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ODLUM BROWN FINANCIAL SERVICES LIMITED

2018 FEDERAL BUDGET HIGHLIGHTS

On February 27, 2018, Minister of Finance Bill Morneau delivered the government's 2018 Federal Budget, forecasting a deficit of $19.4 billion for 2017-18.

Here is a brief overview of some of the notable personal and small business tax changes proposed.

Budget 2018 can be viewed online in its entirety on the Department of Finance Canada's website and is subject to parliamentary approval.

Proposed Tax Measures at a Glance

Personal

- Expand reporting requirements for trusts
- Extend period for qualifying family members to be Registered Disability Savings Plan (RDSP) holders
- Enhance the Employment Insurance (EI) Parental Sharing Benefit
- Extend the mineral exploration tax credit for flow-through shares for another year
- Enhance and rename Canada Workers Benefit
- No change in personal tax rates

Small Business

- Changes to holding passive investments inside a Canadian-controlled private corporation (CCPC):
  - Limit access to the small business tax rate
  - Limit access to the refundable taxes for larger CCPCs
- As previously announced:
  - Limit ability to income sprinkle
  - No change to the lifetime capital gains exemption
  - No change to the capital dividend account
- No change to corporate tax rates (beyond previous announced measures)

PERSONAL TAX MEASURES

Expanding reporting requirements for trusts

Enhanced income tax reporting is being proposed for certain trusts in an effort to improve the availability of beneficial ownership information. The new requirements will impose an obligation to file a T3 return where one does not currently exist. Identities of trustees, beneficiaries and settlors of the trust will be required along with the identity of each person who has the ability to exercise control over trustee decisions regarding the allocation of capital or income of the trust. The new reporting requirements are effective for returns filed for the 2021 and subsequent tax years.

The following trusts **will not** be required to report under the new requirements:

- mutual fund trusts
- trusts governed by registered plans
- graduated rate estates and disability trusts
- trusts that qualify as non-profit organizations or registered charities
- trusts that have been in existence for less than three months or that hold less than $50,000 in assets throughout the tax year

Registered Disability Savings Plans (RDSP) – Qualifying plan holders

A temporary measure was introduced in Budget 2012 to allow a qualifying family member (i.e., a parent, spouse or common-law partner) to become RDSP plan holders when an adult who would otherwise qualify for an RDSP lacked capacity to enter into a contract. This measure is legislated to expire at the end of 2018. Budget 2018 proposes to extend the temporary measure by five years, to the end of 2023.

Employment Insurance (EI) Parental Sharing Benefit

Budget 2018 proposes to provide enhanced parental benefits, effective June 2019. When both parents **share** the parental leave, and each parent agrees to take a minimum of five weeks, the combined time is increased by five weeks (40 weeks total).

Current Rules	New EI Parental Sharing Benefit *Available when both parents agree to **share** parental leave*
Either parent may take up to **35 WEEKS** (paid at 55% of average weekly earnings).	Either parent may take up to **35 WEEKS** (paid at 55% of average weekly earnings).
The other parent may take the remainder of the **35 TOTAL WEEKS.**	The other parent may take the remainder of the **40 TOTAL WEEKS.**
Parents can share the 35 weeks in various combinations **35 TOTAL WEEKS** (e.g., 20/15, 10/25).	Parents can share the 40 weeks in various combinations **40 TOTAL WEEKS** (e.g., 20/20, 15/25).
If a couple decides that one parent takes **35 WEEKS**, there are no weeks available to the other parent.	A minimum of **5 WEEKS** is available for each parent.

Source: Finance Canada, Budget Plan 2018

Mineral Exploration Tax Credit for Flow-Through Shares

As in previous years, the 2018 federal budget proposes to extend the tax credit for another year. The credit will apply to flow-through share agreements entered into, on, or before March 31, 2019.

Canada Workers Benefit

The Working Income Tax Benefit (WITB) is a refundable tax that supplements the earnings of low-income workers. The Budget proposes to enhance and rename this benefit the Canada Workers Benefit, starting in 2019. Taxpayers eligible for the disability tax credit may receive a disability supplement to the new Canada Workers Benefit.

SMALL BUSINESS TAX MEASURES

Holding passive investments inside a private corporation

There is a tax deferral advantage of up to 37.8% in BC when business owners hold passive investments inside their corporations versus distributing the assets and investing personally. The 2018 budget proposes two new measures to limit deferral advantages from holding passive investments in a corporation.

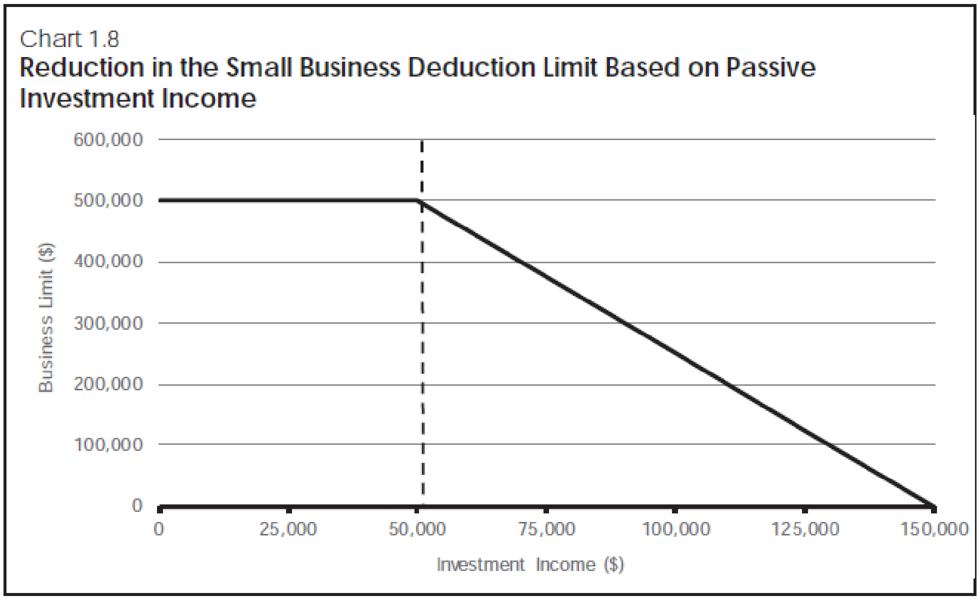
Limiting access to the small business tax rate – *Effective after 2018*

The first measure proposes to reduce access to the small business tax rate for those businesses with passive investment income[1] greater than $50,000. The small business limit allows for up to $500,000 of active business income to be taxed at lower small business tax rates, currently 12% (combined federal and provincial) in BC. Active

[1] Budget 2018 introduces a new definition of passive income called *adjusted aggregate investment income* (AAII) which excludes capital gains realized from the sale of active investments or investment income incidental to the business (e.g., interest on short-term deposits held for operational purposes) when measuring passive investment income for the purposes of this measure. It includes dividends from non-connected corporations (e.g., public company dividends).

business income earned above the $500,000 small business limit threshold is taxed at 27% (combined federal and provincial) in BC.

Under the proposed rules, if a corporation (and its associated corporations) earns more than $50,000 of passive investment income in a year, the small business limit will be reduced by $5 for every $1 of passive investment income in excess of the $50,000 threshold. As a result, the small business limit will be reduced to zero if a corporation earns $150,000 of passive investment income in any given year, as shown in the chart below.



Source: Finance Canada, Budget Plan 2018

For an **investment holding company** that is **<u>not</u>** associated with an active business, there is **no change** to the taxation of passive investments.

Limiting access to refundable taxes *for larger CCPCs – Effective after 2018*

The second measure proposes to limit the tax advantage through accessing refundable taxes when eligible dividends are paid.

The tax system is designed to tax investment income earned by private corporations at a higher rate, roughly equivalent to the top personal income tax rate, and to refund a portion of that tax when investment income is paid out to shareholders.

In practice, however, any taxable dividends paid by a private corporation can trigger a refund of taxes paid on investment income, regardless of the source of that dividend (i.e., whether coming from investment income or lower-taxed active business income).

This means that larger CCPCs[2] can pay out lower-taxed dividends from their pool of active income taxed at the general corporate rate and still claim a refund of taxes paid on their investment income that is intended to be taxed at higher rates. This can provide a significant tax advantage. Budget 2018 proposes that CCPCs no longer be able to

[2] Access to the lower tax rate is phased out on a straight-line basis for associated Canadian-controlled private corporations (CCPCs) having between $10 million and $15 million of aggregate taxable capital employed in Canada.

obtain refunds of taxes paid on investment income while distributing dividends from income taxed at the general corporate rate. Refunds will continue to be available when investment income is paid out.

Previously announced measures

The government will proceed with previously announced tax measures, such as:

- Income tax measures released on December 13, 2017 to address income sprinkling
- Measures to lower the small business tax rate to 10% (from 10.5%), effective January 1, 2018, and to 9%, effective January 1, 2019.

March 2018