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Tax, Retirement & Estate Planning Services

2019 Federal Budget

Budget 2019 - "For the People????"

Introduction

March 19, 2019, Finance Minister Bill Morneau tabled the 2019 Federal Budget. This budget was clearly directed at "the people". There were no changes to personal and corporate tax rates. The focus was mainly on home buying, retraining, and retirement – millennials, people adjusting to working in the new economy and seniors. Very little, other than closing tax loopholes was directed at small business owners, professionals or high-income earners. Within the areas that were the focus, many of the measures related to registered plans.

The following represents a summary of measures of interest to investment and insurance advisors.

Registered Plan Tax Measures:

Permitting Additional Types of Annuities Under Registered Plans

The current tax rules allow certain registered plans to purchase an annuity to provide income in retirement, subject to certain conditions. To provide more flexibility, the budget proposed two new types of annuities for certain registered plans.

- Advanced Life Deferred Annuities (ALDAs) 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 (VPLAs) will be permitted under a PRPP and defined contribution RPP.

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

ALDAs

The current rules do not allow the purchase of a deferred annuity with registered funds. Budget 2019 proposes to amend the tax rules to permit the purchase of a deferred annuity (an ALDA) from under certain registered plans. An ALDA will be a life annuity, the commencement of which may be deferred up to the end of the year in which the annuitant reaches age 85. It appears to be an effort to help Canadians deal with longevity risk and ensure that they have enough income for their later years, unlike with a RRIF where the retirement savings may be effectively depleted by the time they reach 85.

The value of an ALDA will not be included for the purpose of calculating the minimum amount required to be withdrawn in a year from a RRIF, a PRPP member's account or a defined contribution RPP member's account, after the year in which the ALDA is purchased.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

The tax treatment on death is like the current rules that apply to matured RRSPs. Payments to the surviving spouse or common-law partner of a deceased annuitant will be included in the income of the surviving spouse or common-law partner for tax purposes.

If the beneficiary of a lump-sum death benefit is the deceased annuitant's surviving spouse or common-law partner, or a financially dependent child or grandchild of the deceased annuitant, the lump-sum death benefit will be included in the income of the beneficiary for tax purposes. All or a portion of that amount will be permitted to be transferred on a tax-deferred basis (or "rollover" basis) to the RRSP, RRIF or other qualifying vehicle of the beneficiary provided that, where the beneficiary is a financially dependent child or grandchild, the beneficiary was dependent on the deceased annuitant by reason of physical or mental infirmity. Otherwise the lump-sum death benefit paid to a beneficiary will be included in their income.

VPLAs

Currently, if someone wants to buy an annuity from their PRPP or defined contribution RPP the annuity must be purchased from a licensed annuities provider. Budget 2019 proposes to permit PRPPs and defined contribution RPPs to provide a VPLA to members directly from the plan.

A minimum of 10 retired members are required to participate in a VPLA to establish such an arrangement. Payments from a VPLA can be adjusted to reflect the investment performance of the annuities fund and mortality experience of the pool of VPLA annuitants.

The tax treatment of VPLAs on the death of the annuitant will follow the current rules regarding the purchase of an annuity with PRPP and defined contribution RRP savings.

Home Buyers Plan (HBP) and related home buying incentives

To make it easier for Canadians to afford their first home, the budget proposes to provide first-time home buyers with greater access to their RRSP savings to buy or build a home. The budget proposes to increase the withdrawal limit under the HBP from $25,000 to $35,000. As a result, a couple could potentially withdraw up to $70,000 from their RRSPs to buy their first home.

The increase in the withdrawal limit to $35,000 will also apply to individuals eligible for the disability tax credit that qualify under the HBP. The new limits would apply to withdrawals made after March 19, 2019.

To help Canadians maintain home ownership after experiencing a breakdown in their marriage or common-law partnership, the budget proposes that these individuals are no longer required to be a first-time home buyer to participate in the HBP. To qualify an individual must live separate and apart from their spouse or common-law partner for at least 90 days as a result of the breakdown of their marriage or common-law partnership. Also, the individual must live 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 the withdrawal is made or any time in the four preceding years. This measure would also be available for withdrawals made after 2019.

Introducing the First-Time Home Buyer Incentive

Consistent with the theme of improving housing affordability the budget proposes to introduce the First-Time Home Buyer Incentive. This provision allows eligible first-time home buyers who meet the minimum down payment for an insured mortgage to apply to finance a portion of their home purchase through a shared equity mortgage with Canada Mortgage and Housing Corporation (CMHC) and reduce the monthly payments required to buy a home.

Registered Disability Savings Plan (RDSP)

RDSPs are tax assisted savings for disabled persons which enable the disabled person and their family to save for that person's financial security. The person for whom the plan is established must qualify for the disability tax credit (DTC). Currently when a beneficiary of an RDSP ceases to be eligible for the DTC, no contributions may be made to the plan and no Canada Disability Savings Grants and Canada Disability Savings Bonds may be paid into the RDSP. The RDSP must be closed by the end of the year following the first full year throughout which the beneficiary is not eligible for the DTC. Amounts held back by the issuer of the RDSP for grants and bonds also must be repaid.

Prior amendments to the Act permitted an extension for an RDSP to remain open after ineligibility for the DTC until the end of the fourth calendar year following the first full year of ineligibility. To qualify for the extension a medical practitioner had to certify in writing that the beneficiary was likely to be eligible for the DTC in the foreseeable future due to their condition.

The proposed measures will allow more flexibility for RDSPs where there is a loss of the DTC. The budget proposes to remove the time limitation on the period that the RDSP may remain open after a beneficiary becomes ineligible for the DTC and to eliminate the medical certification requirement. Withdrawals during this period will remain subject to the current proportional repayment rule but the holdback amount (for grant and bond repayment) will be modified based on the beneficiary's age.

Even though there is no time limitation on keeping the RDSP open, a rollover of proceeds from a deceased individual's RRSP or RRIF 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 year following the first full calendar year of ineligibility for the DTC. A plan holder can always request a plan closure, in which case the normal rules apply with modification for the holdback amount as calculated.

If a beneficiary becomes eligible for the DTC again, the regular RDSP rules apply – contributions are permitted, new grants or bonds may be paid. These measures apply after 2020. An RDSP issuer will not be required to close an RDSP on or after budget day and before 2021 because the beneficiary is no longer eligible for the DTC.

A related measure proposes to exempt RDSPs, like RRSPs, from seizure by creditors in bankruptcy, except for contributions made in the 12 months before the filing.

Individual Pension Plans (IPPs)

IPPs are a defined benefit pension plan used to provide lifetime retirement benefits to owner-managers in respect of their employment. On termination of membership in a defined benefit pension plan like an IPP there are two ways to roll over all or part of the commuted value of the plan on a tax deferred basis:

- transfer the full commuted value to another defined benefit plan sponsored by another employer; or
- transfer the prescribed transfer limit to the member's RRSP or similar registered plan and take the excess into income.

To avoid these prescribed transfer limits and potentially being forced to take a significant portion of the commuted value into income some individuals are incorporating corporations and using their new corporation to establish an IPP. This allowed them to transfer 100 per cent of the commuted value to their new IPP and avoid the income inclusion.

To prevent this planning, the budget 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 that do not qualify will be considered a non-qualifying 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 March 19, 2019.

Other measures of interest

Guaranteed Income Security (GIS) and Canada Pension Plan (CPP) items

Seniors can earn a very small level of employment income and still qualify for GIS. This earnings exemption is being increased from $3,500 to $5,000 per year per GIS recipient. Self-employed earnings will qualify for the exemption. A partial exemption of 50% is being introduced on the next $10,000 of annual employment or self-employed income. This will be applicable to the July 2020 to July 2021 benefit year.

Legislative amendments will be introduced to proactively enroll CPP contributors who are age 70 or older in 2020 but who have not yet applied to receive their pension benefits.

Canada Training Credit

Applicable to 2019 and subsequent tax years, the budget introduced 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 per year in a notional account up to a maximum of $5,000 over their lifetime. To be eligible an individual must file a tax return for the year, be between 25 and 65 years of age, have earnings of $10,000 or more not exceeding net income of $147,667 in 2019 (indexed annually). Eligible training and fees align with the existing rules for the tuition tax credit but unlike the tuition tax credit educational institutions outside Canada will not be eligible for purposes of the Canada Training Credit. The portion of tuition expenses eligible for the new credit will not qualify under the tuition tax credit but the part not eligible for the new credit would be able to be claimed under the tuition tax credit.

Employee Stock option deduction

The budget provided background that the current usage of the employee stock option deduction is disproportionately represented by very highly paid executives at large, long-established, mature firms. Essentially, this deduction allows stock option benefits to be taxed at half the normal personal tax rate so that it is equivalent to capital gains. It recognized that in start-up firms, stock options are an effective way of providing compensation and did not want to disrupt this use. The budget announced the intention to apply an annual $200,000 cap on employee stock option grants, based on the fair market value of the underlying shares, that may receive tax-preferred treatment for employees of large, long-established, mature firms. For start-ups and emerging businesses, the current rules will continue to apply. Any changes would apply on a go forward basis. Further details are promised before the summer of 2019.

Measures relevant to small businesses

Although few and far between there were a few items of note for small businesses.

Farming and fishing businesses do not have to sell their farm products or fishing catches to co-ops to be excluded from "specified corporate income". Sales can be to any arm's length purchaser corporation. This means that this income remains eligible for the small business deduction.

A statement in the budget expresses the intention "to develop new proposals to better accommodate intergenerational transfers of businesses while protecting the integrity and fairness of the tax system." Current tax rules convert the capital gain that would otherwise arise on a sale of shares of a family business to a corporation controlled by other family members into a deemed dividend. The private company measures announced in July of 2017 as originally proposed would have made things worse. Those measures were subsequently withdrawn. The current issue remains and through the many months of consultation over the private company measures, the government undertook to look at this issue. This statement in the 2019 budget at least leaves this possibility open.

Compliance and enforcement measures:

To close what the government perceives as a tax loophole this budget proposes to prevent the use by mutual fund trusts of a method of allocating capital gains or income to their redeeming unitholders where the use of that method inappropriately defers tax or converts fully taxable ordinary income into capital gains taxed at a lower rate.

The budget reiterated the intention to proceed with information reporting requirements for certain dispositions of an interest in a life insurance policy. In 2016, changes were made to subsection 148(7) which deals with non-arm's length transfers, transfers for no consideration and distributions from a corporation of a life insurance policy. No further details were provided in the budget, but it is assumed that the information relevant to the transfer of the policy would be collected: the adjusted cost basis; cash surrender value and fair market value of consideration given in relation to the transfer.

Recent amendments to the Canada Business Corporations Act require federally regulated corporations to maintain beneficial ownership information. The budget proposes amendments to make this information more readily available to the Canada Revenue Agency (CRA). As announced in the 2018 budget, beneficial ownership information reporting is also coming for trusts for 2021 and later taxation years.

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A Tax-Free Savings Account (TFSA) that carries on a business is liable to pay tax at the top personal rate. The budget proposes that joint and several liability for tax owing on income from carrying on a business within a TFSA be extended to the TFSA holder and the joint and several liability of the TFSA trustee, (normally, a financial institution) be more limited in respect of this.

Expect more CRA audits looking into residential real estate sales. The budget announces more funding for CRA audit teams focusing in this sector. Also, on the radar is non-compliance associated with crypto-currency transactions and the digital economy; income in Canada of non-residents and offshore non-compliance. Again, more funding for audit teams and programs are provided in these areas.

Conclusion

This is clearly a pre-election budget. Nothing too controversial. No incentives to small businesses, professionals or high-income earners, just closing loopholes for them. The key touch points involved options in retirement, enabling home ownership and supporting re-skilling.

A budget "for the people"???

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