# Federal budget 2019-20

## Investing in the middle class


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*EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.*

"We're going to invest in the middle class and in the things that matter most to Canadians: good jobs, strong communities, a clean environment, and better opportunities for future generations. ... So that when young people graduate from school, they've already got the experience they need to get a good job. ...So that when seniors retire, they can look forward to spending their time with family and friends, not worrying about how they'll pay their bills every month. ...So that every Canadian can feel good about what the future holds, and be confident about their place in a changing world.

Federal Finance Minister Bill Morneau
2019 federal budget speech

## Tax policy and economic outlook

On 19 March 2019, federal Finance Minister Bill Morneau tabled his fourth budget. In keeping with this government's previous themes, this budget focuses on continued economic growth, job creation, upskilling Canadians for the changing economy, support for first-time home buyers, investments in cleaning up the environment, improving relations with Canada's Indigenous Peoples, and a new national pharmacare initiative – all with the aim of supporting and building Canada's middle class.

In his budget speech, Morneau stated, "Compared to where we were just a few years ago, our economy is doing very well. Since November 2015, hard-working Canadians have created more than 900,000 new jobs—most of them full-time."

However, he acknowledged the inevitable changes in the economy brought on by digital innovations, among others, and the challenges they pose for Canadian workers of all ages.

"But we have to keep those strong numbers in perspective, Mr. Speaker. If you are a young person still struggling to find meaningful work, a low unemployment rate probably doesn't mean that much. You just want a chance to make a decent living doing work that matters to you.

"Or at the other end of the spectrum, maybe you're someone with a few decades of work experience, but you're worried that the good job you have today might not exist in another 5 or 10 years. Good GDP numbers don't mean a lot when the job you need to feed your family is on the line.

"There's a growing sense of uncertainty taking root around the world, Mr. Speaker, and Canada is not immune to those worries."

# Surplus (deficit) and federal debt outlook

## Federal fiscal outlook

As set out in Table A, after accounting for economic and fiscal developments, the latest government projections call for a budgetary deficit in fiscal 2018-19, an increased budget deficit in 2019-20 and declining budget deficits in each subsequent year of the forecast period. Measured in relation to the size of the economy, the federal debt is expected to decline to 28.6% of gross domestic product (GDP) by 2023-24.

Canada's total government net debt-to-GDP ratio remains the lowest of any G7 country and among the lowest of the advanced G20 countries.

In October 2018, the International Monetary Fund estimated that Canada's total government net debt-to-GDP ratio is the lowest, by far, of any G7 country:

- Canada 27.7%
- Germany 41.5%
- US 77.7%
- UK 78.0%
- France 87.4%
- Italy 118.3%
- Japan 155.7%

**Table A**

*Projections of federal budgetary surplus (deficit) and debt*

| | Surplus (deficit) outlook | Federal debt | |
|---|---|---|---|
| | $b | $b | % of GDP |
| 2018-19 | (14.9) | 685.6 | 30.8 |
| 2019-20 | (19.8) | 705.4 | 30.7 |
| 2020-21 | (19.7) | 725.1 | 30.5 |
| 2021-22 | (14.8) | 739.8 | 30.0 |
| 2022-23 | (12.1) | 751.9 | 29.3 |
| 2023-24 | (9.8) | 761.7 | 28.6 |

*Totals may not add due to rounding.*

# Proposed measures

## Employee stock options

Where a corporation grants stock options with a fair market value (FMV) exercise price to employees, paragraph 110(1)(d) of the Income Tax Act (the Act) provides a deduction equal to 50% of the benefit realized on the exercise or disposition of options where certain other conditions are satisfied (the stock option deduction).

Budget 2019 seeks to limit the availability of the stock option deduction where options are granted to employees of "large, long-established, mature firms."

The proposals would limit the availability of the stock option deduction to an annual maximum of $200,000 of stock option grants (based on the fair market value of the underlying shares on the date of grant).

Example:

> An employee is granted 10,000 options to purchase shares of their employer at a price of $100 per share, Company A, at a time when the FMV of Company A's shares is $100. Since the value of the shares represented by the options at the time of grant is $1m, the stock option deduction will only apply to 2,000 ($200,000/$100) options granted in the year.

Budget 2019 provides that the stock option deduction will remain unchanged for "startups and rapidly growing Canadian business". The budget documents provide that further details on this measure will be released before the summer of 2019, and the Notice of Ways does not contain any further information.

The proposals ostensibly seek to align the Canadian stock option regime with the US incentive stock option rules, but a number of questions remain. Obvious questions concern the definition of "startups and rapidly growing Canadian businesses" which will not be subject to the limits. It is possible that these terms may refer to stock options granted by corporations that are Canadian-controlled private corporations (CCPCs), but there are many large CCPCs that could not be considered to be startups or rapidly growing Canadian business. It is also unclear whether the limit would only apply to the 110(1)(d) deduction or whether it would also apply to the alternate deduction under 110(1)(d.1) for options granted or shares issued by a CCPC to arm's length employees.

Presumably, corporations that do not qualify as "startups or rapidly growing Canadian businesses" will need to track each stock option grant to determine the amount of the grant that will be eligible for the stock option deduction.

The budget documents note that, "Any changes will apply on a go-forward basis only and would not apply to stock options granted prior to the announcement of the legislative proposals to implement any new regime." It therefore appears that stock options granted after Budget 2019, but before the announcement of the legislative proposals, would not be subject to the new regime.

# Business income tax measures

## Corporate tax rates

No changes are proposed to the corporate income tax rates or to the $500,000 small business income limit of a Canadian-controlled private corporation (CCPC). The enacted Canadian federal corporate income tax rates are summarized in Table B.

**Table B**

*Federal corporate income tax rates*

| | 2018 | 2019 |
|---|---|---|
| General corporate rate | 15.0% | 15.0% |
| Small business rate | 10.0% | 9.0% |

## Support for Canadian journalism: refundable labour tax credit

As announced in the 2018 fall economic statement, Budget 2019 confirms the introduction of a new refundable tax credit for qualifying journalism organizations producing original news. More specifically, Budget 2019 proposes a 25% refundable tax credit on salary or wages paid to eligible newsroom employees of qualifying journalism organizations, subject to a cap on labour costs of $55,000 per eligible newsroom employee per year. The credit will apply to salary or wages earned in respect of a period on or after 1 January 2019.

**Qualifying journalism organization:** For purposes of this credit, a qualifying journalism organization will be a qualified Canadian journalism organization (QCJO) that is primarily engaged in the production of original written news content. A QCJO that is a corporation must be either listed on a stock exchange in Canada without being controlled by non-Canadian citizens if it is a public corporation, or, if it is a private corporation, be at least 75% owned by Canadian citizens or such public corporations. Organizations carrying on a broadcasting undertaking (as defined in the *Broadcasting Act*) or receiving funding from the Aid to Publishers component of the Canada Periodical Fund will not qualify for the credit.

**Eligible newsroom employees:** Subject to any recommendations by an independent panel to be established, an eligible newsroom employee will initially generally be an employee of a QCJO who works for a minimum of 26 hours per week, on average, and is employed by the QCJO (or is expected to be employed) for at least 40 consecutive weeks. The employee will also be required to spend 75% of his or her time engaged in the production of news content, including by researching, collecting information, verifying facts, photographing, writing, editing, designing or otherwise preparing content.

**QCJO:** For the purposes of this credit, as well as the personal income tax credit for digital subscriptions (see below under *Tax measures for individuals and trusts*), and the qualified donee status proposed amendment (see below under *Charities and nonprofit organizations*), a QCJO will be required to be organized as a corporation, partnership or trust operating in Canada and meet additional conditions. Subject to any recommendations by an independent panel to be established, these additional conditions will include:

- If the organization is a corporation, it must be incorporated and resident in Canada, and have its chairperson and at least 75% of its directors be Canadian citizens (similar criteria will apply in case of organizations that are partnerships or trusts, so that generally Canadian citizens or such corporations will be required to own at 75% of the interests in them).
- It must be primarily engaged in the production of original news content primarily focused on matters of general interest and reports of current events (including coverage of democratic institutions and processes), but not primarily focused on a particular topic (e.g., industry-specific news, sports, recreation, arts, lifestyle or institutions).
- It must regularly employ two or more arm's-length journalists in the production of its content.
- It must not be significantly engaged in the production of content to promote goods or services, or the interests (or report on the activities) of an organization, an association or their members, or engaged in the production of content for a government, Crown corporation or government agency.
- It must not be a Crown corporation, municipal corporation or government agency.
- It must be designated by an administrative body to be established.

## Small business deduction: farming and fishing income

Budget 2016 introduced measures to limit access to the small business deduction under certain corporate and partnership structures that were previously able to multiply the number of small business deduction limits within a group. For example, a CCPC's specified corporate income is not eligible for the small business deduction under these rules. Specified corporate income includes income earned from the provision of services or property, directly or indirectly, to another private corporation where the CCPC, one of its shareholders or a person who does not deal at arm's length with such a shareholder has a direct or indirect interest in the private corporation. Some exceptions apply, including certain income earned by a CCPC's farming or fishing business from sales to a farming or fishing co-operative corporation.

Effective retroactively to taxation years beginning after 21 March 2016, the 2019 federal budget proposes to enhance this exception from specified corporate income to include a CCPC's income from sales of farming products or fishing catches of its farming or fishing business to any arm's-length purchaser corporation. This exception will not apply to amounts allocated to a CCPC as patronage payments from a purchaser corporation.

## Canadian film or video production tax credit: Canadian-Belgium co-productions

The Canadian film or video production tax credit is a 25% refundable credit provided to qualified corporations in respect of qualified labour expenditures (for up to 60% of the total cost of a production, net of assistance) of an eligible Canadian film or video production. Audiovisual co-production treaties and similar instruments allow joint production projects of producers from two different countries to qualify for purposes of the Canadian film or video production tax credit.

Budget 2019 proposes to add *The Memorandum of Understanding between the Government of Canada and the Respective Governments of the Flemish, French and German-speaking Communities of the Kingdom of Belgium concerning Audiovisual Coproduction* (signed on 12 March 2018) as an instrument to qualify a film or video production as a treaty co-production for this purpose. As a result, joint projects of producers from Canada and Belgium may qualify for the Canadian film or video production tax credit, effective 12 March 2018.

## Electronic delivery of requirements for information from banks and credit unions

Effective 1 January 2020, the CRA will be allowed to send requirements for information to banks and credit unions electronically, in respect of third-party financial information. Currently, such requests are generally sent by registered mail. To issue such requirements electronically, the bank or credit union must notify the CRA that it consents to this method of service.

## Accelerated capital cost allowance

Budget 2019 confirms the government's intention to proceed with the following three capital cost allowance (CCA) acceleration measures announced in the 21 November 2018 fall economic statement:

- Full expensing for the cost of manufacturing and processing machinery and equipment on a temporary basis
- Full expensing for the cost of specified clean energy equipment on a temporary basis
- A temporary accelerated investment incentive

An immediate write-off of the cost of M&P manufacturing equipment (previously qualifying for a temporary accelerated CCA rate of 50% on a declining-balance basis) and specified clean energy equipment (previously qualifying for either an accelerated 30% or 50% CCA rate, both on a declining-balance basis) is available under these proposals for acquisitions after 20 November 2018 if the property becomes available for use prior to 2024. A reduced first-year write-off of 75% of the cost will be available for property that becomes available for use in 2024 or 2025, and a 55% first-year write-off will apply for property that becomes available for use in 2026 or 2027.

The proposals also include an accelerated investment incentive that provides for a temporary enhanced CCA deduction of up to three times the normal first-year CCA deduction for other capital assets subject to the CCA regime, with a few exceptions. This measure applies to property that would otherwise be subject to the current half-year rule acquired after 20 November 2018 and available for use before 2024. The enhanced allowance is reduced to two times the normal first-year CCA in the 2024–2027 period.

For full details on these proposals, see EY [2018 Tax Alert No. 40].

## Zero-emission vehicles

As part of its efforts to help build a cleaner economy, the federal government announced measures to encourage Canadians to choose zero-emission vehicles by making them more convenient and affordable:

- For businesses, Budget 2019 proposes to provide a full tax write-off for zero-emission vehicles in the year in which the vehicle is purchased beginning on or after 19 March 2019 and before 1 January 2024. Eligible vehicles will include electric battery, plug-in hybrid (with a battery capacity of at least 15 kWh) or hydrogen fuel cell vehicles including light-, medium-, and heavy-duty vehicles that are purchased by a business.

Specifically, the minister has proposed a temporary enhanced first-year CCA rate of 100% for eligible zero-emission vehicles. Two new CCA classes will also be created.

- First, class 54 will be created for zero-emission vehicles that would otherwise be included in class 10 or 10.1. However, for each eligible vehicle, this class has a limit of $55,000 (plus sales taxes) on the amount of CCA deductible. (Note that the limit of $55,000 will be reviewed annually due to ensure it remains in line with market changes over time.)
- Second, class 55 will be created for zero-emission vehicles otherwise included in class 16.
- Changes are also proposed to the GST/HST legislation to increase the maximum input tax credit (ITC) claims on the purchase and improvements to zero-emission vehicles to correspond to the income tax measures noted above.
- For individuals, proposed measures include a new federal purchase incentive of up to $5,000 for electric battery or hydrogen fuel cell vehicles retailing for less than $45,000.

In addition, the federal government will invest $130 million over 5 years to expand the network of vehicle charging and refueling stations across Canada, including remote locations.

## The Scientific Research and Experimental Development (SR&ED) program

Prior to Budget 2019, Canadian-controlled private corporations (CCPCs) could access the enhanced SR&ED tax credit rate of 35% for expenditures up to $3 million each year. However, this limit was impacted by the taxable income and taxable capital in the previous taxation year.

Budget 2019 proposes to eliminate the use of taxable income in the previous taxation year as a factor in determining a CCPC's annual expenditure limit for the purpose of accessing the 35% rate. This change will be effective for taxation years that end on or after 19 March 2019.

The new rules are intended to better support growing innovative businesses as they grow and scale up. However, keeping the taxable capital thresholds in place will help to ensure that the enhanced rate remains targeted towards small and medium-sized businesses.

# International tax measures

## Transfer pricing

### Update on the Base Erosion and Profit Shifting (BEPS) Project

Although no legislative changes are proposed in Budget 2019 relating to BEPS, the government continues its commitment to safeguarding Canada's tax system and be an active participant in the OECD/G20 BEPS initiative. The federal government reaffirms its commitment to work with its international partners to improve and update the international tax system, and to ensure a coherent and consistent response to fight cross-border tax avoidance.

Country-by-country reports are an important tool in combatting BEPS by providing the CRA and other tax authorities with new information to better assess transfer pricing risks. The first exchanges of these reports took place in 2018. Canada is participating in an OECD review of the standard for these reports to ensure they provide tax administrations with better information that allows for proper assessment of transfer pricing and other BEPS risks. This review is scheduled to be completed in 2020.

Furthermore, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (known as the Multilateral Instrument or MLI) is an important tool in facilitating a number of the measures developed under the OECD/G20 BEPS project, and in combatting international tax avoidance. The MLI is intended to allow participating jurisdictions to modify their existing tax treaties without having to individually renegotiate those treaties. Canada, along with another 86 jurisdictions to date, is a signatory to the MLI. The federal government is taking the necessary steps to enact the MLI into Canadian law and to ratify the MLI as needed to bring it into force.

### Order of application of the transfer pricing rules

Budget 2019 proposes a new measure relating to the relationship between the transfer pricing rules in section 247 with other provisions in the Act. Where both the transfer pricing rules and another provision of the Act may apply to the same amount that is relevant to the computation of tax, questions have arisen as to whether adjustments under the transfer pricing rules are made in priority to the application of other provisions. This may have various implications, including with respect to the applicability of penalties under 247(3).

Budget 2019 proposes to add a new provision intended to clarify that section 247 transfer pricing rules in Part XVI.1 apply in priority to the application of the provisions in other parts of the Act, including the provisions relating to income computation in Part I. The current exceptions to the application of the transfer pricing rules that pertain to situations in which a Canadian resident corporation has an amount owing from, or extends a guarantee in respect of an amount owing by, a controlled foreign affiliate will continue to apply. This measure will apply to taxation years that begin on or after 19 March 2019.

### Applicable reassessment period for transfer pricing adjustments

Budget 2019 proposes to expand the applicability of the extended reassessment period for transfer pricing adjustments. The transfer pricing rules include an expanded definition of "transaction" in subjection 247(1) which includes an "arrangement or event." This allows the transfer pricing rules to apply to a broad range of situations that may arise in the context of a multinational enterprise's operations.

Subsection 152(4)(b)(iii)(A) provides an extended three-year reassessment period in respect of a reassessment made as a consequence of a transaction involving a taxpayer and a nonresident with whom the taxpayer does not deal at arm's length. However, the expanded definition of "transaction" used in the transfer pricing rules does not apply for the purposes of the rule establishing this extended reassessment period.

Budget 2019 proposes to amend the *Income Tax Act* to provide that the definition of "transaction" used in the transfer pricing rules also be used for the purposes of the extended reassessment period relating to transactions involving a taxpayer and a nonresident with whom the taxpayer does not deal at arm's length. This measure will apply to taxation years for which the normal reassessment period ends on or after 19 March 2019.

## Foreign affiliate dumping

The foreign affiliate dumping (FAD) rules in section 212.3 of the Act are anti-avoidance rules that generally apply if a corporation resident in Canada (a CRIC) that is controlled by a nonresident corporation makes an investment in a foreign affiliate. If applicable, the FAD rules generally result in:

- A reduction in the paid-up capital of one or more classes of shares of the CRIC (or in certain cases a related corporation resident in Canada)
- A deemed dividend paid by the CRIC to the controlling nonresident (or in certain cases the dividend may be deemed to be paid by a qualifying corporation resident in Canada or to another nonresident corporation)

Budget 2019 proposes to extend the application of the FAD rules to CRICs that are controlled by a:

- Nonresident individual
- Nonresident trust
- Group of persons that do not deal with each other at arm's-length, where the group comprises any combination of nonresident corporations, nonresident individuals and nonresident trusts

The proposals will also extend the meaning of "related" for these and certain other specified purposes to ensure that a nonresident trust will be considered related to another nonresident person in circumstances similar to where a nonresident corporation would be so related.

The measure will apply to transactions that occur on or after 19 March 2019.

## Cross-border share lending arrangements

Budget 2019 proposes new measures targeting certain cross-border securities lending arrangements (SLAs). An example of a targeted SLA is where a nonresident person lends a share to a Canadian resident (the Canadian borrower), and the Canadian borrower agrees to return an identical share to the nonresident in the future. The Canadian borrower typically provides collateral as security to the nonresident, and over the term of the arrangement, the Canadian borrower must make payments as compensation for any dividends received on the lent share (dividend compensation payments). Ultimately, the nonresident retains the same economic risks and returns in respect of the lent share, albeit receiving dividend compensation payments from the Canadian borrower in lieu of receiving dividends directly.

The Act contains rules meant to generally ensure that a lender under a SLA is in the same tax position as if the securities had not been lent, including rules that determine the character of any dividend compensation payment made by a Canadian borrower to a nonresident for purposes of withholding tax. These characterization rules deem a dividend compensation payment made under a "fully collateralized" SLA to be a dividend payable to the nonresident on the lent share. As such, a 25% withholding tax would apply, although the rate of withholding tax may be reduced under a tax treaty.

For the purposes of these rules, an SLA is "fully collateralized" if the Canadian resident provides collateral to the nonresident in the form of money or government debt obligations with a value of 95% or more of the lent share, among other conditions. If an SLA is not "fully collateralized," the dividend compensation payment is instead deemed to be paid as interest by the Canadian borrower to the nonresident. However, since 2008, no withholding tax applies to interest paid to arm's-length parties.

### *Canadian shares*

Budget 2019 proposes amendments impacting situations where a nonresident lends a share of a Canadian corporation to a Canadian borrower.

One proposal addresses situations where the arrangement is designed to fail the "fully-collateralized" test but is, in substance, fully collateralized. To ensure that a dividend compensation payment made under a SLA by a Canadian borrower to a nonresident in respect of a Canadian share is always treated as a dividend, the dividend characterization rule will apply whether or not the arrangement is "fully collateralized."

A second proposal addresses situations where the arrangement is designed to fail the requirements for the SLA definition in the Act. In such cases, dividend compensation payments may not be deemed to be either dividend or interest payments, and taxpayers have taken the position that such payments are merely payments under a derivative contract to which withholding tax does not apply. The proposal extends the characterization rules to apply also to "specified security lending arrangements." This term was introduced in Budget 2018 and generally extends the characterization rules to apply to payments in respect of any arrangement that is substantially similar to an SLA but as a technical matter fails certain conditions required to be an SLA.

Finally, Budget 2019 proposes complementary amendments to ensure that the SLA rules cannot be used to obtain unintended tax benefits, such as ensuring that the deemed dividend under a dividend compensatory payment is deemed to be paid by the issuer of the lent share to the nonresident, and not by the Canadian borrower, for purposes determining the rate of tax that may be imposed under a dividend article in a tax treaty.

These measures will apply to compensation payments that are made on or after 19 March 2019 unless the securities loan was in place before that date, in which case the amendments will apply to compensation payments that are made after September 2019.

### *Foreign shares*

The existing SLA characterization rules may apply inappropriately in cases where the lent share is a share of a corporation that is not resident in Canada, as they may characterize dividend compensation payments in respect of foreign shares as a dividend payment that is subject to withholding tax, whereas if the nonresident continued to hold the foreign share directly, Canadian withholding tax would not apply in respect of dividends paid.

Budget 2019 proposes relieving measures to broaden the existing exemption from Canadian dividend withholding to include any dividend compensation payment made by a Canadian borrower to a nonresident under an SLA if the SLA is "fully collateralized" and the lent security is a foreign share.

These measures will apply to dividend compensation payments that are made on or after 19 March 2019.

# Tax measures for individuals and trusts

## Personal income tax rates

There are no individual income tax rate or tax bracket changes in this budget. The brackets will continue to be indexed for inflation. See Table C for the 2019 federal rates and the Appendix for the top combined marginal rates by province and territory.

**Table C**
*Federal personal income tax rates*

| | 2019 |
|---|---|
| Up to $47,630 | 15.0% |
| $47,631 to $95,259 | 20.5% |
| $95,260 to $147,667 | 26.0% |
| $147,668 to $210,371 | 29.0% |
| Over $210,371 | 33.0% |

## Other personal tax measures

### Canada training credit

Budget 2019 introduces measures to address the barriers to professional development for working Canadians. A refundable tax credit will be available to help cover the cost of up to one-half of eligible tuition and fees associated with training (generally the same tuition and fees under the same rules for the tuition tax credit). Eligible individuals will accumulate $250 each year in a notional account which can be used to cover the training costs.

To accumulate the $250 each year, a Canadian resident individual (who is between 25 and 64 years of age at the end of the year) must file a tax return, have working-type earnings in excess of $10,000 and have net income that does not exceed the top of the third tax bracket ($147,667 for 2019). The maximum accumulation over a lifetime will be $5,000, which will expire at the end of the year in which the individual turns 65.

The amount of the refundable credit that can be claimed in a taxation year will be equal to the lesser of one-half of the eligible tuition and fees paid in respect of the year and the individual's notional account balance. The refundable Canada training credit will reduce the amount that will qualify as an eligible expense for the tuition tax credit.

The annual accumulation will start with the 2019 taxation year and the first credit will be able to be claimed for the 2020 taxation year.

### Registered plans: permitting additional types of annuities

To allow for greater flexibility in managing retirement savings, Budget 2019 introduces two new types of annuities for certain registered plans for 2020 and subsequent taxation years, including advanced life deferred annuities and variable payment life annuities.

#### *Advanced life deferred annuities*

The tax rules will be amended to permit an advanced life deferred annuity (ALDA) to be a qualifying annuity purchase under an RRSP, RRIF, deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) and a defined contribution registered pension plan (RPP), as well as a qualified investment for a trust governed by an RRSP or RRIF. An ALDA will be a life annuity, the commencement of which may be deferred until the end of the year in which the annuitant turns 85.

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

Individuals will be subject to both a lifetime ALDA limit in relation to a particular qualifying plan equal to 25% of the sum of the value of all property (other than most annuities) held in the qualifying plan at the end of the previous year, and any amounts from the qualifying plan used to purchase ALDAs in previous years. In addition, an individual will also be subject to a comprehensive lifetime ALDA dollar limit of $150,000 for all qualifying plans (indexed to inflation for taxation years after 2020, rounded to the nearest $10,000). Individuals who exceed their ALDA limit will be subject to a 1% per-month penalty tax on the excess; however, in certain circumstances this tax may be waived or cancelled.

Certain requirements must be met for an annuity contract to qualify as an ALDA. For example, the contract must provide for annual or more frequent periodic payments for the life of the annuitant or for the joint lives of the annuitant and the annuitant's spouse or common-law partner beginning no later than the end of the year in which the annuitant turns 85 years of age. Where the ALDA requirements are not met, existing rules for non-qualifying annuity purchases and non-qualified investments will apply.

### *Variable payment life annuities*

Currently, the tax rules require that retirement benefits from a PRPP or defined contribution RPP be provided to a plan member by means of a transfer of funds from the member's account to an RRSP or RRIF of the member. Budget 2019 proposes to amend the tax rules to permit PRPPs and defined contribution RPPs to provide a variable payment life annuity (VPLA) to members directly from the plan.

A VPLA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants. Administrators of a PRPP or defined contribution RPP will be allowed to establish a separate annuities fund under the plan to receive transfers of amounts from members' accounts to provide VLPAs (i.e., direct employee and employer contributions to the annuities fund will be prohibited). For a plan to establish such an arrangement, a minimum of 10 retired members must participate in the VPLA arrangement on an ongoing basis. In addition to complying with existing tax rules for PRPPs and defined contribution RPPs, additional requirements must be met by a VLPA. For example, payments must commence by the later of the end of the year in which the member attains 71 years of age and the end of the calendar year in which the VLPA is acquired.

The government will consult on potential changes to the federal pension benefits standards legislation to accommodate VPLAs for federally regulated PRPPs and defined contribution RPPs. Provincial pension benefits standards legislation may need to be amended if a province wishes to permit VPLAs for provincially regulated PRPPs and defined contribution RPPs.

### *Registered disability savings plan: cessation of eligibility for the disability tax credit*

Under existing tax rules, when a beneficiary of a registered disability savings plan (RDSP) ceases to be eligible for the disability tax credit (DTC), no contributions may generally be made to the RDSP, and no Canada disability savings grants and bonds may be paid into the RDSP. In addition, 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, unless the plan holder elects to extend the life of the RDSP for four additional years if a medical practitioner has certified in writing that the beneficiary will likely become DTC eligible in the foreseeable future. During the period of the election, no contributions may be made and no new grants or bonds will be paid, but withdrawals are permitted subject to the regular limitations.

For 2021 and later years, Budget 2019 proposes to remove the time limitation on the period that an RDSP may remain open after a beneficiary ceases to be DTC eligible, and to remove the requirement for medical certification that the beneficiary is likely to become DTC eligible in the foreseeable future. Existing rules that apply when an election is filed to extend the life of an RDSP will continue to apply subject to a number of modifications. In particular, withdrawals from the RDSP will continue to be subject to the proportional repayment rule, but the assistance holdback amount (generally the amount of grants and bonds paid into the plan in the 10-year period preceding the payment) will be modified, depending on the beneficiary's age.

In addition, 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 calendar year following the first full year throughout which the beneficiary is ineligible for the DTC. If a beneficiary regains eligibility for the DTC in a year, the regular RDSP rules will once again apply to the RDSP commencing in that year.

As a transitional measure, an RDSP issuer will not be required to close an RDSP after 18 March 2019 and before 2021 solely because an RDSP beneficiary ceases to be eligible for the DTC.

## Home buyers' plan

To provide first-time home buyers with greater access to their RRSPs to purchase or build a home, Budget 2019 proposes to increase the withdrawal limit for 2019 and subsequent years to $35,000 from $25,000.

Access will also now be extended to help Canadians maintain home ownership after the breakdown of a marriage or common-law partnership. This measure will apply to withdrawals made after 2019.

### Carrying on business in a tax-free savings account

To recognize that a tax-free savings account (TFSA) holder is typically in the best position to know whether the activities of the TFSA constitute carrying on a business, Budget 2019 proposes that the joint and several liability for tax owing on income from carrying on a business in a TFSA be extended to the TFSA holder. The joint and several liability of a trustee will be limited to the property held in the TFSA at that time plus the amount of all distributions on or after the date that the notice of assessment is sent. This measure will apply to 2019 and subsequent taxation years.

### Change of use rules for multi-unit residential properties

To improve the consistency of the tax treatment of owners of multi-unit residential properties in comparison to owners of single-unit residential properties, Budget 2019 proposes to allow a taxpayer to elect that the deemed disposition that normally applies on a change of use of part of a property not apply. This measure will apply to changes on or after 19 March 2019.

### Tax measures for kinship care providers

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, with a higher benefit amount being provided to eligible families (couples and single parents) than to single individuals with no dependents.

Budget 2019 proposes to amend the *Income Tax Act* to clarify that an individual may be considered a parent of a child in their care for the purpose of the Canada workers benefit regardless of whether they receive financial assistance under a kinship care program.

Budget 2019 also proposes to amend the *Income Tax Act* to clarify that financial assistance payments received under a kinship care program are neither taxable nor included in income for the purpose of determining entitlement to income-tested benefits and credits.

### Medical expense tax credit

Budget 2019 proposes to amend the *Income Tax Act* to reflect the current regulations for accessing cannabis for medical purposes. This measure will apply to expenses incurred on or after17 October 2018.

### Support for Canadian journalism: non-refundable tax credit for digital subscriptions

As announced in the 2018 fall economic statement, Budget 2019 confirms the introduction of a new temporary non-refundable tax credit for digital subscriptions. More specifically, Budget 2019 proposes a 15% non-refundable tax credit on amounts paid by individuals for eligible digital news subscriptions, subject to a cap on $500 annually (limited to the cost of a standalone digital subscription where the subscription is a combined digital and newsprint subscription). The credit will apply to amounts paid after 2019 and before 2025.

Eligible digital subscriptions will be those that entitle a taxpayer to access content provided in digital form by a qualified Canadian journalism organization (QCJO) that is primarily engaged in the production of written content (see above under *Business income tax measures* for more details on QCJOs). A subscription with a QCJO carrying on a broadcasting undertaking (as defined in the *Broadcasting Act*) will not qualify for the credit.

## Other personal tax measures

### Pensionable service under an individual pension plan

To prevent planning undertaken to circumvent the prescribed transfer limits related to individual pension plans (IPPs), 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 considered to be 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 19 March 2019.

### Mutual funds: allocation to redeemers methodology

#### *Deferral*

Certain mutual fund trusts have been using the allocation to redeemers methodology to allocate capital gains to redeeming unitholders in excess of the capital gains that would otherwise have been realized by these unitholders on the redemption of their units. This has resulted in a deferral in the realization of capital gains for the remaining unitholders because the excess portion does not need to be allocated by the mutual fund trust. This unrealized capital gain is taxed only when the remaining unitholders redeem their units.

Budget 2019 proposes to introduce a new rule that would deny a mutual fund trust a deduction in respect of the portion of an allocation made to a unitholder on a redemption of a unit of the mutual fund trust that is greater than the capital gain that would otherwise have been realized by the unitholder on the redemption, if the following conditions are met:

- The allocated amount is a capital gain
- The unitholder's redemption proceeds are reduced by the allocation

This measure will apply to taxation years of mutual fund trusts that begin on or after 19 March 2019.

#### *Character conversion*

Certain mutual fund trusts have also been using the allocation to redeemers methodology in a way that allows the mutual fund trust to convert the returns on an investment that would have the character of ordinary income to capital gains for their remaining unitholders. This character conversion planning is possible when the redeeming unitholders hold their units on income account but other unitholders hold their units on capital account.

Budget 2019 proposes to introduce a new rule that will deny a mutual fund trust a deduction in respect of an allocation made to a unitholder on a redemption, if:

- The allocated amount is ordinary income
- The unitholder's redemption proceeds are reduced by the allocation

This measure will apply to taxation years of mutual fund trusts that begin on or after 19 March 2019.

# Charities and non-profit organizations

## Support for Canadian journalism: qualified donee status

As announced in the 2018 fall economic statement, Budget 2019 confirms that registered journalism organizations will be added as a new category of qualified donee. This addition will be applicable as of 1 January 2020.

Registered journalism organizations will be required to be a corporation or a trust that is a qualified Canadian journalism organization (QCJO) and that is constituted and operates for purposes exclusively related to journalism (see above under *Business income tax measures* for more details on QCJOs). Any business activities carried on by these organizations will be required to be related to their purposes. These organizations will not be permitted to distribute their profits, if any, or allow their income to be available for the personal benefit of certain individuals connected with the organization.

Additional conditions to be recognized as a registered journalism organization will include:

- Having a board of directors or trustees, dealing at arm's length with each other
- Not being factually controlled by a person or group of related persons
- Not generally receiving gifts that represent more than 20% of its total revenues (including donations) from one source (excluding bequests and one-time gifts made on the initial establishment of the organization)

Registered journalism organizations will be required to file an annual return and they will be listed on the Government of Canada website. The names of any donors that make donations of more than $5,000 and the amount donated will have to be disclosed in the organization's annual return, which will be available to the public.

## Donations of cultural property

Budget 2019 proposes, effective 19 March 2019, to amend the *Income Tax Act* and the *Cultural Property Export and Import Act* to remove the requirement that property be of "national importance" to qualify for the enhanced tax incentives for donations of cultural property (i.e., the charitable donation tax credit for individuals, the donation taxable income deduction for corporations, and the income tax exemption for capital gains that may arise on the disposition).

# GST/HST and excise duty legislative amendments

## GST/HST measures

### Human ova and in vitro embryos

Budget 2019 proposes to zero-rate the supply and import of human ova and *in vitro* embryos. This measure will apply to supplies and imports made after 19 March 2019.

### Foot care devices supplied on the order of a podiatrist or chiropodist

Currently, certain medical and assistive devices can be supplied on a zero-rated basis only when supplied on the written order of a physician, nurse, physiotherapist or occupational therapist. Podiatrists and chiropodists, although they are regulated health professionals in most provinces, are not listed among practitioners on whose order certain medical devices can be sold on a zero-rated basis.

Budget 2019 proposes to add licensed podiatrists and chiropodists to the list of practitioners on whose order supplies of foot care devices are zero-rated. This measure will apply to supplies of these items made after 19 March 2019.

### Multidisciplinary health care services

Budget 2019 proposes to exempt from GST/HST the supply of multidisciplinary health services when rendered by a team of health professionals, such as doctors, physiotherapists and occupational therapists, whose services are exempt when supplied separately. The exemption will apply provided that all or substantially all of the consideration for the service is reasonably attributable to services rendered by such a team of health professionals acting within the scope of their profession. This measure will apply to supplies of multidisciplinary health services made after 19 March 2019.

## Excise duty measures

### Cannabis taxation

Currently five classes of cannabis products are permitted for legal sale: fresh cannabis, dried cannabis, cannabis oil, cannabis plant seeds and cannabis plants. Duty applies to these at the higher of a flat rate applied to the quantity (by weight) of cannabis contained in the final product and a percentage of the dutiable amount of the product as sold by the producer.

The government released for consultation in December 2018 draft regulations governing the production and sale of additional classes of cannabis products: edible cannabis, cannabis extracts (will include cannabis oil) and cannabis topicals. Budget 2019 proposes that edible cannabis, cannabis extracts (including cannabis oils) and cannabis topicals be subject to excise duties imposed on cannabis licensees at a flat rate applied to the quantity of total tetrahydrocannabinol (THC) measured in milligrams. This will simplify tracking the quantity of cannabis material contained in cannabis oils and would allow producers and administrators to more easily calculate and verify excise duties for cannabis edibles, extracts and topicals.

The current excise duty regime and rates for fresh and dried cannabis and seeds and seedlings will be unchanged.

The combined federal-provincial-territorial THC-based excise duty rate for cannabis edibles, cannabis extracts and cannabis topicals (including cannabis oils) is proposed to be $0.01 milligram of total THC.

These proposed changes will come into effect on 1 May 2019 and will apply to any cannabis oil product packaged on or after 1 May 2019.

# Other administrative tax measures

## Improving tax compliance

Significant investments have been made in recent years to strengthen the Canada Revenue Agency's (CRA's) capabilities. Starting in 2015, the CRA expanded the number of audit teams that focus on high-net-worth individuals and their associated corporate structures. As a result, there are now more than 1,100 offshore audits underway, resulting in more than 50 criminal investigations with links to offshore transactions.

To further combat tax evasion and aggressive tax avoidance, Budget 2019 proposes to invest an additional $150.8 million over five years, starting in 2019–20. This investment is in addition to the $444.4 million and $523.9 million spending previously announced in the 2016 and 2017 federal budgets.

The proposed Budget 2019 investment will allow the CRA to fund new initiatives and extend existing programs, including:

- Hiring additional auditors, conducting outreach and building technical expertise to target non-compliance associated with cryptocurrency transactions and the digital economy
- Creating a new data quality examination team to ensure proper withholding, remitting and reporting of income earned by nonresidents
- Extending programs aimed at combatting offshore non-compliance

Budget 2019 includes an expected revenue impact of $369.0 million over five years from these targeted compliance initiatives. These amounts do not reflect benefits to provinces and territories, whose tax revenues are also expected to increase.

Further, to help the CRA stay ahead of non-compliance schemes driven by the use of new and advanced technologies, Budget 2019 also proposes to invest $65.8 million over five years to improve the CRA's information technology systems. The spending will replace legacy systems to build an infrastructure that is better able to fight tax evasion and aggressive tax avoidance.

Budget 2019 proposes to give the CRA $50 million over five years, starting in 2019-20 to create four new dedicated residential and commercial real estate audit teams in high-risk regions, notably in British Columbia and Ontario.

# Pending legislation

The government will proceed with the following pending legislative and regulatory proposals and other previously announced measures, modified to take into account consultations and deliberations since their release.

## Income tax

- Bill S-6, *Canada-Madagascar Tax Conventions Act, 2018* (2nd reading (House): 27 February 2019)
- Legislative proposals re salary overpayments (15 January 2019)
- 2019 automobile deduction limits announcement (27 December 2018)
- 2018 fall economic statement notice of ways and means motion (21 November 2018) [Refer to EY Tax Alert 2018 No. 40]
  - Full expensing for M&P machinery and equipment
  - Full expensing for clean energy equipment
  - Accelerated investment incentive (also applicable to eligible CDE and COGPE)
- 2018 fall economic statement additional announcements (21 November 2018) [Refer to EY Tax Alert 2018 No. 40]
  - Mineral exploration credit 5-year extension
- Final list of prescribed drought regions for 2018 (31 October 2018)
- Bill C-82, *Multilateral instrument in Respect of Tax Conventions Act* (MLI) (Reported from committee without amendment (House): 1 March 2019) [Refer to EY Tax Alerts 2017 No. 25 and No. 28]
- Remaining measures from the 2018 federal budget (tabled 27 February 2018) and from the related 27 July 2018 draft legislation [Refer to EY Tax Alerts 2018 No. 7 and No. 31]
  - Health and welfare trusts
  - New reporting requirements for trusts
- 2018 automobile deduction limits announcement (22 December 2017)
- Tax deferral extension announcement re 2016-17 bovine tuberculosis outbreak (6 November 2017)

- Final list of prescribed drought regions for 2017 (6 November 2017)
- Remaining measures from the 16 September 2016 legislative proposals re technical amendments
  - Prescribed shares – employee stock options
- Remaining measures from the 2016 federal budget (tabled 22 March 2016) [Refer to EY Tax Alert 2016 No. 14]
  - New reporting requirements for corporate and partnership life insurance beneficiaries that are not policyholders
  - Expansion of accelerated CCA Classes 43.1 and 43.2 for clean energy assets

### Indirect taxes

- Draft regulations amending Part I of Schedule 1 and Schedule 2 to the *Greenhouse Gas Pollution Pricing Act* (23 October 2018) [Refer to EY Tax Alert 2018 No. 2 for background]
  *(Regulations establishing the output-based pricing system (OBPS), which will apply to industrial facilities with high emission levels, have yet to be released also)*
- Draft amendments to the Fuel Charge Regulations (23 October 2018)
- Draft proposals re excise duties on cannabis and amendments to related regulations (17 September 2018)
- Remaining measures from the 2018 federal budget (tabled 27 February 2018) and from the related 27 July 2018 draft legislation [Refer to EY Tax Alerts 2018 No. 7, No. 31 and No. 32]
  - GST/HST holding corporation rules
  - GST/HST regulatory change re printed books rebate
- Remaining measures from the 2016 federal budget (tabled 22 March 2016) [Refer to EY Tax Alert 2016 No. 14]
  - GST/HST joint venture election (stemming from the 2014 proposals under the previous government)

## Webcasts

**19 March webcast:** The evening following the finance minister's address, members of the EY Tax team will record their analysis and insights on the tax measures in the 2019 budget. View our webcast at ey.com/ca/budget.

**25 March webcast:** Join us for a candid discussion of how the budget measures might impact Canadian private companies. The session will be hosted by EY Tax partners Jonathan Bicher and Ryan Ball.

## Learn more

For more information on the above measures or any other topics which may be of concern, contact your EY or EY Law advisor. And for up-to-date information on the federal, provincial and territorial budgets, visit ey.com/ca/Budget.

# Appendix

*Maximum combined personal marginal income tax rates (as at 19 March 2019)*

| | Ordinary income | | | 2019 | | |
|---|---|---|---|---|---|---|
| | 2018 | 2019 | Increase (decrease) | Eligible dividends | Ordinary dividends | Capital gains |
| | % | % | % | % | % | % |
| Federal only | 33.00 | 33.00 | 0.00 | 24.81 | 27.57 | 16.50 |
| BC | 49.80 | 49.80 | 0.00 | 31.44 | 44.64 | 24.90 |
| Alberta* | 48.00 | 48.00 | 0.00 | 31.71 | 42.47 | 24.00 |
| Saskatchewan | 47.50 | 47.50 | 0.00 | 29.64 | 40.37 | 23.75 |
| Manitoba | 50.40 | 50.40 | 0.00 | 37.78 | 46.67 | 25.20 |
| Ontario | 53.53 | 53.53 | 0.00 | 39.34 | 47.40 | 26.76 |
| Quebec | 53.31 | 53.31 | 0.00 | 40.00 | 46.25 | 26.65 |
| NB** | 53.30 | 53.30 | 0.00 | 33.51 | 47.75 | 26.65 |
| NS | 54.00 | 54.00 | 0.00 | 41.58 | 48.27 | 27.00 |
| PEI | 51.37 | 51.37 | 0.00 | 34.22 | 45.23 | 25.69 |
| NL | 51.30 | 51.30 | 0.00 | 42.61 | 44.59 | 25.65 |
| NWT | 47.05 | 47.05 | 0.00 | 28.33 | 36.82 | 23.53 |
| Nunavut | 44.50 | 44.50 | 0.00 | 33.08 | 37.79 | 22.25 |
| Yukon | 48.00 | 48.00 | 0.00 | 28.92 | 42.17 | 24.00 |

**The Alberta Government recently increased the 2018 dividend tax credit (DTC) rate for other dividend income in response to federal changes. However, the 2019 DTC rate was not announced. We have assumed that the factor used to calculate the 2019 DTC rate for other dividend income will be unchanged from the adjusted factor used to calculate the 2018 DTC rate.*

*** New Brunswick's 2019 budget changes to personal tax rates are not reflected in this table.*

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