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Budget Canada 2019

Summary for Investors

March 19, 2019

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Individuals

1. Permitting Additional Types of Annuities Under Registered Plans

The tax rules allow funds from certain registered plans to be used to purchase an annuity to provide income in retirement, subject to specified conditions.

Budget 2019 proposes to permit two new types of annuities under the tax rules for certain registered plans:

- **advanced life deferred annuities** will be permitted under registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), deferred profit sharing plans (DPSPs), pooled registered pension plans (PRPPs) and defined contribution registered pension plans (RPPs); and
- **variable payment life annuities** will be permitted under PRPPs and defined contribution RPPs.

The measures will apply to the 2020 and subsequent taxation years.

<u>Advanced Life Deferred Annuities</u>

The tax rules generally require an annuity purchased with registered funds to commence by the end of the year in which the annuitant attains 71 years of age. Budget 2019 proposes to amend the tax rules to permit an advanced life deferred annuity (ALDA) to be a qualifying annuity purchase, or a qualified investment, under certain registered plans.

An 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The value of an ALDA will not be included for the purpose of calculating the minimum amount required to be withdrawn in a year from a RRIF, a PRPP member's account or a defined contribution RPP member's account, after the year in which the ALDA is purchased.

An individual will be subject to a lifetime ALDA limit equal to 25 per cent 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.

An individual will also be subject to a comprehensive lifetime ALDA dollar limit of $150,000 from all qualifying plans. The lifetime ALDA dollar limit will be indexed to inflation for taxation years after 2020, rounded to the nearest $10,000.

In order to qualify as an ALDA, numerous requirements need to be satisfied.

If an individual purchases ALDA contracts in excess of their ALDA limit, a tax of one per cent per month will apply to the excess portion.

<u>Variable Payment Life Annuities</u>

Budget 2019 proposes to amend the tax rules to permit PRPPs and defined contribution RPPs to provide a variable payment life annuity (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.

PRPP and defined contribution RPP administrators will be permitted to establish a separate annuities fund under the plan to receive transfers of amounts from members' accounts to provide VPLAs. Only transfers from a member's account will be permitted to be made to the annuities fund. Direct employee and employer contributions to the annuities fund will not be permitted.

A minimum of 10 retired members will be required to participate in a VPLA arrangement in order for a plan to establish such an arrangement, and it must be reasonable to expect that at least 10 retired members will participate in the arrangement on an ongoing basis.

VPLAs will be required to comply with certain existing tax rules applicable to PRPPs and defined contribution RPPs, as well as additional requirements.

The existing rules for PRPPs and defined contribution RPPs relating to noncompliance will apply in respect of non-compliance with the tax rules for VPLAs.

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

The *Income Tax Act* deems a taxpayer to have disposed of, and reacquired, a property when the taxpayer converts the property from an income-producing use (e.g., a rental property) to a personal use (e.g., a residential property) or *vice versa*. Where the use of an **entire property** is changed to an income-producing use, or an income-producing property becomes a principal residence, the taxpayer may **elect** that this **deemed disposition** not apply. As a consequence, the election can provide a deferral of the realization of any accrued capital gain on the property until it is realized on a future disposition.

As well, where an election is made on a conversion of a property to or from a principal residence, the property can be designated as a taxpayer's principal residence for an additional period of up to four years before or after the period for which the taxpayer could otherwise claim the principal residence exemption in respect of the property (provided no other principal residence exemption is claimed in respect of those additional years).

The **deemed** disposition also occurs when the use of **part of a property** is changed. For example, this can occur where a taxpayer owns a multi-unit residential property, such as a duplex, and either starts renting or moves into one of the units. However, under the current rules, a taxpayer **cannot elect out** of the deemed disposition that arises on a change in use of part of a property.

To improve the consistency of the tax treatment of owners of multi-unit residential properties in comparison to owners of single-unit residential properties, Budget 2019 proposes to allow 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 Budget Day.

3. Support for First-Time Home Buyers

Home Buyers' Plan

The home buyers' plan (HBP) 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. First-time home buyers purchasing a home jointly may each withdraw up to $25,000 from their own RRSP under the HBP.

For HBP purposes, an individual is not considered to be a first-time home buyer if, in the relevant calendar year or in any of the four preceding calendar years,

- the individual, or the individual's spouse or common-law partner, owned and occupied another home, and
- that home was the individual's principal place of residence.

Withdrawal Limit

Budget 2019 proposes to increase the HBP withdrawal limit to $35,000 from $25,000. As a result, a couple will potentially be able to withdraw $70,000 from their RRSPs to purchase a first home.

This increase in the HBP withdrawal limit will apply to the 2019 and subsequent calendar years in respect of withdrawals made after Budget Day.

Breakdown of a Marriage or Common-Law Partnership

Budget 2019 also proposes to extend access to the HBP to help Canadians maintain homeownership after the breakdown of a marriage or common-law partnership.

Generally, an individual will not be prevented from participating in the HBP because they do not meet the first-time home buyer requirement, provided that 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. The individual will be able to make a withdrawal under the HBP if the individual lives separate and apart from their spouse or common-law partner at the time of the withdrawal and began to live separate and apart in the year in which the withdrawal is made or any time in the four preceding years. However, in the case where an individual's principal place of residence is a home owned and occupied by a new spouse or common-law partner, the individual will not be able to make an HBP withdrawal under these rules.

An individual will be required to dispose of their previous principal place of residence no later than two years after the end of the year in which the HBP withdrawal is made. The requirement to dispose of the previous principal place of residence will be waived for individuals buying out the share of the residence owned by the individual's spouse or common-law partner. The existing rule that individuals may not acquire the home more than 30 days before making the HBP withdrawal will also be waived in this circumstance.

Existing HBP rules will otherwise generally apply.

This measure will apply to HBP withdrawals made after 2019.

Introducing the First-Time Home Buyer Incentive

To help make homeownership more affordable for first-time home buyers, Budget 2019 proposes to introduce the First-Time Home Buyer Incentive.

The CMHC First-Time Home Buyer Incentive is a shared equity mortgage that would give eligible first-time home buyers the ability to lower their borrowing costs by sharing the cost of buying a home with CMHC. The Incentive would provide funding of 5 or 10 per cent of the home purchase price. No ongoing monthly payments are required. The buyer would repay the Incentive, for example at re-sale.

The Incentive would be available to first-time home buyers with household incomes under $120,000 per year. In addition, participants' insured mortgage and the Incentive amount cannot be greater than four times the participants' annual household income.

More details regarding CMHC's First-Time Home Buyer Incentive and funds to assist other providers of shared equity mortgages will be released later this year, with the programs expected to be operational by September 2019.

4. Registered Disability Savings Plan – Cessation of Eligibility for the Disability Tax Credit

A registered disability savings plan (RDSP) may be established only for a beneficiary who is eligible for the Disability Tax Credit (DTC).

The Government of Canada supplements private RDSP contributions with *Canada Disability Savings Grants* and provides *Canada Disability Savings Bonds*.

Current Treatment

When a beneficiary of an RDSP ceases to be eligible for the DTC, no contributions may be made to, and no *Canada Disability Savings Grants* and *Canada Disability Savings Bonds* may be paid into, the RDSP. The income tax rules generally require that the RDSP be closed by the end of the year following the first full year throughout which the beneficiary is not eligible for the DTC.

Upon plan closure, an amount (referred to as the "assistance holdback amount") must be repaid to the Government. Any assets remaining in the RDSP after this repayment are paid to the beneficiary.

The *Income Tax Act* allows an RDSP plan holder to **elect** to extend the period for which an RDSP may remain open after a beneficiary becomes ineligible for the DTC if a medical practitioner certifies in writing that the nature of the beneficiary's condition makes it likely that the beneficiary will, because of the condition, be eligible for the DTC in the foreseeable future.

During the period for which an **election** is valid, several specific rules apply, commencing with the first full calendar year throughout which the beneficiary is no longer eligible for the DTC.

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An **election** is generally valid until the end of the fourth calendar year following the first full calendar year throughout which a beneficiary is ineligible for the DTC. If a beneficiary becomes eligible for the DTC while an election is valid, the regular RDSP rules apply commencing with the year in which the beneficiary becomes eligible. If the beneficiary does not regain eligibility for the DTC during the election period, the RDSP must be closed by the end of the first year following the end of the election period and the assistance holdback amount, determined immediately prior to cessation of the beneficiary's eligibility for the DTC, must be repaid to the Government.

Proposed Treatment

Budget 2019 proposes to remove the time limitation on the period that an RDSP may remain open after a beneficiary becomes ineligible for the DTC and to eliminate 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. The general rules that currently apply in respect of a period during which an **election** is valid, as described above, will apply to an RDSP in any period during which the beneficiary is ineligible for the DTC, with the following modifications:

- There will be no requirement for medical certification that the individual is likely to become eligible for the DTC in the future.
- Withdrawals from the RDSP will be subject to the proportional repayment rule, but the assistance holdback amount will be modified, depending on the beneficiary's age.
- A rollover of proceeds from a deceased individual's Registered Retirement Savings Plan or Registered Retirement Income Fund to the RDSP of a financially dependent infirm child or grandchild will be permitted only if the rollover occurs by the end of the fourth calendar year following the first full calendar year throughout which the beneficiary is ineligible for the DTC.
- A plan holder may, at any time during which the beneficiary is ineligible for the DTC, request closure of the RDSP of the beneficiary. Closure of an RDSP will be subject to the general rules that apply in the event of a closure, with the exception that the amount required to be repaid upon closure will be equal to the assistance holdback amount at that time, in accordance to the proposed modifications regarding the beneficiary's age.

This measure will apply after 2020. An RDSP issuer will not, however, be required to close an RDSP on or after Budget Day and before 2021 solely because the RDSP beneficiary is no longer eligible for the DTC.

5. Registered Disability Savings Plan – Bankruptcy

Unlike RRSPs, amounts held in RDSPs are not exempt from seizure by creditors in bankruptcy. Budget 2019 proposes to exempt RDSPs from seizure in bankruptcy, with the exception of contributions made in the 12 months before the filing.

This measure requires modifications to the *Bankruptcy and Insolvency Act* and therefore no application date has yet been determined.

6. Canada Training Credit

Budget 2019 proposes to introduce the Canada Training Benefit to address barriers to professional development for working Canadians. The Canada Training Benefit will include as one of its key components the new Canada Training Credit, a refundable tax credit aimed at providing 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 which can be accessed for this purpose.

To accumulate the amount of $250 in respect of a year, an individual must:

- file a tax return for the year;
- be at least 25 years old and less than 65 years old at the end of the year;
- be resident in Canada throughout the year;
- have earnings of $10,000 or more in the year; and
- have individual net income for the year that does not exceed the top of the third tax bracket for the year ($147,667 in 2019).

Methods of calculating the credit are included in the Budget.

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Individuals will be able to accumulate up to a maximum amount of $5,000 over a lifetime. Any unused balance will expire at the end of the year in which an individual turns 65.

Tuition and other fees eligible for the Canada Training Credit will generally be the same as under the existing rules for the Tuition Tax Credit.

Unlike the Tuition Tax Credit, educational institutions outside of Canada will not be eligible for the purpose of 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.

Earning and income thresholds under the Canada Training Credit will be subject to annual indexation.

7. Employee Stock Options

The current tax rules provide employee stock options with preferential personal income tax treatment in the form of a stock option deduction which effectively results in the benefit being taxed at a rate equal to one half of the normal rate of personal taxation, the same rate as capital gains.

Budget 2019 announces the Government's intention to limit the use of the current employee stock option tax regime, for high-income employees of large, long-established, mature firms by applying a $200,000 **annual** cap on employee stock option grants (based on the fair market value of the underlying shares).

Further details of this measure will be released before the summer of 2019. Any changes would apply on a go-forward basis only and would not apply to employee stock options granted prior to the announcement of legislative proposals to implement any new regime.

8. Improving the Economic Security of Low-Income Seniors

The Guaranteed Income Supplement (GIS) earnings exemption currently allows low-income seniors and their spouses to each earn up to $3,500 per year in **employment income** without triggering a reduction in GIS or Allowance benefits.

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

- 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 per cent, 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.

9. Protecting Canadians' Pensions

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.

Amongst others, the proposed pension measures will protect the benefits by clarifying in federal pension law that if a plan is wound-up, it must still provide the same pension benefits as when it was ongoing.

No application date has yet been determined.

10. Donations of Cultural Property

The Government of Canada provides certain enhanced tax incentives to encourage donations of cultural property to certain designated institutions and public authorities in Canada, to ensure that such property remains in Canada.

To qualify for the incentives, a donated property must be of “outstanding significance” by reason of its close association with Canadian history or national life, its aesthetic qualities or its value in the study of the arts or sciences. In addition, it must be of “national importance” to such a degree that its loss to Canada would significantly diminish the national heritage.

A recent court decision related to the export of cultural property interpreted the “national importance” test as requiring that a cultural property have a direct connection with Canada’s cultural heritage. This decision has raised concerns that certain donations of important works of art that are of outstanding significance but of foreign origin may not qualify for the enhanced tax incentives.

Budget 2019 proposes to amend the *Income Tax Act* and 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. No changes are proposed that would affect the export of cultural property.

This measure will apply in respect of donations made on or after Budget Day.

11. Carrying on Business in a Tax-Free Savings Account

A TFSA is liable to pay tax at the top personal tax rate on income from a business carried on by the TFSA or from non-qualified investments.

Under the current rules, the trustee of a TFSA (i.e., a financial institution) is jointly and severally liable with the TFSA for the payment of tax while the holder of the TFSA is not.

Budget 2019 proposes that the joint and several liability for tax owing on income from carrying on a business in a TFSA be extended to the TFSA holder.

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Businesses

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1. Intergenerational Business Transfers

The Government will continue its outreach to farmers, fishers and other business owners throughout 2019 to develop new proposals to better accommodate intergenerational transfers of businesses while protecting the integrity and fairness of the tax system.

2. Character Conversion Transactions

In the past, certain taxpayers entered into financial arrangements (character conversion transactions) that sought to reduce tax by converting, with the use of derivative contracts, the returns on an investment that would have the character of ordinary income to capital gains, only 50 per cent of which are included in income.

Rules were introduced in 2013 that treat any gain arising from a "*derivative forward agreement*" as ordinary income rather than as a capital gain. For the purposes of these rules, a *derivative forward agreement* is defined to include any agreement to purchase a capital property where:

- the term of the agreement (or series of agreements) 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., it is attributable, in whole or in part, to an underlying interest **other than certain excluded interests**).

One important **excluded interest** is where the economic return from a purchase or sale agreement is based on the economic performance of the actual property being purchased or sold. This exception is intended to exclude certain commercial transactions (e.g., merger and acquisition transactions) from the scope of the derivative forward agreement rules.

An alternative character conversion transaction has been developed that attempts to misuse this commercial transaction exception as it applies to purchase agreements.

Although this alternative transaction can be challenged by the Government based on existing rules in the *Income Tax Act*, these challenges could be both time-consuming and costly. As a result, the Government is proposing a specific legislative measure

Budget 2019 proposes an amendment that introduces an additional qualification for the commercial transaction exception in the definition "derivative forward agreement" as the exception applies to purchase agreements. In general terms, this amendment will provide that the commercial transaction exception is unavailable if it can reasonably be considered that one of the main purposes of the series of transactions, of which an agreement to purchase a security in the future (or an equivalent agreement) is part, is for a taxpayer to convert into a capital gain an amount paid on the security, by the issuer of the security, during the period that the security is subject to the agreement.

This measure will apply to transactions entered into on or after Budget Day. It will also apply after December 2019 to transactions that were entered into before Budget Day including those that extended or renewed the terms of the agreement on or after Budget Day. This grandfathering will incorporate the same growth limits used under the transitional relief provided under the derivative forward agreement rules introduced in 2013 to ensure that no new money flows into grandfathered transactions on or after Budget Day.

3. Small Business Deduction – Farming and Fishing

In general terms, income from an active business carried on in Canada by a Canadian-controlled private corporation (CCPC) is eligible for a reduced rate of taxation under the small business deduction rules (SBD) in the *Income Tax Act*. Essentially, these rules allow CCPCs to reduce their federal corporate income tax rate up to $500,000. The *Income Tax Act* contains various rules that are intended to prevent the inappropriate multiplication of this $500,000 limit.

One such rule, enacted in 2016, has the effect of disqualifying "*specified corporate income*" of a CCPC from eligibility for the SBD. This income includes certain amounts earned by a CCPC from sales to a private corporation in which the CCPC, or certain specified persons, holds a direct or indirect interest. However, certain income of a CCPC's farming or fishing business that arises from sales to a farming or fishing cooperative corporation is excluded from *specified corporate income* and, as a result, such income remains eligible for the SBD.

Budget 2019 proposes to eliminate the requirement that sales be to a farming or fishing cooperative corporation in order to be excluded from *specified corporate income*. As such, this exclusion will apply to the income of a CCPC from sales of the farming products or fishing catches of its farming or fishing business to any arm's length purchaser corporation. However, consistent with the existing rules, amounts allocated to a CCPC as patronage payments from a purchaser corporation will not qualify for this exclusion.

This measure will apply to taxation years that begin after March 21, 2016

4. Individual Pension Plan

An individual pension plan (IPP) is a defined benefit registered pension plan that has fewer than four members, at least one of whom (e.g., a controlling shareholder) is related to an employer that participates in the plan.

When an individual terminates membership in a defined benefit registered pension plan, the income tax rules allow for a tax-deferred transfer of all or a portion of the commuted value of the member's accrued benefits in one of two ways:

- a transfer of the full commuted value to another defined benefit plan sponsored by another employer; or
- subject to a prescribed transfer limit (normally about 50 per cent of the member's commuted value), a transfer of a portion of the commuted value to the member's registered retirement savings plan or similar registered plan.

Planning is being undertaken that seeks to circumvent these prescribed transfer limits. This circumvention is implemented by establishing an IPP sponsored by a newly incorporated private corporation controlled by an individual who has terminated employment with their former employer. This planning seeks to obtain a 100-per-cent transfer of assets to the new IPP instead of the restricted transfer of assets to the individual's registered retirement savings plan.

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 (or its predecessor 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 to be a nonqualifying transfer that is required to be included in the income of the member for income tax purposes.

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

5. Support for Canadian Journalism

Budget 2019 proposes to introduce three new tax measures to support Canadian journalism. For each of the three measures, the *Qualified Canadian Journalism Organization* (QCJO) status will be necessary. To be a QCJO, an organization will be required to meet certain criteria. Here are the three new tax measures:

1. allowing journalism organizations to register as tax-exempt "*qualified donees*"; this measure will apply as of January 1, 2020;
2. a 25-per-cent refundable tax credit on salary or wages paid to eligible newsroom employees of qualifying QCJOs; this measure will apply to salary or wages earned in respect of a period on or after January 1, 2019; and
3. a temporary, non-refundable 15-per-cent 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. Amounts paid to an organization will be eligible only if, at the time they are paid, the organization is a QCJO. This credit will be available in respect of eligible amounts paid after 2019 and before 2025.

Other Measures

1. Mutual Fund Trusts

When a mutual fund trust disposes of investments to fund a redemption of its units, any accrued gain on the investments is realized by the trust and is subject to tax, and may be taxed again in the hands of the unitholder who disposes of units at a redemption price that reflects this accrued gain. Mutual fund trusts have access to a capital gains refund mechanism under the *Income Tax Act,* which is intended to address this potential for "double taxation".

However, because this mechanism is a formulaic approximation, it does not always fully relieve "double taxation".

The "allocation to redeemers methodology" was developed to more effectively match the capital gains realized by the mutual fund trust on its investments with the capital gains realized by the redeeming unitholders on their units.

Certain mutual fund trusts have been using the allocation to redeemers methodology to allocate capital gains to redeeming unitholders in excess of the capital gains that would otherwise have been realized by these unitholders on the redemption of their units. This results in an inappropriate tax deferral applicable on this excess amount for holders of remaining unit holders.

Budget 2019 proposes to introduce a new rule that would deny a mutual fund trust a deduction in respect of the portion of an allocation made to a unitholder on a redemption of a unit 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:

- the allocated amount is a capital gain; and
- 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 Budget Day.

2. Electronic Delivery of Requirements for Information

The Canada Revenue Agency (CRA) may issue a requirement for information to oblige a person to provide information or documents for the purposes of the administration and enforcement of various Acts.

To improve the efficiency of the requirement-for-information process and to reduce administration and compliance costs, Budget 2019 proposes to allow the CRA to send requirements for information electronically to banks and credit unions.