2019

Federal budget

Insights from our
Tax & Estate Planning professionals

On March 19, 2019, Finance Minister Bill Morneau announced the Liberal Government's fourth federal budget plan, "**Investing in the Middle Class.**" The plan pledges continued focus on supporting middle-class Canadians, which is reflected in several of the individual tax measures that expand existing programs to encourage first-time homebuyers, education, and additional retirement income support for seniors. The plan also provides tightening of income tax measures that are perceived to provide advantages for high-income executives and entrepreneurs. The changes appear to focus on providing assistance to Canadians who aspire to join the middle class and a promise of a better future.

The following report details some of the specific budget proposals that may have an impact on Richardson GMP clients and their families.

Some of the highlights include:

- Expanded rules to assist first-time home buyers
- A new Canada Training Credit
- Restrictions on the preferential tax treatment of employee stock options
- Less restrictive rules for Registered Disability Savings Plan (RDSP) holders who no longer qualify for the Disability Tax Credit (DTC)
- Proactive Canada Pension Plan (CPP) enrolment for seniors over age 70
- New annuity payment options for retirees
- Rule changes for transfers of Individual Pension Plans (IPP)
- Changes in the tax treatment of mutual fund trusts
- Improved consistency in the taxation of multi-use residential properties
- Greater flexibility in the small business deduction for farming and fishing businesses
- Encouraged investment in zero emission vehicles
- Expansion of rules for donations of cultural property
- Support for the Canadian journalism industry

First-Time Home Buyer Incentive

Budget 2019 recognizes the mounting constraints that individuals are facing in recent years in obtaining home ownership (such as rising home prices and limited supply) and proposes to introduce the First-Time Home Buyer Incentive to supplement existing benefits, such as the non-refundable tax credit for purchases of a first home.

The First-Time Home Buyer Incentive is a shared equity mortgage program with Canada Mortgage and Housing Corporation (CMHC) intended to reduce the mortgage payments required to own a home. The incentive would provide funding of 5% (for an existing home) or 10% (for a newly constructed home) of the home purchase price. No ongoing monthly payments of the funding are required and the buyer would repay the funding at re-sale. The First-Time Home Buyer Incentive is only available for first-time home buyers with household incomes under $120,000 per year.

For example, an individual could purchase a $400,000 home with a 5% down payment and a 5% CMHC shared equity mortgage. This reduces the size of the individual's insured mortgage from $380,000 to $360,000, helping to lower the monthly mortgage bill.

Home Buyers' Plan (HBP)

The HBP allows first-time home buyers to withdraw up to $25,000 from their Registered Retirement Savings Plans (RRSP) to purchase or build a home, without having to pay tax immediately on the withdrawal. Minimum repayments of the outstanding HBP, however, are required over a 15-year period to avoid tax on withdrawals.

Consistent with the goal of promoting first-time home ownership, budget 2019 proposes to increase the HBP withdrawal limit to **$35,000**. This would be available for withdrawals made after March 19, 2019. Furthermore, budget 2019 proposes to allow for individuals who experience the breakdown of a marriage or common-law partnership to be eligible to participate in the HBP, even if they do not meet the first-time home buyer requirement. This could occur, for example, if a separated couple previously purchased a family home while married and are now unable to continue maintaining the home together.

Canada Training Benefit

Budget 2019 proposes to support young Canadians through improvements in the Canada Student Loan program. The proposals include reduced interest rates as well as a six-month interest-free grace period after leaving school.

In addition, budget 2019 introduces a new Canada Training Benefit to assist working Canadians with professional development. The Canada Training Benefit will include a Canada Training Credit, which is a non-taxable credit that can cover up to half of eligible tuition and fees associated with training. Eligible individuals will accumulate $250 each year in a notional account which can be accessed for this purpose, with a lifetime maximum of $5,000. To accumulate a $250 credit in a year, the individual has to be at least 25 years old and less than 65 years old at the end of the year, have earnings of at least $10,000 in the year, file a tax return in the year, and have net income under the top of the third tax bracket for the year ($147,667 in 2019).

The credit will accrue and can be used against eligible tuition and training fees. The individual will have to pay for the eligible fees upfront and claim the non-taxable credit when the tax return is filed for the year. Any unused balance will expire at the end of the year in which an individual turns 65.

The tuition and training fees that are eligible for the Canada Training Credit will generally be the same as under the existing rules for the Tuition Tax Credit; however, educational institutions outside of Canada will not be eligible for the Canada Training Credit.

This measure will apply to the 2019 and subsequent taxation years. Consequently, the annual accumulation to the notional account will start based on eligibility in respect of the 2019 taxation year and the credit will be available to be claimed for expenses in respect of the 2020 taxation year.

Employee Stock Options

Employee stock options are an alternative compensation method used by companies to attract talented individuals in the job market and promote their long-term retention, engagement, and growth. To that end, the government has provided preferential personal income tax treatment in the form of a stock option deduction. If eligible, the stock option deduction effectively results in the employment benefit associated with employee stock options being taxable at capital gains rates (currently 50% of ordinary rates).

The government believes that the benefit of the existing stock option deduction, which was intended to support younger and growing Canadian businesses, is being disproportionately accrued to high-income employees of large, mature companies. To address this perceived inequity, budget 2019 proposes to apply a $200,000 annual cap on employee stock options grants (based on the fair market value of the underlying shares) that may receive tax-preferred treatment for employees of "large, long-established, mature firms."

According to the government, this treatment will align more closely with the U.S. in terms of its tax treatment of stock options.

The annual $200,000 cap will not apply to “start-ups and rapidly growing Canadian businesses,” meaning that these businesses can continue the ability to use employee stock options to attract and reward employees, and employees can continue to receive the full benefit of the stock option deduction.

No proposed legislation was included in budget 2019 for this measure. The government has indicated that they will provide further details before the summer of 2019. Items that would need to be addressed in the proposed legislation include definitions of what constitutes a “large, long-established, mature firm” and a “start-up and rapidly growing Canadian business” and how a company transitions from one category to the other. However, budget 2019 has confirmed that the changes to the employee stock options rules will apply on a go-forward basis only and would not apply to employee stock options granted prior to the announcement of legislative proposals.

Example of pre-budget 2019 rules:

David is an executive of a large, long-established, mature Canadian public company and has received the option of acquiring 100,000 shares of the company at a price of $50 per share (the fair market value of the shares on the date the options were granted). In a future year when the options have vested, David decides to exercise them all, when the share price has risen to $70 per share.

Under pre-budget 2019 rules, David’s employment benefit is equal to:

- $2,000,000 [100,000 shares exercised x ($70 - $50)]
- Less: $1,000,000 stock option deduction (based on the current capital gains rate of 50%)
- Equals: **$1,000,000 taxable employment income**.

Example of proposed rules:

Using the same fact pattern for David, the proposed rules would apply in his scenario because he is employed at a large, long-established, mature company and the fair market value of the shares at the time of grant ($50 x 100,000 = $5,000,000) exceeds the $200,000 annual limit.

Based on these figures, only 4,000 of the 100,000 options ($200,000 / $50 = 4,000) are eligible for the stock option deduction, while the remaining 96,000 options will be taxed to David at ordinary rates. Therefore, when David exercises all of his options in a future year at $70 per share, his employment benefit is equal to:

- $80,000 [4,000 shares eligible for stock option deduction x ($70 - $50)]
- Less: $40,000 stock option deduction available only for the 4,000 shares eligible for the deduction
- Plus: $1,920,000 [96,000 shares ineligible for stock option deduction x ($70 - $50)]
- Equals: **$1,960,000 taxable employment income.**

Comparison:

The proposed rules result in a **$960,000 increase in taxable income for David**, compared to pre-budget 2019 rules.

Improvements to the RDSP

The RDSP is designed to help Canadians with severe disabilities, along with their families, save for their long-term financial security. Private contributions to an RDSP can attract Canada Disability Savings Grants at matching rates of 100%, 200%, or 300%, depending on family income and the amount contributed. No private contributions are required to receive the Canada Disability Savings Bond, making this an important financial support for individuals and families with low and modest incomes.

To ensure that the RDSP continues to respond to the needs of Canadians with disabilities, budget 2019 proposes two changes that will better protect the long-term savings of persons with disabilities:

- **More flexible options for individuals who suffer periods of severe, but episodic, disability**
  To open an RDSP an individual must be eligible for the DTC. When a beneficiary no longer qualifies for the DTC, the RDSP rules can require that the plan be closed and grants and bonds be repaid to the government. Budget 2019 proposes, with specific conditions, to eliminate the requirement to close an RDSP when a beneficiary no longer qualifies for the DTC.

- **Protection from seizure by creditors in bankruptcy**
  Unlike RRSPs, amounts held in RDSPs are not exempt from seizure by creditors in bankruptcy. To level the playing field, budget 2019 also proposes to exempt RDSPs from seizure in bankruptcy, with the exception of contributions made in the 12 months before the filing.

Changes to Retirement Income Planning for Seniors

Canadians are living longer and many retirees worry that their retirement savings may not be flexible enough to continue to support lifestyle needs later in life. Two specific measures are introduced in budget 2019:

1. **Proactive CPP Enrolment**
   Budget 2019 continues to support the measures previously introduced in 2016 to enhance public pension income through the following:

   - Enhancement of the CPP, which will raise the maximum CPP retirement benefit by up to 50% over time
   - Increased Guaranteed Income Supplement (GIS) top up payments by up to $947 per year for single seniors; and
   - Higher benefits for those couples who receive GIS and allowance benefits and have to live apart for reasons beyond their control

   The traditional age to begin receiving CPP and OAS benefits is 65; however, there may be a significant benefit to delaying the start of these pensions as late as age 70, especially if the individual lives a long life. The deferral of the commencement date provides a permanent increase in the monthly income amount.

   For those eligible for CPP, the government recognizes that some Canadians never apply for these benefits, possibly due to the small amount of time spent in the workforce. Budget 2019 proposes a new proactive enrolment plan for CPP contributors who are age 70 or older in 2020 but have not yet applied to receive their retirement benefit. This proactive enrolment process may limit the flexibility of some retired Canadians who would otherwise have qualified for federal or provincial income-tested benefits. The government proposes to extend the period under which a person can choose not to receive a CPP retirement pension from six months to a year to assist with this transition.

2. **New Annuity Options**
   In addition to CPP and OAS, and potentially GIS, most Canadians rely on one or more registered savings plans to support their retirement needs, including:

   - RRSP;
   - Registered Retirement Income Fund (RRIF);
   - Deferred Profit Sharing Plan (DPSP);
   - Pooled Registered Pension Plan (PRPP); and
   - Registered Pension Plan (RPP).

   As one option to provide for retirement income, the tax rules allow funds from the above-mentioned plans to be used to purchase an annuity to provide income in retirement. In exchange for a lump-sum amount of funds, an annuity provides a stream of periodic payments to an individual (i.e., the annuitant), generally 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. Generally, an annuity purchased with registered funds must commence by the end of the year in which the annuitant attains 71 years of age. The income stream received from the annuity in future years cannot be altered, other than with possible increases for inflation based on the annuity contract.

Budget 2019 proposes to provide more flexibility to annuitants by permitting two new types of annuities under the tax rules for certain registered plans:

1. **Advanced Life Deferred Annuity** (ALDA)
   An ALDA will be a life annuity with a deferred commencement date until the end of the year in which the annuitant attains 85 years of age. The value of an ALDA will not be included for the purpose of calculating the minimum amount required to be withdrawn in a year from a RRIF, a PRPP member's account or a defined contribution RPP member's account, after the year in which the ALDA is purchased.

   There will be a lifetime limit for the ALDA equal to 25% of a specified amount in relation to a particular qualifying plan. The specified amount will equal the sum of:

   - the value of all property (other than most annuities, including ALDAs) held in the qualifying plan as at the end of the previous year; and
   - any amounts from the qualifying plan used to purchase ALDAs in previous years.

   There is also a comprehensive lifetime ALDA dollar limit of $150,000 from all qualifying plans, indexed for inflation after 2020.

   The ALDA may provide for a more guaranteed income stream in later life that was not anticipated when the annuitant began their retirement income from registered plans at age 71 or earlier.

2. **Variable Payment Life Annuity** (VPLA)
   Budget 2019 proposes to amend the tax rules to permit administrators of PRPPs and defined contribution RPPs to provide a VPLA to members directly from the plan. A VPLA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants.

   The VPLA may provide the annuitant with more opportunistic access to market performance which is not typically available from a traditional annuity. In order to participate in a VPLA, a minimum of 10 retired members will be required on an ongoing basis.

These two new retirement income options will apply to the 2020 and subsequent taxation years.

Changes to IPP – Pensionable Service

An IPP is a defined benefit registered pension plan that can provide owner-managers with a mechanism to provide lifetime retirement benefits.

When an individual terminates membership in an IPP, existing rules allow for a tax-deferred transfer of all or a portion of the commuted value of the member's accrued benefits to another defined benefit plan sponsored by another employer or to a RRSP or similar registered plan (subject to prescribed transfer limits). The government acknowledges that taxpayers are circumventing the prescribed transfer limits by establishing an IPP sponsored by a newly incorporated private corporation controlled by the same individual and obtaining a fully tax-deferred transfer to the new IPP, rather than the restricted transfer of assets to his or her RRSP.

Budget 2019 proposes to prohibit IPPs from providing retirement benefits in respect of past years of employment that were pensionable service under a defined benefit plan of an employer other than the IPP's participating employer. Any assets transferred from a former employer's defined benefit plan to an IPP that relate to benefits provided in respect of prohibited service will be considered a non-qualifying transfer that will be taxable to the member. This measure applies to pensionable service credited under an IPP on or after March 19, 2019.

Mutual Funds – Deferral and Recharacterization of Capital Gains

Mutual fund trusts are used to pool and invest funds. For income tax purposes, these trusts are generally treated as conduits and as such its capital gains and ordinary income are allocated to its unitholders and taxed in their hands. The mutual fund trust is then entitled to a deduction for amounts allocated out to unitholders.

The government recognizes that there are scenarios where the conduit treatment of mutual fund trusts can be utilized to defer income or recharacterize the income to capital gains, which are taxed at a preferential rate. Therefore, budget 2019 introduces rules to prevent the use by mutual fund trusts of a method of allocating capital gains or income to their redeeming unitholders where the use of that method inappropriately defers tax or converts fully taxable ordinary income into capital gains taxed at a lower rate.

Change-in-Use Rules for Multi-Unit Residential Properties

Under tax rules, an individual is deemed to dispose of and immediately reacquire a property when s/he converts either a part or the entirety of it from personal-use to income-producing purposes, and vice versa. This can force the recognition of accrued gains, even though an actual disposition has not occurred. Existing rules have provided special elections that taxpayers can make when a change-in-use has occurred which effectively defers the tax on any accrued capital gain in the property until a future disposition. However, these special elections were only allowed if the entirety of a property was converted, even though the deemed disposition rules applied if only part of a property was changed.

Budget 2019 proposes to improve the consistency of the tax treatment by extending the election to owners of multi-unit residential properties. This extension will apply to changes in use of property that occur on or after March 19, 2019. The extension of the election will benefit homeowners who may convert a portion of their home (e.g., the basement) to a separate rental dwelling without forcing a deemed disposition while also preserving their principal residence exemption.

On the topic of real estate, budget 2019 proposes to provide the Canada Revenue Agency (CRA) with $50 million of funding over the next five years to support their audit efforts to ensure that taxpayers are properly reporting transactions involving personal and business-use real estate.

Small Business Deduction – Farming and Fishing

Prior Budgets have introduced significant changes to private corporations, one of them being the reduction of the federal small business corporate rate from 15% to 9% on up to $500,000 of active business income. Recognizing the potential incentive by taxpayers to “multiply” the $500,000 limit within a corporate group, the government introduced rules to disqualify “specified corporate income” of a Canadian-controlled private corporation (CCPC) from the preferential corporate rates. One exception from specified corporate income included income from a CCPC’s farming or fishing business arising from sales to a farming or fishing cooperative corporation, meaning that such income continued to benefit from the small business rates.

For farming and fishing income, budget 2019 proposes to eliminate the requirement that the farming and fishing income be from sales to a farming or fishing cooperative corporation. As such, a CCPC’s farming or fishing business income to any arm’s length purchaser will not be treated as specified corporate income and thus will be eligible for the small business rates. This measure will apply to taxation years beginning after March 21, 2016.

Accelerated Write-off of Zero-Emission Vehicles

In computing income, certain individuals and corporations are allowed to claim capital cost allowance (CCA) (i.e., tax depreciation) on depreciable assets used in business. Depreciable assets are categorized into classes under the CCA system and arbitrary depreciation rates are applied. The basic CCA rate applicable to most motor vehicles is 30%.

In line with the government’s objective of promoting a cleaner economy, budget 2019 proposes to provide a temporary enhanced first-year CCA rate of 100% in respect of zero-emission vehicles. This measure will apply to eligible zero-emission vehicles acquired on or after March 19, 2019 and that become available for use before 2028. However, the enhanced allowance is reduced from 100% to 75% for vehicles that become available for use between 2024 and 2025, and to 55% between 2026 and 2027.

Donations of Cultural Property

Currently, donations of cultural property to certain designated institutions and public authorities in Canada are eligible for the charitable donation tax credit as well as an exemption from income tax for any capital gains arising on the disposition of such property. To qualify for the incentives, the cultural property must be of "outstanding significance" by reason of its close association with Canadian history or national life and be of "national importance" to such a degree that its loss to Canada would significantly diminish the national heritage.

Budget 2019 proposes to remove the requirement for the property to be of "national importance" in order to qualify for the tax incentives for donations of cultural property. Therefore, cultural property must only be of "outstanding significance." This measure will apply in respect of donations made on or after March 19, 2019.

Support for Canadian Journalism

Budget 2019 proposes to introduce three new tax measures to support Canadian journalism. This proposal is spearheaded with a new registration category in the *Income Tax Act* for organizations to be granted a status of Qualified Canadian Journalism Organization (QCJO). In order to be a QCJO, an organization will be required to be recognized as meeting specific criteria developed by the independent panel.

With this status, the following benefits may be available:

1. allowing journalism organizations to register as qualified donees, similar treatment to registered charities;
2. a refundable labour tax credit for qualifying journalism organizations; and
3. a personal non-refundable tax credit for subscriptions to Canadian digital news.

The third measure mentioned above will be of interest to individual Canadians. The proposal is for a temporary, non-refundable 15% tax credit on amounts paid by individuals for eligible digital news subscriptions. This will allow individuals to claim up to $500 in costs paid towards eligible digital subscriptions in a taxation year, for a maximum tax credit of $75 annually.

Eligible digital subscriptions are those that entitle a taxpayer to access content provided in a digital form by a QCJO that is primarily engaged in the production of written content. A subscription with a QCJO carrying on a broadcasting undertaking (as defined in the *Broadcasting Act*) will not qualify for this credit.

This credit will be available in respect of eligible amounts paid after 2019 and before 2025.