MACKENZIE TAX & ESTATE PLANNING:

BUDGET BULLETIN

2019 Federal Budget Analysis

The 2019 Federal Budget tabled several proposals that will impact the financial, tax and estate plans of Canadians. The following is a summary of the most relevant budget proposals that may impact financial advisors and their clients.

Measures for Individuals

Canada Training Credit

Effective for 2019 and subsequent taxation years, the budget proposes to introduce the Canada Training Credit, a refundable tax credit to assist working Canadians with the cost of professional development. The credit is the lesser of eligible tuition and a new notional account. Eligible individuals will accumulate $250 each taxation year in a notional account.

To be eligible individuals 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 taxation year;
- have net income under the third federal bracket $147,667 (for 2019)

The lifetime maximum is $5,000, which expires the year an individual turns 65 years of age.

The federal tuition 15 per cent non-refundable tax credit will still be available on the difference between the eligible tuition fees and the refundable Canada Training Credit.

Home Buyers Plan

Effective March 21, 2019, the 2019 budget proposes to increase the withdrawal for first time home buyers under the Homebuyers Plan from $25,000 to $35,000 ($70,000 spouse/common-law partner) from their registered retirement savings plan (RRSP) to purchase or build a home, without being taxed on the withdrawal. The withdrawal must be repaid over 15 years, starting the second year following the year in which the withdrawal was made.

Also, individuals experiencing a marriage breakdown generally would not qualify as first-time homebuyers under the Homebuyers plan. However, the proposals will allow these individuals to now qualify as first-time homeowners to access $35,000 from their RRSP to purchase a home.

Change in Use of Multi-Unit Residential Properties

When a taxpayer's property changes use from an income producing to principal residence or vice versa the *Income Tax Act* (ITA)deems the taxpayer to have disposed of, and reacquired, the property at fair market value. An election is available to defer the deemed disposition until the property is sold, offering a tax deferral if an income producing property had an inherent gain or, as in the case of a principal residence, 4 additional years can be designated for tax exemption, provided certain criteria are met.

Under the current rules these elections are only available for complete changes in use and not partial changes of use. Generally, multi-unit residential properties such as a duplex could not benefit from use of these elections.

Effective March 21, 2019, the budget proposes to extend the elections to partial changes of use that are currently available for complete changes of use.

Additional Options in Creating Retirement Income from Registered Plans

To provide Canadians with greater flexibility in managing their retirement savings, Budget 2019 proposes to permit two new types of annuities for certain registered plans:

- Advanced life deferred annuities (ALDA) will be permitted under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), deferred profit-sharing plan (DPSP), pooled registered pension plan (PRPP) and defined contribution registered pension plan (RPP); and
- variable payment life annuities will be permitted under a PRPP and defined contribution RPP.

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

a) Advanced Life Deferred Annuities (ALDA)

When an individual chooses to purchase an annuity with registered funds, the tax rules require commencement of the annuity by the end of the year in which the annuitant reaches age 71. Budget 2019 proposes to amend the tax rules to permit an ALDA to be a qualifying annuity purchase, or a qualified investment for certain registered plans. An ALDA is a life annuity that can be deferred until the end of the year in which the annuitant attains 85 years of age. In addition, the Budget proposes the following requirements and limits:

1) The value of the ALDA is not included for purposes of calculating the minimum amounts required to be withdrawn from registered plans for the year after purchase

2) An individual will be subject to a lifetime ALDA limit equal to 25% of the value of all property in the plan (subject to adjustments), and a lifetime ALDA dollar limit of $150,000 from all qualifying plans. This limit will be indexed to inflation for tax years after 2020, rounded to the nearest $10,000

3) An ALDA must meet several other requirements and conditions

4) A 1% per month penalty tax will apply if ALDA purchases exceed their ALDA limits

b) Variable Payment Life Annuities (VPLA)

A VPLA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality expectation of VPLA annuitants. This option was not previously available and gives PRPP and defined contribution RPP members additional options in creating an income stream in retirement.

Registered Disability Savings Plan -Cessation of Eligibility for the Disability Tax Credit

Registered Disability Savings Plans are used to help Canadian individuals with disabilities save for retirement, provided they qualify for the disability tax credit and other conditions are met. To encourage savings the Government offers grants and bonds (a combined lifetime maximum of $90,000) until the year the individual beneficiary turns 49 years of age. Currently, if an individual beneficiary loses the disability tax credit, by election the account can remain open provided a medical practitioner certifies the DTC is likely to be reinstated based on the nature of the beneficiary's disability.

The 2019 Federal Budget proposes to eliminate the medical certification requirement including the requirement to close the account when the individual loses the disability tax credit. This will help retain the grants and bonds in the account that would under the current rules be required repaid to the Government. In addition, a tax deferred rollover of a deceased parent or grandparent's registered retirement account (RRSP/RRIF) will be permitted until the end of the fifth calendar year following the loss of the DTC which is not allowed under the current rules.

The 2019 Federal budget also proposes to creditor protect RDSP's from seizure in bankruptcy exempt contributions made 12 months prior to filing

If an RDSP beneficiary becomes DTC ineligible the issuer will not be required to close the account on or after March 20, 2019.

Kinship Care Providers

Kinship and close-relationship care programs are alternatives for foster care for children in need of protection.

The Canada Workers Benefit is a refundable tax credit that supplements the earnings of low-income workers and improves work incentives for low-income Canadians.

Effective for the 2019 and subsequent taxation years, Budget 2019 proposes to extend the meaning of a parent of a child to a kinship care provider for purposes of them being able to claim the Canada Workers benefit, provided all other criteria are met. Under the proposals there is no requirement if the caregiver receives financial assistance from a government under a kinship care program.

In addition, financial assistance payments in this capacity are not taxable or used for income tests for benefit and credit eligibility.

Donations of Cultural property

Currently, an individual could receive an enhanced tax incentive by way of a credit and a corporation by way of a deduction when donating cultural property. Effective after March 20, 2019, Budget 2019 proposes to eliminate the requirement a cultural property be of "national importance" to ensure cultural property of foreign origin qualifies for the enhanced tax incentive.

Medical Expense Tax Credit

Medical expenses are subject to a 15 per cent non-refundable tax credit exceeding the lesser of $2,352 or 3% of net income. Budget 2019 proposes to extend the meaning of medical expenses to include other classes of cannabis purposed for medical reasons once legal sale is permitted under the Cannabis Act. This measure applies to expenses incurred subsequent to October 16, 2018.

Contributions to Specified Multi-Employer Plan (SMEP) for Older Members

Budget 2019 proposes to amend the tax rules to prohibit contributions to a SMEP in respect of a member after the end of the year the member attains 71 years of age and to a defined benefit provision of a SMEP if the member is receiving a pension from the plan (except under a qualifying phased retirement program). The proposed changes will ensure that employers do not make pension contributions on behalf of older SMEP members in situations from which they cannot benefit. This is more aligned with how other defined benefit RPPs operate.

Individual Pension Plans (IPPs) & Pensionable Service

Upon termination of 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, as either a transfer of the full commuted value to another defined benefit plan, or as a partial transfer of the commuted value (subject to prescribed transfer limits within the Income Tax Regulations), to a locked-in retirement savings plan (or similar 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 a non-qualifying transfer that is required to be included in the income of the member for income tax purposes.

This measure will prevent a member from transferring 100% of their defined benefit plan to a newly created IPP, instead of the restricted transfer of assets to the locked in plan. This measure applies to pensionable service credited under an IPP on or after Budget Day.

Refining Mutual Fund Trust Taxation

When a mutual fund trust disposes of investments to fund a redemption of its units, any accrued capital gain on the investments is realized by the trust and is subject to tax. The unitholder may again be taxed upon the disposition of units on any accrued capital gains. A capital gains refund mechanism (CGRM) provides a refund to the mutual fund trust in respect of tax that the fund had paid on its capital gains attributable to redeeming unitholders. Since the method is based on prescribed formula, it is an approximation and does not always relieve double taxation. Methods have been developed to more effectively match the capital gains realized by the mutual fund trust on its investments with the capital gains realized by redeeming unitholders. However, the Government continues to refine the process to reflect more accurate and fair tax policy and has introduced two new rules in Budget 2019.

1) Deny a tax deduction to the mutual fund trust to the extent that capital gains triggered in the trust are greater than the capital gain realized upon the redemption of units by the unitholder (subject to meeting certain conditions). This eliminates a tax deferral that existed previously

2) Deny a tax deduction to the mutual fund trust in respect of an allocation made to a unitholder on a redemption if the allocated amount is ordinary income and the unitholders proceeds are reduced by the allocated amount. This eliminates a character conversion that has been occurring.

These measures will apply to taxation years of a mutual fund trust that begin on or after March 19, 2019.

Carrying on Business in a Tax-Free Savings Account

Effective for 2019 and subsequent taxation years, the 2019 Federal Budget proposes that the joint and several liability for taxes owing on income earned from carrying on a business within the TFSA also be the responsibility of the TFSA holder and not just the trustee (i.e. Institutions) under the current rules. Under the proposals the trustee's liability is limited to property held in the TFSA and distributions from the date of the notice of assessment.

Tax Credit for Digital Subscriptions

Budget 2019 proposes 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. Eligible digital subscriptions include amounts paid to a Qualified Canadian Journalism Organization (QCJO), a status necessary for the non-refundable tax credit

Measures for Corporations

Business investments in zero emission vehicles

Effective for eligible business acquisitions on or after March 20, 2019 available for use before 2028 (subject to a phaseout) Budget 2019 proposes a CCA rate of 100% for eligible zero-emission vehicles. Subject to certain conditions, passenger vehicles up to $55,000 (plus sales tax) can be fully written off.

To be eligible for the first-year enhancement a vehicle must:

- Be a motor vehicle as defined in the ITA;
- Would have been included in Class 10, 10.1 or 16;
- Be a hybrid (subject to certain criteria) or fully electric;

Small Business Deduction – Farming & Fishing

A reduced rate of tax is available on the first $500,000 of active business income earned by a Canadian-controlled private corporation (CCPC). Existing rules prevent the multiplication of this limit, including situations where certain amounts that are earned by a CCPC come from sales to a private corporation where the CCPC (or certain persons) hold a direct or indirect interest. However, certain income of a CCPCs farming or fishing business that arises from sales to a farming or fishing cooperative corporation is eligible for the small business deduction.

To provide greater flexibility to farming and fishing businesses, 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.

Character Conversion Transactions

New rules introduced in 2013 known as character conversion transactions, effectively eliminated the use of forward contracts as a means of converting the returns on an investment from ordinary income into capital gains, of which only 50 percent is taxable. As a result, any gain that arises from a derivative forward agreement is taxed as ordinary income rather than a capital gain. An important exception to this rule applies to certain commercial transactions, such as merger and acquisition transactions. New character conversion transactions have been developed as an attempt to misuse the commercial transaction exception. As a result, Budget 2019 proposes an amendment that introduces an additional qualification for the commercial transaction exception to ensure that taxation on these transactions remain taxable as ordinary income, and not capital gains.

Possible Changes to Taxation of Employee Stock Options

Employee stock options are provided to employees as an incentive. A stock option grants an employee the right to purchase stocks of the employer at a set price. Once exercised, the difference between the set price and fair market value of the stock is included in the employee's income as a taxable employee benefit. This benefit however can be reduced by a stock option deduction of 50% of the difference, which has the effect of the benefit being taxed similar to a capital gain. The Federal Government is looking to limit or "cap" the amount of stock options subject to the deduction at a value of $200,000 of the fair market value of the stocks obtained by the option. Any value over the $200,000 (for example in a case of options exercised and worth $300,000) would have the difference taxed as 100% income to the employee. More details will be provided by the summer of 2019.

Previously Announced Measures

Budget 2019 confirms the Government's intention to proceed with the following previously announced tax and related measures announced on November 21, 2018;

- provide for the Accelerated Investment Incentive,
- allow the full cost of machinery and equipment used in the manufacturing and processing of goods, and the full cost of specified clean energy equipment, to be written off immediately,
- extend the 15 per cent mineral exploration tax credit for an additional five years, and
- ensure that business income of communal organizations retains its character when it is allocated to members of the communal organization for tax purposes.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated.

This should not be construed to be legal or tax advice, as each client's situation is different. Please consult your own legal and tax advisor.