2018 Federal budget highlights

Fidelity Investments Canada Budget Team

The big picture

On February 27, 2018, the Liberal federal government presented its third annual budget, entitled *Equity + Growth: A Strong Middle Class*. This year's budget focuses mainly on investments in areas of innovation and research and in pay equity to position Canada's economy for success over the long term. For advisors and investors, there are multiple tax measures related to Canadian controlled private corporations and other matters that they should pay attention to for potential impact.

Highlights

Small business tax measures

- **Passive investments:** New rules have been introduced to limit the ability of Canadian-controlled private corporations (CCPCs) to benefit from earning passive investment income, to the extent that a CCPC earns more than $50,000 of investment income in a year. These measures replace more complex measures that had been previously proposed in 2017 (see more details below).

- **Income sprinkling:** The government confirmed its intention to proceed with "income sprinkling" measures announced on December 13, 2017. These rules are effective for 2018, meaning that paying dividends to certain family members may no longer be effective in reducing a family's tax burden.

- **Small-business tax rate:** The government also confirmed that it will proceed with lowering the small-business tax rate from 10.5% to 10%, effective January 1, 2018, and to 9% effective January 1, 2019. However, this will be accompanied by a corresponding increase in the non-eligible dividend tax rate.

Other tax related measures

- **Capital gains inclusion rate** – Despite speculation that the capital gains inclusion rate would be increased, it remains at 50 per cent.

- **Tax credits –** The Working Income Tax Benefit is renamed and enhanced as the Canada Workers Benefit. Starting in 2019, eligible low-income earners could receive up to $1,355 under this tax credit.

- **CRA funding –** To combat tax evasion and tax avoidance, the Government will invest $90 million over five years to target non-compliance in the highest-risk areas, including wealthy individuals with offshore accounts. Additional funding will also be made available for the federal tax court system, including the Tax Court of Canada.

- **Tax loopholes –** The Government continues to close perceived loopholes, including artificial losses using equity-based financial arrangements, and stop-loss rules on share repurchase transactions.

Innovation & Research

Targeted investments: Nearly $4 billion in targeted funding is promised over the next five years, covering a wide range of programs to develop opportunities for innovation in Canada. Some of the highlights include additional funding to the granting councils for fundamental research, advanced computing and big data, and support to reduce barriers for women entrepreneurs in high-growth areas of the economy.

Pay equity

Pay equity legislation: Recognizing that in Canada, women earn on average 31% less than men in annual earnings, the government will move forward with new proactive pay equity legislation that would ensure that women and men in federally regulated sectors will receive the same pay for work of equal value.

More details on the taxation of passive investments held by CCPCs

- **Previously proposed measures dropped –** As noted above, the government had previously proposed measures to limit the potential benefits associated with holding passive investments within a CCPC. Given the complexity of those proposals and the significant burden those proposals would have added to small businesses, these measures have been dropped.

- **Limiting access to the small business tax rate –** CCPCs that earn more than $50,000 in passive investment income will see their access to the small business tax rate limited or eliminated. This lower rate is achieved through the small business deduction; the limit is currently $500,000 of active business income. Above the limit, income is taxed at the higher general corporate rate.

    - For every dollar of investment income earned above $50,000, the small business deduction limit will be reduced by $5. Thus, the small business limit will be reduced gradually as the level of investment income increases above $50,000, and will be reduced to zero when a CCPC earns $150,000 of investment income.

    - The $50,000 includes interest income, foreign income, the taxable portion of capital gains, and dividends from non-connected corporations. Income from savings in life insurance policies that are not exempt policies is also included.

    - Income from investments that are incidental to the business (e.g. interest on short-term deposits held for operational purposes) as well as capital gains realized from the sale of active investments will be excluded from the $50,000.

    - There is no longer any differentiation between assets held prior to the change in taxation and those acquired once the new rules are in place.

- **Ordering of dividend refunds:** Larger CCPCs will no longer be able to obtain refunds of taxes paid on investment income while distributing dividends from income taxed at the general corporate rate. This will be achieved through the establishment of a second “refundable dividend tax on hand” (RDTOH) account, combined with an ordering rule.

- **Effective date:** The new rules will apply to taxation years that begin after 2018.

836041.1.0 02/27 SAL 24060