

Federal Budget Brief 2018



A strong Canada must include a competitive tax system

The federal budget offers a broad range of initiatives to help Canadians achieve a better future, but it could do more to meet immediate challenges faced in keeping Canada competitive.

We operate in a global economy and uncertainty lingers, especially when faced by actions such as tax reform in the United States. An independent, comprehensive tax review would greatly assist in creating a best-in-class tax system to generate jobs, attract investment and foster inclusive growth for the benefit of all Canadians.

While the fiscal blueprint does not pledge an extensive tax review, it does note that the Department of Finance Canada will conduct a detailed analysis of the U.S. federal tax reforms to assess any potential impacts on Canada. This is an issue of immediate importance and more information on how this analysis will be carried out is needed.

Among the budget measures is a new approach relating to passive income for private corporations. Under the proposal, described in more detail below, if a corporation and its associated corporations earn more than \$50,000 of passive investment income in a given year, the amount of income eligible for the small business tax rate will be reduced.

The new plan is much simpler than what was originally proposed, and the government deserves credit for listening to Canadians. We still firmly believe that the best approach to deal with Canada's tax system is not to assess proposals in isolation, but as part of a comprehensive review.

CPA Canada supports further investments and actions outlined in the budget to combat tax evasion. This is a serious global issue, and we will continue to work with the federal government and international bodies to help prevent abuse of the tax system.

In addition, there is still no timeline to bring the annual federal budget back into balance. CPA Canada believes the country needs a plan for fiscal stability — one that establishes a target date for a return to balanced budgets over the medium term.

The government's long-term goal of building a strong economy and society includes:

- improving women's economic success
- providing additional assistance to low-income working Canadians
- measures to enhance the well-being of Indigenous Peoples
- better support for Canada's innovators
- creating an Advisory Council on the Implementation of National Pharmacare
- a significant investment in cyber security.

Below we summarize some key measures in Budget 2018 and their impact on Canadians and Canadian businesses.

Business Tax Measures

Taxation of private corporations

Budget 2018 includes the promised details on the government's plans to limit the deferral advantages from holding passive savings in a corporation, but takes a substantially different approach than previously announced. The government's three key principles in designing these rules are to:

- protect passive investments already made by private corporations' owners, including the future income earned from those investments
- implement a \$50,000 threshold on passive income in a year (equivalent to \$1 million in savings, based on a nominal 5-per-cent rate of return) to give flexibility for business owners to hold savings, for example, for sick leave, maternity or parental leave, or retirement
- maintain incentives to continue to encourage Canada's venture capital and angel investors to invest in the next generation of Canadian innovation.

Budget 2018 accomplishes these goals through two measures, described below. These measures take effect for taxation years that begin after 2018. We welcome the delayed effective date to allow business owners and their advisors to adjust to the new rules, as we recommended in earlier submissions to the government. Further, while we are pleased to see that the current proposals are simpler than earlier indications, such rules should be assessed as part of a detailed review of how they fit within the broader tax system.

Limiting access to small business tax rate

Under the first measure, the government proposes to reduce the business limit on a straight-line basis for Canadian controlled private corporations (and their associated corporations) having between \$50,000 and \$150,000 in investment income. This measure will operate alongside the current business limit reduction for CCPCs with taxable capital over \$10 million, so that the business limit will be the greater of the reduction under the new measure and the existing reduction based on taxable capital.

The budget includes details on the types of passive investments that are included in calculating the new limit.

Refundability of taxes on investment income

Under the second measure, the budget aims to end the tax advantage for larger CCPCs by paying out lower-taxed dividends from active income taxed at the general corporate rate and still claiming refunds of taxes paid on their investment income which is intended to be taxed at higher tax rates.

The budget introduces a second refundable dividend tax on hand (RDTOH) account, which will track refundable taxes (Part IV tax) on eligible portfolio dividends. Any taxable dividend (i.e., eligible or non-eligible) will entitle the corporation to a refund from its eligible RDTOH account. The current RDTOH account (now called “non-eligible RDTOH”) will track refundable taxes on investment income (under Part I) and non-eligible portfolio dividends (under Part IV). Refunds from this account will be obtained only on paying non-eligible dividends.

Other outstanding measures for private corporations

Among other previously announced measures, Budget 2018 says the government intends to move forward with the small business tax rate reductions announced on October 16, 2017 and the measures to address income sprinkling announced on December 13, 2017. Unfortunately, unlike the passive investment proposals, the government did not simplify the rules or delay their application to give business owners time to adjust, as CPA Canada and others have recommended.

Accelerated depreciation for clean energy technologies

Budget 2018 proposes to extend eligibility for class 43.2 to qualifying property acquired before 2025. Class 43.2 provides accelerated (50 percent) depreciation for investments in technologies that can contribute to a reduced greenhouse gas and air pollutants and renewable, non-emitting electricity.

Health and Welfare Trusts

Budget 2018 announces plans to consult on ways to apply one set of tax rules for Employee Life and Health Trusts, which are now covered in the Income Tax Act, and Health and Welfare Trusts, which are covered by CRA administrative positions. Stakeholders are invited to submit comments on transitional issues to facilitate the conversion of Health and Welfare Trusts and discontinuation of the administrative regime.

Personal Taxes and Benefits

Canada Workers Benefit

Budget 2018 confirms the increased support and improvements announced in the 2017 Fall Economic Statement for the Canada Workers Benefit (the budget's new name for the Working Income Tax Benefit).

The budget also proposes to improve access to the program by allowing the Canada Revenue Agency (CRA) to determine whether an individual who has not claimed the benefit is eligible and assess their return as if they had made the claim.

To help the CRA administer the benefit (and other measures supporting students, such as the Lifelong Learning Plan and exemption for scholarship and similar income), the CRA will also have access to new required reports on student enrolment from designated educational institutions.

More personal tax measures

Other personal tax measures in Budget 2018 include:

- extending eligibility for the medical expense tax credit to expenses related to animals specially trained to help people with a severe mental impairment
- extending to the end of 2023 the temporary measure that allows a parent, spouse or common-law parent to be named as plan holder for a registered disability plan holder for an eligible adult with no current legal representative.
- allow federal tax deduction of the enhanced portion of Quebec Pension Plan contributions, consistent with the tax treatment of enhanced Canada Pension Plan contributions
- extending eligibility for the mineral exploration tax credit for one year, to flow-through share agreements entered into on or before March 31, 2019.

Improving Tax Administration

Improving services for taxpayers

CPA Canada supports the CRA's efforts to improve services for taxpayers through its tax committees (see CPA Canada's recent [tax blog](#)) and through the provincial CPA bodies' extensive involvement in the Community Volunteer Income Tax Program (CVITP) (see our [blog](#)).

CPA Canada welcomes this budget's commitment to devote \$206 million over five years to improve service quality and availability in three areas:

- doubling the size of the CVITP, providing funding for “year-round” benefit clinics and conducting more outreach with vulnerable population segments
- improving the CRA's telephone helpline services by enhancing technology, hiring more agents and providing additional training
- updating the CRA's information technology infrastructure to improve user-friendliness and improving its interface with Revenu Québec to offer Quebec residents the same level of digital services as residents in other parts of Canada

Protecting the Tax Base

Combatting tax evasion and avoidance

Tax evasion is illegal, unethical and harmful for the economy and society, and CPA Canada welcomes Budget 2018's additional commitments to invest in strengthening tax compliance, ensure fairness and better protect the country's tax base. This budget pledges \$90.6 million over five years to address more cases of domestic and international tax avoidance identified through enhanced risk assessment systems.

The budget commits \$41.9 million over five years, and \$9.3 million annually after that, to ensure the Tax Court of Canada and other federal courts have adequate support and resources to manage the growing and increasingly complex case load arising from the CRA's stepped-up enforcement efforts.

The government will also provide \$38.7 million over five years to the CRA to allow the agency to expand its offshore compliance activities through the use of improved risk assessment systems and business intelligence. The funds will also facilitate the hiring of additional auditors.

Beneficial owners of trusts

Following on a Budget 2017 announcement, Budget 2018 takes steps to counter aggressive tax avoidance and evasion, money laundering and other criminal activities by improving the collection of beneficial ownership information.

Under this year's proposals, certain trusts will be required to provide additional information annually by filing T3 trust information return. The CRA will use the information to assess the tax liability for trusts and its beneficiaries.

Reassessment periods and filing deadlines

The government has proposed measures that will give the CRA more time to conduct complex audits to enforce compliance:

- Due to the complexity of international tax audits and time required to get information from foreign governments, Budget 2018 proposes to increase reassessment period by 3 years (for a total of 6 years) for income from a foreign affiliate of the taxpayer.
- The government proposes to give the CRA an additional three years to reassess a prior taxation year of a taxpayer, to the extent the reassessment relates to the adjustment of the loss carryback, where a reassessment of a taxation year results from a transaction involving a taxpayer and a related non-resident.

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- Similarly, Budget 2018 proposes to align the information return deadline for a taxpayer's foreign affiliate with the taxpayer's tax return deadline by requiring the information returns to be filed within six months after the end of the taxpayer's tax year.
 - Budget 2018 proposes to introduce a "stop-the-clock" rule for requirements for information generally and for compliance orders. This rule will extend the reassessment period of a taxpayer by the period of time during which the requirement or compliance order is contested.

Tackling international tax avoidance

In addition to confirming Canada's commitment to continue working with the Organisation for Economic Co-operation and Development's (OECD) and other countries to address base erosion and profit shifting, the budget proposes to add anti-avoidance rules to stop taxpayers from avoiding Canadian tax by shifting assets into foreign affiliates.

Specifically, these proposals would address arrangements that avoid having income taxed as "foreign accrual property income" by amending:

- the definition of "investment business" (i.e., more than five employee test, trading or dealing in indebtedness)
- the conditions for deeming controlled foreign affiliate status (i.e., tracking arrangements).

The recent implementation of the OECD/G20 Common Reporting Standard will result in the CRA receiving information that can be leveraged to address the highest-risk population of tax evaders.

Other budget measures would prevent unintended tax-free distributions by Canadian corporations to non-resident shareholders through the use of certain transactions involving partnerships and trusts. Budget 2018 proposes to amend the tax rules to add comprehensive "look-through" rules for such entities. These rules will allocate the assets, liabilities and transactions of a partnership or trust to its members or beneficiaries, based on the relative fair market value of their interests.

Tackling domestic tax avoidance

Domestically, Budget 2018 proposes to shore up the tax base by closing the following “loopholes”:

- In response to the Federal Court of Appeals decision in *Green*, the budget proposes to clarify how the at-risk rules apply to each level of a tiered limited partnership. Clarifying the rules was recommended in a submission by the Joint Committee on Taxation of the Canadian Bar Association and CPA Canada.
- Budget 2018 also proposes to strengthen existing anti-avoidance rules that aim to prevent a small group of taxpayers (e.g., Canadian banks and other financial institutions) from creating artificial losses through the use of synthetic equity arrangements and securities lending arrangements.

Indirect Tax Measures

Consultations on GST/HST holding corporation rule

Budget 2018 says that in the near future, the government will release draft legislation and open consultations on the GST/HST holding corporation rule, which generally allows a parent corporation to claim input tax credits to recover GST/HST paid on expenses that relate to another corporation. In particular, the government will review which expenses qualify, the limitation of the rule to corporations and the required degree of relationship between the parent corporation and the commercial operating corporation.

More indirect tax measures

Other sales and excise tax measures in Budget 2018 include:

- moving forward with the September 8, 2017 GST/HST draft legislation and regulatory proposals on management and administrative services provided to investment limited partnerships, subject to certain changes and relieving amendments
- adjusting tobacco excise duty rates for inflation every year (instead of every five years)
- proposing a new federal excise duty framework for cannabis products, following on the government's proposed framework released in November 2017.

Supporting Charities

Clarifying rules on political activities

Following the government's expert review of political activities of charities, the government will provide its response in the coming months. Budget 2018 says the aim will be to clarify the rules to ensure charities can pursue their goals without political harassment, recognizing their contribution to public policy.

Technical fixes

Budget 2018 proposes some technical measures for charities to help preserve the support they provide. These include:

- allowing transfers from deregistered charities to municipalities free of the revocation tax to ensure the ongoing availability of charitable assets that are important to the community
- simplify the charitable registration process for universities outside of Canada by removing the requirement that they be prescribed in the Income Tax Regulations.

Confronting Climate Change

Pan-Canadian Framework for Clean Growth and Climate Change

Several measures were included in Budget 2018 to support the Pan-Canadian Framework for Clean Growth and Climate Change, negotiated between federal, provincial and territorial governments in 2016. The CRA and Environment and Climate Change Canada will receive \$109 million over five years to administer and enforce the federal carbon pollution pricing system.

To ensure the actions taken under the Pan-Canadian Framework are transparent and informed by science and evidence, the federal budget will provide \$20 million over five years to engage external experts to assess the effectiveness of its measures and identify best practices.

More funds for sustainability and adaptation

To facilitate climate change adaptation, Environment and Climate Change Canada will receive funds to complete the modernization of weather forecast and severe weather warning systems as well as to revitalize and support the operation of water stations.

The most significant investment in environmental sustainability is \$1.3 billion over five years to support Canada's biodiversity and species at risk. Of that investment, \$500 million is devoted to creating a new \$1 billion Nature Fund, in partnership with corporate, not-for-profit, provincial, territorial, and other partners. The fund will make it possible to secure private land, support provincial and territorial species protection efforts, and help build Indigenous capacity to conserve land and species.

Canada will support the implementation of the Sustainable Development Goals, including climate action, with existing departmental funding over the next 13 years. In this year's budget, the goal of gender equality is the central goal driving commitments and is also featured in Canada's G7 presidency in 2018.

Promoting Economic Growth

Innovative business environment

Innovation program review

Budget 2017 announced a cross-departmental review of all federal business innovation programs with a goal of improving their responsiveness to clients' needs and to better promote business growth. As a result of that review, the government proposes to restructure its suite of innovation programs based on three principles:

- a business-centric lens
- focus on growing high-potential firms
- accountability.

With the introduction of new innovation programs, total funding for innovation programming will increase. At the same time, the total number of business innovation programs will be reduced by up to two-thirds. The changes will be rolled out over the next two years with implementation details to follow. All current programs remain in place until details are announced.

- Consolidated programs will be delivered through four flagship “platforms”:
- Industrial Research Assistance Program (IRAP)
- Strategic Innovation Fund
- Canadian Trade Commissioner Service
- regional development agencies.

Budget 2018 proposes to invest \$700 million over five years in IRAP, and \$150 million annually after that. These funds will be primarily directed to small and medium enterprises. A new threshold of \$10 million will apply to IRAP-funded projects.

Likewise, the Strategic Innovation Fund will move away from supporting smaller projects to support larger projects that can lead to significant job creation. Responsibility for the Centres of Excellence for Commercialization and Research and the Business-led Networks of Centres of Excellence — previously funded through the granting councils — will be consolidated under the Strategic Innovation Fund.

To simplify the client experience, a number of trade-related innovation programs — CanExport, Canadian Technology Accelerators, Going Global Innovation, and Canadian International Innovation Program — will be amalgamated under the Trade Commissioner Service. The Canadian Technology Accelerators program, which helps high-growth Canadian technology businesses to export to key markets in the United States, will be renewed with funding of \$2 million per year.

Canada's regional development agencies will receive an additional \$400 million over five years on an accrual basis. This funding will include \$105 million to support nationally coordinated, regionally tailored support for women entrepreneurs as part of the new Women Entrepreneurship Strategy. Over the next year, the government will explore ways to simplify the 22 existing programs offered by the regional development agencies.

Budget 2017 also announced a parallel review of the Scientific Research and Experimental Development program (SR&ED) to improve its efficiency and effectiveness. No mention is made of its status in Budget 2018.

Business-academia collaboration

A significant objective of Budget 2018 is to enhance funding for Canadian scientists and researchers following on the expert panel on Canada's Fundamental Science Review. Canada's three granting councils will receive additional funding, the Canada Research Chairs Program will also receive a new investment, and the National Research Council has been "re-imagined", among other initiatives. The total investment amounts to \$3 billion over five years.

To better facilitate the collaboration between post-secondary research and businesses, Budget 2018 proposes to consolidate programming within each granting council. The government also plans to increase support to the College and Community Innovation Program.

Supporting intellectual property

Budget 2018 announces a new Intellectual Property Strategy to help Canadian entrepreneurs better understand and protect intellectual property and get better access to shared intellectual property. The strategy includes creation of a Patent Collective, which will work with Canada's entrepreneurs to pool patents so that small and medium-sized enterprises have better access to shared IP. It will also provide improved access for entrepreneurs to intellectual property expertise and legal advice, as well as an "intellectual property marketplace" to improve entrepreneurs' access to public sector-owned IP.

Strengthening cyber security

One of the most significant investments in Budget 2018 is to implement a new National Cyber Security Strategy. The government proposes investing \$507.7 million over five years, and \$108.8 million annually after that, to:

- ensure secure and resilient Canadian systems
- build an innovative and adaptive cyber ecosystem
- support effective leadership and collaboration between different levels of Canadian government, and partners around the world
- The government proposes working alongside key partners, including the business community, to proactively solve mutual cyber issues.

These measures are welcome as they address a concern highlighted by our research. CPA Canada's 2017 Fraud Survey found that 73 per cent of respondents agreed they were concerned that Canadian businesses are vulnerable to cyberattacks regarding personal information. The soon-to-be-released 2018 version of the survey echoes that finding.

Regulatory reform

Budget 2018 responds to recommendations by the Advisory Council on Economic Growth to establish an agile regulatory system designed for the new economy. The government plans to pursue a "regulatory reform agenda", which will include targeted reviews of regulatory barriers and bottlenecks.

The agenda will also include playing a leadership role at the Canadian Free Trade Agreement Regulatory Reconciliation and Cooperation Table, and developing an online platform to engage Canadians on regulation and to improve transparency and efficiency of the rule-making process. Legislation to reduce the regulatory burden faced by businesses is also promised.

CPA Canada has consistently called for a reduction of the regulatory burden faced by business, and particularly, better coordination between different federal departments and agencies and different levels of government. This regulatory reform agenda is welcome and will be worth watching as it is developed.

Gender equality and the wage gap

In keeping with the budget's title of "Equality + Growth: A Strong Middle Class," Budget 2018 states that advancing women's equality and economic success contributes to Canada's growth and prosperity. Every decision in this budget was subject to gender-based analysis plus (where "plus" refers to other socio-cultural differences). In addition, the government had launched its new Gender Results Framework with goals and indicators to guide its decisions and measure its progress on those goals.

To support more equal work and parenting, fathers or non-birth parents may take leave via a new Employment Insurance (EI) Parental Sharing Benefit, which provides "use it or lose it" benefits for an extra five weeks (eight weeks if the person elects for the extended 18-month period). This measure will cost \$1.2 billion over five years starting this fiscal year and then \$344.7 million per year onward (funded through the EI operating account within the Consolidated Revenue Fund). With respect to the federally regulated sector, the government will introduce pay equity legislation and require more information on pay practices of employers to provide workers with "pay transparency."

The pay equity legislation is expected to narrow the gender wage gap in the federal public service by 2.7 cents on the dollar, and by 2.6 cents for the federally regulated public sector.

Skills and human capital development

The government will conduct a horizontal review of all skills programming available across departments over the next year in order to assess the effectiveness of these programs. Meantime, better labour market information will be supported over the next five years with funding of \$27.5 million in total, followed by \$5.5 million per year, for an Education and Labour Market Longitudinal Linkage Platform.

Women and skills training

To address the large gender gap in apprenticeship training, a pilot program will be introduced this fiscal year to provide \$19.9 million over five years for an Apprenticeship Incentive Grant for Women. There will also be a new Pre-Apprenticeship Program, with \$46 million over five years starting in 2018-19 and then \$10 million per year onward, to encourage women and other under-represented groups to enter the skilled trades.

Women's entrepreneurship

A new Women Entrepreneurship Strategy will help women-owned businesses grow through investments of \$105 million over five years. It will also improve access to federal business innovation programming and increase support for export-oriented business with an extra investment of \$10 million over five years in the Business Women in International Trade program. Notably, there will be increased access to capital for women entrepreneurs through the Business Development Bank of Canada and Export Development Canada with \$1.65 billion over three years.

Newcomer women

A new three-year pilot program will support newcomer women overcome barriers they face as immigrants to getting into and staying in the workforce. Funding will be \$31.8 million over three years starting in 2018-19.

ABOUT CPA CANADA

The new Canadian designation, Chartered Professional Accountant (CPA), is now used by Canada's accounting profession across the country. The profession's national body, Chartered Professional Accountants of Canada (CPA Canada), is one of the largest in the world with more than 210,000 members, both at home and abroad. The Canadian CPA was created with the unification of three legacy accounting designations (CA, CGA and CMA). CPAs are valued for their financial and tax expertise, strategic thinking, business insight, management skills and leadership. CPA Canada conducts research into current and emerging business issues and supports the setting of accounting, auditing and assurance standards for business, not-for-profit organizations and government. CPA Canada also issues guidance and thought leadership on a variety of technical matters, publishes professional literature and develops education and professional certification programs. cpacanada.ca

