  - advanced life deferred annuities under an RRSP, registered retirement income fund, deferred profit sharing plan, pooled registered pension plan (PRPP) and defined contribution registered pension plan; and
  - variable payment life annuities under a PRPP and defined contribution RPP.

- Applicable after 2020, in respect of registered disability savings plans (RDSPs), the budget proposes to remove:
  - the time limitation on the period that an RDSP may remain open after a beneficiary becomes ineligible for the disability tax credit (DTC), and
  - the requirement for medical certification that the beneficiary is likely to become eligible for the DTC in the future in order for the plan to remain open.

- In recognition of kinship care programs, the budget proposes, for the 2009 and subsequent taxation years, to amend the Income Tax Act to clarify that:
  - An individual may be considered to be the parent of a child in his or her care for the purpose of the Canada Workers Benefit, regardless of whether he or she receives financial assistance under a kinship care program, and
  - Financial assistance payments received by care providers under a kinship care program are neither taxable nor included in income for the purposes of determining entitlement to income-tested benefits and credits.

- For donations of cultural property, amendments to the Income Tax Act and the Cultural Property Export and Import Act are proposed to remove the requirement that property be of "national importance" to qualify for the enhanced tax incentives. The amendments will apply in respect of donations made on or after March 19, 2019.

- The budget proposes to expand, as they become legal for sale, the range of cannabis products eligible for the medical expense tax credit, effective October 17, 2018.

- Budget 2019 proposes to prohibit contributions to a specified multi-employer pension plan (SMEP) in respect of a member after the end of the year that the member turns 71 and also to a defined benefit provision of a SMEP if the member is receiving a benefit from that plan. These proposed changes are effective in respect of SMEP contributions made pursuant to a collective bargaining agreement entered into after 2019, in relation to contributions made after the date that the arrangement is entered into.

- The budget proposes to restrict certain benefits that may be provided by Individual Pension Plans (IPP) by treating any transfer from a former employer's defined benefit pension plan to an IPP that relates to benefits provided in respect of prohibited services as a non-qualifying transfer that is included in the member's income for tax purposes. This proposed measure applies to pensionable service credited under an IPP on or after March 19, 2019.

- Rules are introduced to prevent mutual fund trusts from allocating income or capital gains to redeeming unitholders in a manner that is considered to inappropriately defer tax or convert ordinary income to lower taxed capital gains. The rules would deny a deduction to the mutual fund trust of the allocation or a portion thereof in certain circumstances. This measure would apply to taxation years that begin on or after March 19, 2019.

- A tax–free savings account (TFSA) is subject to income tax if the TFSA earns business income or income from non-qualified investments. Liability for this tax in the case of income from business carried on by the TFSA currently rests jointly and severally with the TFSA and the trustee (typically a financial institution). The budget proposes to extend this joint and several liability to the TFSA holder. As well, the liability of the TFSA trustee will be limited. This measure would apply to the 2019 and subsequent taxation years.

- Budget 2019 proposes a new 15% non-refundable tax credit for amounts paid by individuals for eligible new subscriptions paid to a QCJO. The maximum amount of this tax credit is $75 annually and applies for payments made from January 1, 2020 to December 31, 2024.

Business tax measures

- For taxation years ending on or after March 19, 2019, the use of taxable income in computing a corporation's expenditure limit for the purpose of its eligibility for the enhanced refundable investment tax credits under the Scientific Research and Experimental Development program is proposed to be repealed. The current reduction to the expenditure limit for taxable capital remains unchanged.

- For purchases of zero emission vehicles on or after March 19, 2019, the budget proposes to introduce two new classes for capital cost allowance (CCA) that will be eligible for CCA at 100% with no half-year rule. Class 54 will be used for zero emission vehicles that would otherwise be included in class 10 or class 10.1. Class 55 will be used for zero emission vehicles that would otherwise be included in class 16. These enhanced capital cost allowance rules will be phased out between 2024 and 2027.

- It is proposed, for taxation years beginning after March 21, 2016, the definition of specified corporate income be modified. With the change, Canadian-controlled private corporations in the business of farming and fishing will be entitled to claim a small business deduction on income from sales to any arm's length purchaser.

- For transactions entered into on or after March 19, 2019, Budget 2019 proposes to amendments to certain derivative transactions that convert what would otherwise be ordinary income into capital gains. The definition of a "derivative forward agreement" will be amended to ensure ordinary income treatment for these transactions.

- The budget proposes, effective January 1, 2020, that registered journalism organizations be granted status as qualified donees under the Income Tax Act to allow individuals to claim a charitable donation tax credit, or corporations to claim a deduction, for donations made to these organizations. To qualify, journalism organizations must meet certain conditions to be recognized as a Qualified Canadian Journalism Organization (QCJO).

- It is proposed that a new 25% refundable tax credit be introduced on salary and wages paid to eligible newsroom employees of a QCJO on or after January 1, 2019. The credit is capped at $13,750 per individual per year. The QCJO will be required to meet additional criteria in order to be eligible for the credit.

- Effective March 12, 2018, the budget proposes to allow joint projects of producers from Canada and Belgium to qualify for the Canadian film or video production tax credit.

International tax measures

- The foreign affiliate dumping rules, which aim to prevent the tax-free extraction of surplus when, generally, a corporation resident in Canada (CRIC) that is controlled by a non-resident corporation invests in a foreign affiliate, are proposed to be amended to apply in additional circumstances. For transactions that occur on or after March 19, 2019, the rules will also apply to CRICs that are controlled by a non-resident individual, trust or a non-arm's length group comprised of any combination of non-resident individual(s), trust(s) or corporation(s). This measure will apply to transactions and events that occur on or after March 19, 2019.

- For taxation years beginning on or after March 19, 2019, the budget proposes the introduction of an ordering provision in the Income Tax Act to ensure that the transfer pricing rules apply before other rules. This will affect a number of computations, notably the computation of income and the calculation of transfer pricing penalties. The current exceptions to the application or the transfer pricing rules for situations involving amounts owing (and related guarantees in respect thereof) by a controlled foreign affiliate will continue to apply.

- The budget proposes to expand the application of the definition of "transaction", which currently applies for transfer pricing purposes only, to all circumstances involving the three-year extended reassessment period related to transactions involving non-resident non-arm's length parties. This amendment is proposed to apply to taxation years for which the normal reassessment period ends on or after March 19, 2019.

- Amendments are proposed to the rules for cross-border share lending arrangements, applicable to dividend compensation payments made on or after March 19, 2019:
    - It is proposed that a dividend compensation payment made under a securities lending arrangement (or a specified securities lending arrangement) by a Canadian resident to a non-resident, in respect of a share of a Canadian corporation, is always treated as a dividend and, as such, always subject to Canadian dividend withholding tax. An anti-avoidance measure will be introduced to ensure that the appropriate dividend withholding tax rate applies in the circumstances.
    - In the case of a securities lending arrangement involving foreign shares, it is proposed that the exemption from Canadian dividend withholding tax be

expanded to include any dividend compensation payment made by a Canadian resident to a non-resident under a securities lending arrangement if the securities lending arrangement is fully collateralized.

Other measures

- As of January 1, 2020, it is proposed that the CRA will be allowed to send requirements for information electronically to banks or credit unions that consent to this method of service.

- The budget proposes to extend the application of GST/HST relief to certain human reproduction procedures, foot care devices and multidisciplinary health care services, effective after March 19, 2019.

- For the taxation of cannabis, Budget 2019 proposes that edible cannabis, cannabis extracts and cannabis topicals be subject to excise duties imposed on cannabis licensees at a flat rate applied on the quantity of total tetrahydrocannabinol (THC), effective as of May 1, 2019.

For further details, we refer you to the Ministry of Finance website.

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