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THE MARCH 19, 2019 FEDERAL BUDGET

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on the March 19, 2019 Federal Budget. Although these proposals are likely to be implemented in their present form, these provisions are not yet law and the final legislation should be reviewed before initiating any transaction. It is important to note that this Legal Business Report only contains Budget highlights, and the 2019 Federal Budget should be consulted for the full list of tax implications arising from the Federal Budget.

Alpert Law Firm is experienced in providing legal services to its clients in corporate-commercial transactions, tax and estate planning matters, wealth preservation, tax dispute resolution, tax litigation and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Taxation Law, and also as a Specialist in Corporate and Commercial Law.

A. MEASURES AFFECTING BUSINESSES

1. Corporate Income Tax Rates

The March 19, 2019 Federal Budget (the “2019 Budget”) proposes no changes to the federal corporate income tax rates. The enacted federal corporate income tax rates are as follows:

	Federal	**Ontario**	**Combined Federal and Ontario**
General	15%	11.5%	26.5%
M&P	15%	10%	25%
Active Business Income (CCPCs)	9%	3.5%	12.5%
Investment income (CCPCs)	38.67%	11.5%	50.17%

2. Scientific Research & Experimental Development (“SRED”) Program

Under the current SRED regime in the Income Tax Act (the “Act”), a Canadian-controlled private corporation (“CCPC”) may be entitled to an enhanced refundable tax credit of 35% on up to $3,000,000 of qualifying annual SRED expenditures. A CCPC’s entitlement to the SRED credit is gradually phased out where: (i) the total taxable

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income of the CCPC and its associated corporations exceeds $500,000 for the preceding taxation year; or (ii) the total taxable capital employed in Canada by the CCPC and its associated corporations exceeds $10,000,000 for the preceding taxation year.

The 2019 Budget proposes to eliminate the use of taxable income as a factor for the purpose of computing a CCPC's entitlement to the SRED credit. As a result, a CCPC's access to the SRED credit will only be gradually phased out if the total taxable capital employed in Canada by the CCPC and its associated corporations exceeds $10,000,000 for the preceding taxation year. This measure will apply to taxation years that end on or after March 19, 2019.

3. <u>Conversion of Income to Capital Gains by Mutual Funds</u>

The Act was amended in 2013 to add rules to treat gains arising from a "derivative forward agreement" ("DFA") as ordinary income rather than as capital gain. A DFA is defined to include any agreement to purchase a capital property where the term of the agreement exceeds 180 days and the difference between the fair market value of the property delivered on settlement of the agreement and the amount paid for the property is derivative in nature (i.e., attributable, in whole or in part, to an underlying interest).

The definition of DFA excludes any agreement where the difference between the fair market value of the property delivered on settlement and the amount paid for the property is attributable to the economic performance of the actual property being purchased and sold, rather than an underlying reference property. This exception is intended to exclude certain ordinary commercial transactions (i.e. merger and acquisition transactions) from the scope of the DFA rules. The federal government believes that certain character conversation transactions have been developed to exploit this exception in an unintended manner.

The 2019 Budget provides the example of a mutual fund trust ("Investor Fund") entering into a forward purchase agreement with a counterparty to acquire units of a second mutual fund trust ("Reference Fund"), for a purchase price equal to the value of such units on the date the agreement is entered into. Following settlement of the forward purchase agreement, Investor Fund redeems or sells the units of Reference Fund and realizes a gain, which it treats as a capital gain. Investor Fund does not treat the forward purchase agreement as a DFA on the basis that the agreement falls within the above-mentioned exception because Investor Fund's return under the agreement is based on the economic performance of the acquired units of Reference Fund over the

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term of the agreement. The 2019 Budget states that Investor Fund is essentially provided with an economic return that is based on the performance of the portfolio of investments held by Reference Fund, and that these portfolio investments would typically give rise to income gains if held directly by Investor Fund.

To address this perceived abuse, the 2019 Budget proposes an amendment which introduces additional qualifications for the commercial transaction exception described above. Under the proposed rules, a forward purchase agreement in connection with Canadian securities will generally not be excepted from the DFA definition if one of the main purposes of the agreement is for a taxpayer to convert the amount paid or payable on the Canadian security by its issuer during the term of the agreement from ordinary income into capital gains.

The 2019 Budget proposes that this measure will apply to transactions entered into on or after March 19, 2019. In addition, beginning in 2020, this measure will also apply to transactions that were entered into before March 19, 2019, including those that extended or renewed the terms of the agreement on or after March 19, 2019, subject to certain transitional rules.

4. Business Investment in Zero-Emission Vehicles

The 2019 Budget proposes to introduce a temporary enhanced first-year capital cost allowance (“CCA”) rate of 100% for eligible zero-emission vehicles acquired by businesses on or after March 19, 2019. A phase-out period will apply in respect of eligible zero-emission vehicles acquired by businesses after 2023.

Specifically, the 2019 Budget introduces two new classes of depreciable property which will be eligible for the enhanced first-year CCA rate: (i) Class 54 for zero-emission vehicles that would otherwise be included in Class 10 or 10.1 (i.e. passenger vehicles); and (ii) Class 55 for zero-emission vehicles that would otherwise be included in Class 16 (i.e. taxis, short-term rental vehicles and freight trucks). Class 55 zero-emission vehicles will be eligible to a full first-year write-off in respect of the cost of such vehicles, while Class 54 zero-emission vehicles will be subject to a first-year deduction limit of $55,000.

5. Support for Canadian Journalism

The 2019 Budget proposes to introduce the concept of a “Qualified Canadian Journalism Organization” (“QCJO”) and proposes to afford QCJOs and their subscribers the following benefits:

(i) Effective January 1, 2020, the ability for certain QCJOs to register as "qualified donees" for the purposes of the Act's charitable giving regime;

(ii) Effective January 1, 2019, the availability of a 25% refundable labour tax credit for qualifying QCJOs on wages or salary paid to "eligible newsroom employees", subject to a cap on labour costs of $55,000 per eligible newsroom employee per year (i.e. maximum tax credit of $13,750 per eligible employee per year); and

(iii) The availability of a 15% non-refundable personal tax credit for "qualifying subscriptions expenses" paid by individuals after 2019 and before 2025 in respect of "digital news subscriptions" to qualifying QCJOs, subject to a cap of $500 in subscriptions expenses annually (i.e. maximum tax credit of $75 annually).

6. Small Business Deduction for Farming and Fishing Income

Pursuant to subsection 125(7) of the Act, the "specified corporate income" ("SCI") of a CCPC is not eligible for the small business deduction. SCI includes certain amounts earned by a CCPC from sales to another private corporation where the CCPC, one of its shareholders or a person who does not deal at arm's length with such a shareholder has a direct or indirect interest in the private corporation. However, certain income earned by a CCPC's farming or fishing business that arises from sales to a farming or fishing cooperative corporation is excluded from SCI, with the result that such income remains eligible for the small business deduction.

The 2019 Budget proposes to expand the farming and fishing income that is excluded from SCI to include income earned by a CCPC from the sales of farming products or fishing catches of its farming or fishing business to any arm's length purchaser corporation. This measure will apply retroactively to taxation years that begin after March 21, 2016.

7. Canadian Film or Video Production Tax Credit – Canada-Belgium Co-Productions

Audio-visual co-production treaties and similar instruments allow certain joint production projects of producers from two different countries to qualify for the Canadian film or video production tax credit. On March 12, 2018, Canada and Belgium signed an audio-visual co-production instrument referred to as the Memorandum of

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Understanding. As a result, the 2019 Budget proposes to amend the Act to allow certain joint audio-visual production projects between Canada and Belgium to qualify for the Canadian film or video production tax credit, effective as of March 12, 2018.

B. MEASURES AFFECTING INDIVIDUALS

1. Personal Income Tax Rates

The 2019 Budget proposes no changes to the federal personal income tax rates. The combined federal/provincial top marginal personal income tax rates (i.e. the rates on income over $220,000) for an Ontario resident is as follows:

Personal Tax Rates	**2019**
Ordinary Income	53.53%
Capital Gains	26.76%
Eligible Dividends	39.34%
Non-eligible Dividends	47.40%

2. Employee Stock Options

The employee stock option tax regime in the Act generally requires an employee to include in his or her income, as an employee benefit, an amount equal to the difference between the fair market value of the shares at the time the stock option was exercised and the exercise price paid by the employee. If certain conditions are met, an employee may claim a deduction equal to 50% of the stock option income inclusion pursuant to paragraph 110(1)(d) of the Act.

The 2019 Budget proposes to limit availability of the employee stock option deduction by applying a $200,000 annual cap on employee stock option grants (based on the fair market value of the underlying shares at the time of grant) that may benefit from the 50% deduction. This measure will apply only for employees of “large, long-established, mature firms” and there will be no cap for employees of “start-ups and rapidly growing Canadian businesses”.

The 2019 Budget states that further details of this measure will be released before summer 2019 and that any changes will apply only on a prospective basis. Employee stock options granted prior to the announcement of legislative proposals to implement the new regime will be unaffected.

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3. <u>Additional Types of Annuities Permitted Under Registered Plans</u>

The 2019 Budget introduces two new eligible annuities for certain registered plans for 2020 and subsequent taxation years: (i) advanced life deferred annuities ("ALDA"); and (ii) variable payment life annuities ("VPLA").

The ALDA will be a life annuity, the commencement of which may be deferred until the end of the year in which the annuitant attains 85 years of age. The ALDA will be permitted under Registered Retirement Savings Plans, Registered Retirement Income Funds, Deferred Profit Sharing Plans, Pooled Registered Pension Plans and defined contribution Registered Pension Plans.

The VLPA will provide payments that vary based on the investment performance of an underlying annuities fund and on the mortality experience of the participating members. The VPLA will be permitted under Pooled Registered Pension Plans and defined contribution Registered Pension Plans.

4. <u>Mutual Funds – Allocation to Redeemers Methodology</u>

When the unitholder of a mutual fund trust redeems his or her units, the trust often needs to dispose of investments in order to fund the redemption. This may result in double taxation, since (i) the trust realizes an accrued gain on the disposition of investments; and (ii) the unitholder realizes a gain on the redemption of the mutual fund trust units.

In order to avoid double taxation, mutual fund trusts often use the allocation to redeemers methodology, which allows the trust to allocate the capital gains triggered on the disposition of investments to the redeeming unitholder and to claim a corresponding deduction. The allocated capital gains are included in computing the redeeming unitholder's income, and the unitholder's redemption proceeds are correspondingly reduced by the allocated amount.

(i) Deferral

The federal government alleges that the allocation to redeemers methodology is being used by certain mutual fund trusts to inappropriately defer taxes, by allocating capital gains to redeeming unitholders in excess of the capital gains that would otherwise have been realized by such unitholders on the redemption of the units, which results in a deferral benefit to the remaining unitholders.

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The 2019 Budget proposes to introduce a new rule that will deny a mutual fund trust a deduction in respect of the portion of an allocation made to a unitholder on a redemption of units of the mutual fund trust that is greater than the capital gain that would otherwise have been realized by the unitholder on the redemption, if the following conditions are met: (i) the allocated amount is a capital gain; and (ii) the unitholder's redemption proceeds are reduced by the allocation. This measure will apply to taxation years of mutual fund trusts that begin on or after March 19, 2019.

(ii) Character Conversion

The federal government also alleges that certain mutual fund trusts have been using the allocation to redeemers methodology to convert what would otherwise be ordinary income of the mutual fund into capital gains for the remaining unitholders. Such character conversion may be possible where the redeeming unitholders held their units on income account but other unitholders hold their units on capital account.

The 2019 Budget proposes to introduce a new rule that will deny a mutual fund trust a deduction in respect of an allocation made to a unitholder on a redemption, if (i) the allocated amount is ordinary income; and (ii) the unitholder's redemption proceeds are reduced by the allocation. This measure will apply to taxation years of mutual fund trusts that begin on or after March 19, 2019.

5. <u>Home Buyers' Plan</u>

(i) Increase in Withdrawal Limit

Currently, the Home Buyers' Plan helps first-time home buyers by allowing them to withdraw up to $25,000 from a Registered Retirement Savings Plan ("RRSP") to purchase or build a home without having to pay tax on the withdrawal. The 2019 budget proposes to increase the Home Buyers' Plan RRSP withdrawal limit for 2019 and subsequent years to $35,000.

(ii) Breakdown of a Marriage or Common-Law Partnership

The 2019 Budget also proposes to extend access to the Home Buyers' Plan to Canadians who have experienced a breakdown in their marriage or common-law partnership, even if they do not meet the first-time home buyer requirement.

An individual who is not a first-time home buyer will be eligible to participate in the Home Buyers' Plan and withdraw up to $35,000 from a RRSP to purchase or build a

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home without having to pay tax on the withdrawal, if (i) the individual lives separate and apart from their spouse or common-law partner for a period of at least 90 days as a result of a breakdown in their marriage or common-law partnership; and (ii) the individual began to live separate and apart in the year in which the withdrawal is made, or any time in the four preceding years.

6. Carrying on Business in a TFSA

A tax-free savings account ("TFSA") is liable to pay income tax, at the top personal tax rate, on income from a business carried on by the TFSA. Currently, the trustee of a TFSA is jointly and severally liable with the TFSA for the tax.

The 2019 Budget proposes that the joint and several liability for tax owing on income from a business carried on by the TFSA will be extended to the TFSA holder. The 2019 Budget further proposes that the joint and several liability of the trustee will be limited to the amount of property remaining in the TFSA plus the amount of the distributions made on or after the date that the notice of assessment is sent to the TFSA. This measure will apply for 2019 and subsequent taxation years.

7. Canada Training Credit

The 2019 Budget introduces the Canada Training Credit ("CTC"), which aims to address barriers to professional development for working Canadians.

Starting in 2019, eligible individuals will accumulate $250 each taxation year in a notional CTC account, up to a lifetime maximum accumulation of $5,000. To be eligible to accumulate the $250 in respect of a taxation year, an individual must (i) file a tax return for the year; (ii) be at least 25 years old and less than 65 years old at the end of the year; (iii) be resident in Canada throughout the year; (iv) have qualifying earnings of $10,000 or more in the year; and (v) have individual net income for the year not exceeding the top of the third tax bracket for the year ($147,667 in 2019).

The amount of the CTC that can be claimed for a taxation year by an individual will be equal to the lesser of (i) 50% of the eligible tuition and fees paid in respect of the taxation year; and (ii) the individual's notional CTC account balance for the taxation year. The portion of tuition and fees refunded through the CTC will not qualify as eligible expenses for the tuition tax credit. Any unused balance in the notional CTC account will expire at the end of the year in which the individual turns 65.

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8. RDSPs - Cessation of Eligibility for the Disability Tax Credit

Currently, when a beneficiary of a Registered Disability Savings Plan ("RDSP") ceases to be eligible for the disability tax credit ("DTC"), the beneficiary is generally required to close the RDSP by the end of the year following the first full year throughout which the beneficiary is not eligible for the DTC, unless a medical practitioner has certified in writing that the beneficiary will likely become eligible for the DTC again in the foreseeable future.

The 2019 Budget seeks to address concerns that the current rules may be onerous for individuals who have intermittent episodes of disability. The 2019 Budget proposes to remove the time limitation on the period that a RDSP may remain open after a beneficiary becomes ineligible for the DTC, and to permit the RDSP to remain open without requiring medical certification that the beneficiary is likely to become eligible for the DTC in the future.

This measure will apply after 2020. However, an RDSP issuer will not be required to close an RDSP on or after March 19, 2019 and before 2021 solely because the RDSP beneficiary is no longer eligible for the DTC.

9. Pensionable Service under an Individual Pension Plan

In general, when an individual terminates membership in an Individual Pension Plan ("IPP"), the commuted value of the individual's accrued benefits can be transferred on a tax deferred basis by either:

(i) Transferring the full commuted value to another IPP sponsored by another employer; or

(ii) Subject to prescribed transfer limits (generally 50% of the commuted value), transferring to another type of registered plan, such as an RRSP.

Some taxpayers have circumvented the prescribed transfer limits by transferring the full commuted value of the IPP to a second IPP sponsored by a newly incorporated private company controlled by the individual who has terminated employment with the former employer.

The 2019 Budget proposes to eliminate the rollover of the full commuted value of an IPP into a second IPP, except for situations where the two IPPs are sponsored by

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the same employer or a predecessor employer. This measure applies to pensionable service credited under an IPP on or after March 19, 2019.

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

For owners of multi-unit residential properties making a change in use of a portion of the property on or after March 19, 2019, the 2019 Budget proposes to allow a taxpayer to elect that the deemed disposition that normally arises on a change in use of a property not apply.

11. Medical Expense Tax Credit

The 2019 Budget proposes to amend the Act to allow certain expenses incurred for medical cannabis obtained under the new *Cannabis Act* and *Cannabis Regulations* to qualify for the medical expense tax credit. This measure will apply to expenses incurred on or after October 17, 2018.

12. Donations of Cultural Property

The 2019 Budget proposes to amend provisions of the Act and of the *Cultural Property Export and Import* Act to remove the requirement that property be of "national importance" to qualify for the enhanced tax incentives for donations of cultural property. This measure aims to address concerns that certain donations that are of outstanding significance but of foreign origin (e.g. important works of art) were previously excluded from qualifying for enhanced tax incentives. This measure is effective as of March 19, 2019.

C. INTERNATIONAL TAX MEASURES

1. Transfer Pricing Measures

The 2019 Budget proposes two measures concerning the relationship between the transfer pricing rules and other provisions of the Act.

(i) Ordering of Application of the Transfer Pricing Rules

The 2019 Budget proposes to amend the Act to clarify that the transfer pricing rules apply in priority to the application of the other provisions of the Act, including those relating to income computation in Part I. This measure will apply to taxation years that begin on or after March 19, 2019.

(ii) Applicable Reassessment Period for Transfer Pricing Adjustments

Pursuant to ss. 152(4)(b)(iii)(A) of the Act, the normal reassessment period is generally extended by three years for reassessments relating to transactions involving a taxpayer and a non-resident with whom the taxpayer does not deal at arm's length.

The transfer pricing rules provide an expanded definition of "transaction", which includes an "arrangement or event". This allows the transfer pricing rules to apply to a broad range of situations that may arise in the context of a multinational enterprise's operations. The 2019 Budget proposes to amend the Act to extend the use of the expanded definition of "transaction" in the transfer pricing rules for the purposes of the extended reassessment period test under ss. 152(4)(b)(iii)(A) of the Act. This measure will apply to taxation years for which the normal reassessment period ends on or after March 19, 2019.

2. Foreign Affiliate Dumping

The foreign affiliate dumping rules contained in section 212.3 of the Act are anti-avoidance rules that generally apply if a corporation resident in Canada ("CRIC") that is controlled by a non-resident corporation makes an investment in a foreign affiliate.

The 2019 Budget proposes to extend the application of the foreign affiliate dumping rules to CRICs that are controlled by: (i) a non-resident individual; (ii) a non-resident trust; or (iii) a group of persons that do not deal with each other at arm's length comprising any combination of non-resident corporations, non-resident individuals and non-resident trusts. This measure will apply to foreign affiliate dumping transactions that occur on or after March 19, 2019.

3. Cross-Border Securities Lending Arrangements

A securities loan is an arrangement in which the lender transfers a security to the borrower, who agrees to return an identical security to the lender in the future. The borrower typically provides collateral to the lender. The borrower is also obligated to make compensation payments to the lender for dividends or interest received on the security over the term of the arrangement.

Securities loans that satisfy certain conditions are considered securities lending arrangements ("SLA"). SLAs are subject to special rules in the Act, including withholding tax rules for cross-border SLAs. Where a Canadian borrower makes a dividend compensation payment to a non-resident lender, if the SLA is "fully collateralized", the

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payment is deemed as a dividend for withholding tax purposes. Otherwise, the payment is deemed to be paid as interest. For the purposes of these rules, an SLA is "fully collateralized" if the Canadian borrower provides collateral to the non-resident lender in the form of money or government debt obligations, with a value equal to at least 95% of the value of the borrowed securities, and the non-resident borrower is entitled to all or substantially all of the income from this collateral.

The 2019 Budget proposes certain amendments to the cross-border SLA rules in the Act to address planning undertaken by non-residents that attempts to avoid the Canadian dividend withholding tax:

(i) The cross-border SLA withholding tax rules will be extended to compensation payments made under "specified securities lending arrangements" ("Specified SLA"). Specified SLA is a concept introduced in the 2018 Federal Budget designed to prevent taxpayers from realizing artificial losses through the use of equity-based financial arrangements, including securities loans that are substantially similar to SLAs;

(ii) All dividend compensation payments made under SLAs and Specified SLAs will be treated as dividends for withholding tax purposes, regardless of whether the arrangement is "fully collateralized"; and

(iii) Certain new rules are introduced for the purposes of determining the applicable withholding tax rate under a tax treaty.

The 2019 Budget also proposes to introduce a relieving provision to broaden the existing exemption from Canadian dividend withholding tax to include any dividend compensation payment made by a Canadian resident to a non-resident under an SLA if (i) the SLA is fully collateralized; and (ii) the lent security is a foreign share.

These measures will apply to compensation payments that are made on or after March 19, 2019. However, if the securities lending arrangement was in place before March 19, 2019, the measures will apply only to compensation payments made after September 2019.

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D. MEASURES AFFECTING SALES AND EXCISE TAX

1. Human Ova and *In Vitro* Embryos

The 2019 Budget proposes to zero-rate the supply and importation of human ova and *in vitro* embryos. This measure will apply to supplies and imports made on or after March 20, 2019.

2. Multidisciplinary Health Care Services

The 2019 Budget proposes to exempt from GST/HST the supply of multidisciplinary health care services rendered by a team of health professionals, if all or substantially all of the amounts payable for the services would otherwise have been GST/HST-exempt if rendered separately. This measure will apply to supplies of multidisciplinary health care services made on or after March 20, 2019.

3. Foot Care Devices Supplied on the Order of a Podiatrist or Chiropodist

Currently, certain medical and assistive devices can be supplied on a zero-rated basis only when supplied on the written order of a physician, nurse, physiotherapist or occupational therapist.

The 2019 Budget proposes to add licensed podiatrists and chiropodists to the list of practitioners on whose order supplies of foot care devices are zero-rated for GST/HST. This measure will apply to supplies made on or after March 20, 2019.

4. Cannabis Products

Currently, all cannabis products are generally subject to an excise duty under the Excise Tax Act that is the higher of (i) a flat rate applied on the quantity of cannabis contained in a final product; and (ii) a percentage of the dutiable amount of the product as sold by the producer (i.e. *ad valorem* rate).

The 2019 Budget proposes that effective May 1, 2019, cannabis edibles, cannabis extracts (including cannabis oils) and cannabis topicals will be subject to excise duties imposed at a flat rate applied on the quantity of total THC contained in a final product. The excise duty rate for these cannabis products is proposed to be $0.01 per milligram of total THC.

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The current excise duty framework in place for fresh and dried cannabis and for cannabis seeds and seedlings will remain unchanged (i.e., the higher of a flat rate and an *ad valorem* rate).

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without further consultation with professional advisers.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.