2019 Federal Budget

Jamie Golombek and Debbie Pearl-Weinberg
Tax & Estate Planning, CIBC Financial Planning and Advice

The 2019 federal budget (the "Budget") included a number of tax measures that will affect Canadian taxpayers. Rather than summarize every tax measure included in the Budget document, this report, which was prepared from within the Budget lock-up in Ottawa, will focus on some of the tax measures that are of most interest to individuals.

Canada Training Credit

Today's Budget introduces a new refundable tax credit — the "Canada Training Credit" ("CTC") — aimed at providing financial support to help cover up to half of eligible tuition and fees associated with training. Starting in 2019, eligible Canadians will begin to accumulate $250 annually in a notional government tracking account that can be accessed in a future year to help cover the costs of training.

In order to accumulate the $250 for a particular tax year, you must file a tax return, be between 25 and 65 years old, be a resident of Canada throughout the year and have employment (or self-employment) income of $10,000 or more in the year (but total net income below $147,667 in 2019).

Each year, your notional account balance will be tracked by the Canada Revenue Agency (CRA). The amount of CTC that can be claimed in a particular year is equal to the lesser of 50% of your eligible tuition and fees and your notional account balance (based on amounts accumulated less amounts used in respect of previous years). The amount claimed will offset, dollar for dollar, your personal tax otherwise payable (or will be refunded if the amount exceeds your tax payable.)

Note you can still accumulate a $250 credit entitlement for the year in which you claim the CTC. The maximum you can accumulate in your notional account is $5,000 over your lifetime. Any unused balance will expire at the end of the year in which you turn 65.

The portion of the tuition fees refunded through the CTC will not qualify for the tuition tax credit but any excess fees above those refunded by the CTC would qualify. Note that although the annual accumulation to the notional account begins in 2019, the credit will be available for the first time in 2020.

Example

Michelle begins accumulating $250 per year beginning in 2019. By 2023, her notional account balance is $1,000 ($250 for each of 2019, 2020, 2021 and 2022). In that year, Michelle enrolls in training, spends $1,500 in eligible tuition fees and can claim a $750 ($1,500 x 50%) refundable credit for the 2023 taxation year. She also continues to accumulate another $250 for 2023, resulting in a notional balance in 2024 of $500 (i.e. $250 in unused balance from the prior year in addition to the new $250 amount).

She will then be able to accumulate up to an additional $3,750 (i.e. $5,000 - $750 - $500) in her notional account over her lifetime. Michelle will be able to claim a tuition tax credit for $750 ($1,500 - $750) of tuition fees in 2023 which is the amount of tuition paid that was not refunded through the CTC.

Home Buyers' Plan

The home buyers' plan (HBP) allows first-time home buyers to save for a down payment by allowing them to withdraw up to $25,000 from their RRSPs to purchase or build a home without having to pay tax on the withdrawal. First-time home buyers purchasing a home jointly with a spouse or partner can each withdraw up to $25,000 from their own RRSP under the HBP, for a total down payment of $50,000. Amounts withdrawn under the HBP must be repaid to an RRSP over a 15-year period beginning the second year following the year in which the withdrawal was made.

Under the tax rules, an individual is not considered to be a first-time home buyer if, in the current or prior four calendar years, the individual, or their spouse or partner, owned and occupied another home as their principal place of residence.

The Budget proposes to increase the HBP withdrawal limit to $35,000 from $25,000 "to provide first-time home buyers with greater access to their RRSPs to purchase or build a home." As a result of this change, a couple will potentially be able to withdraw up to $70,000 from their RRSPs to purchase a first home. The new limit applies to the 2019 and subsequent calendar years for withdrawals made after March 19, 2019.

The Budget also proposes a technical change to the HBP rules to help Canadians who separate or divorce to maintain homeownership after the breakdown of their relationship. Under the change, to be effective in 2020, an individual will be able to participate in the HBP even if they are not a first-time home buyer, provided that they were living separate and apart from their spouse or partner as a result of a breakdown in their marriage or partnership for at least 90 days.

Tax Credit for Digital Subscriptions

The Budget also announced a temporary, non-refundable 15% tax credit on amounts paid for eligible digital news subscriptions. This will allow you to claim up to $500 in costs paid towards eligible digital subscriptions in a taxation year, for a maximum tax credit of $75 annually. In the case of combined digital and newsprint subscriptions, you'll be limited to claiming the cost of a stand-alone digital subscription.

The credit will be available for amounts paid from 2020 through 2024.

Automatic Enrolment for Canada Pension Plan Retirement Benefits

While the standard age to start collecting CPP benefits is 65, you can begin collecting CPP as early as age 60. You may also start receiving your pension later with a 0.7% monthly increase based on the number of months after 65 up to age 70. If you start receiving your CPP retirement pension at 70, your pension amount will be greater by 42% (0.7% / month x 60 months) than if you had taken it at 65.

In the Budget, the government acknowledged that a small number of Canadians are currently missing out on receiving their CPP benefit because they applied for the benefit late, or not at all! To ensure that all Canadian workers receive the full value of the CPP benefits to which they contributed, the government announced that, starting in 2020, it would proactively enroll CPP contributors who are age 70 or older but have not yet applied to receive CPP.

Employee Stock Options

Qualifying employee stock options are taxed at preferential tax rates. The public policy rationale for this preferential tax treatment was the support of "younger and growing Canadian businesses."

One of the tax changes included in the Liberals' 2015 pre-election platform was to limit the benefits of the stock option deduction by placing a cap on how much can be claimed. At the time, the Liberals' quoted a Department of Finance estimate which found that 8,000 "very high-income Canadians deduct an average of $400,000 from their taxable incomes via stock options." The Budget announced that the government will be moving forward with legislative amendments, to be introduced before the summer, that would cap the amount that can be claimed under the stock option deduction granted by "large, long-established, mature firms."

Current Rules

Under the current tax rules, when a stock option is exercised, the difference between the exercise price and the fair market value of the share is included in income as an employment benefit. For "qualifying" options, an offsetting deduction equal to one-half the benefit may be claimed, which allows the stock option benefit to be taxed like a capital gain. For an option on shares of a public company to qualify, the exercise price can't be less than the fair market value of the underlying shares at the date the options are granted. As a result, employee stock options are effectively taxed like capital gains; however, they are still considered to be employment income and qualify as "earned income" for RRSP contribution room purposes. Also, because they are not actually capital gains, you can't offset the income inclusion with capital losses that you may have.

If an employee of a "Canadian-controlled private corporation" ("CCPC") exercises stock options, the deduction is available so long as the shares are held for at least two years. In addition, CCPC stock option benefits aren't taxable when the options are exercised but rather at the time the underlying shares acquired upon exercise are sold.

Proposed Rules

The proposed rules will limit the benefit of the employee stock option deduction for high-income individuals who are employed at "large, long-established, mature firms." The government will move toward aligning Canada's employee stock option tax treatment with that of the U.S. by applying a $200,000 annual 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 these large firms. The cap will not apply to "start-ups and rapidly growing Canadian businesses", including emerging businesses.

It's important to note that any changes would only apply on a *go-forward basis* and will not apply to employee stock options granted prior to the future legislative announcement.

Example

Henry is an executive of a large, long-established, mature company that has an employee stock option plan. Henry's employer grants him stock options to acquire 100,000 shares at a price of $50 per share (the

FMV of the shares on the date the options are granted), with all of the options vesting in some future year. Since the FMV of the underlying shares at the time of grant ($50 X 100,000 = $5 million) exceeds the $200,000 limit, the amount of stock options that can receive preferential tax treatment will be capped. In this case, Henry's stock option benefits associated with 4,000 ($200,000 ÷ $50 = 4,000) of the options can continue to receive preferential personal income tax treatment; however, the benefits associated with the remaining 96,000 options will be included in Henry's income and fully taxed at ordinary rates.

Let's say the price of the shares has increased to $70 at the time that Henry exercises the options. At that time, $1,920,000 {($70 - $50) X 96,000)} of the employee stock option benefit will be included in Henry's income and fully taxed at ordinary rates, while only $80,000 {($70 - $50) X 4,000)} of the benefit will receive preferential income tax treatment and be taxed at an effective 50% inclusion rate.

Registered Disability Savings Plans (RDSPs)

RDSPs are tax-deferred savings plans open to Canadian residents eligible for the disability tax credit ("DTC"), their parents and other eligible contributors. Up to $200,000 can be contributed to the plan until the end of the year in which the beneficiary turns 59, with no annual contribution limits. While contributions are not tax deductible, all earnings and growth accrue on a tax-deferred basis.

Federal government assistance in the form of matching Canada Disability Savings Grants (CDSGs) and Canada Disability Savings Bonds (CDSBs) may be deposited directly into the plan up until the end of the year in which the beneficiary turns 49. The government will contribute up to a maximum of $3,500 CDSG and $1,000 CDSB per year of eligibility, depending on the beneficiary's family income.

Under the current rules, when the beneficiary of an RDSP ceases to be eligible for the DTC, no contributions may be made to the RDSP and no CDSGs or CDSBs will be paid into the plan. In addition, the tax rules require that the RDSP be closed by the end of the year following the first full year throughout which the beneficiary is no longer eligible for the DTC.

The RDSP issuer is required to set aside an amount (known as the "assistance holdback amount") equal to the CDSGs and CDSBs paid into the RDSP in the preceding ten years (less any grants and bonds repaid.) This requirement ensures that RDSP funds are available to meet potential repayment obligations. When the RDSP is closed, the assistance holdback amount must be repaid to the government, with any remaining assets going to the RDSP beneficiary.

For years, individuals with disabilities, their families and other advocates have raised concerns about the need to close an RDSP and pay back the CDSGs and CDSBs upon loss of DTC eligibility as it did "not appropriately recognize the period of severe and prolonged disability experienced by an RDSP beneficiary."

As a result, the Budget announced that RDSPs can continue to remain open (although contributions will not be permitted) even if the beneficiary becomes ineligible for the DTC. For years throughout which the beneficiary is ineligible for the DTC and that are prior to the year in which the beneficiary turns 51 years of age, the assistance holdback amount rules apply and withdrawals may prompt the repayment of grants and bonds; however, once the beneficiary turns 51, and over the following ten years, the assistance holdback amount will be reduced based on the CDSGs and CDSBs paid into the RDSP during a reference period. For example, for the year in which the beneficiary turns 51, the reference period will be the nine-year period immediately prior to the beneficiary becoming ineligible for the DTC. The assistance holdback amount will therefore be equal to the amount of grants and bonds paid into the RDSP in those nine years, less any repayments of those amounts.

These new rules will generally apply beginning in 2021 but, starting on Budget day, RDSP issuers will no longer be required to close an RDSP solely because an RDSP beneficiary is no longer eligible for the DTC.

Example

In 2009, Bruce's parents open an RDSP for him when he is 5 years old and contribute $1,500 annually to his plan for 10 years, attracting the maximum amount CDSGs of $3,500 annually. Thus, for 2019, the assistance holdback amount for his plan is $35,000. While his parents continue to contribute $1,500 to his plan each year for the subsequent five years (attracting the maximum $3,500 of CDSGs annually)[1]*, the assistance holdback amount for his plan remains at $35,000, as CDSGs received during the first five years that fall out of the assistance holdback amount, are replaced with new grant amounts.*

In 2024, the effects of Bruce's disability improve so that he no longer qualifies for the DTC after 2023. Under the current rules, his plan would generally have to be closed by the end of 2025 and all CDSGs received over the 2014 to 2023 period would have to be repaid. Under the Budget proposals, however, Bruce could choose not to close his RDSP. His assistance holdback amount is frozen at $35,000 until the year he turns age 51 (in 2055), when the amount of his assistance holdback amount begins to decline by $3,500 each year.

By 2064, the year Bruce turns age 60, he will be able to withdraw amounts from his RDSP and no longer be required to repay CDSGs as his assistance holdback amount will have been reduced to zero.

In another change for RDSPs, the Budget proposes to exempt RDSPs from seizure in bankruptcy, with the exception of contributions made in the 12 months before the filing.

Annuities for Registered Plan Holders

Under the current tax rules, you can use your registered plan to purchase an annuity to provide income in retirement, subject to specified conditions. The annuity must provide a stream of periodic payments, generally for a fixed term or for the life of the holder (and sometimes, his or her, spouse or partner).

The Budget is proposing to allow Canadians "greater flexibility in managing their retirement savings" by permitting two new types of annuities: advanced life deferred annuities ("ALDA") and variable payment life annuities ("VPLA"). An ALDA is a life annuity that begins at age 85 and essentially provides a sort of longevity insurance guaranteeing you an annual amount each year until death. A VLPA, which will only be available under pooled registered pension plans and defined contribution registered pension plans, will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants.

These options will begin to be available starting in 2020.

[1] It is assumed that no CDSBs would be available due to the level of family income.

Individual Pension Plans

An individual pension plan (IPP) is a way for individuals who operate their businesses through corporations to save for retirement. An IPP is essentially a defined benefit registered pension plan that has fewer than four members, at least one of whom is the controlling shareholder of the corporation that sponsors the IPP.

But in recent years, IPPs have also been used by employees who wish to take funds from a defined benefit (DB) pension plan with them when they leave their employers. Upon leaving a DB pension plan, the tax rules typically allow an employee to transfer, on a tax-deferred basis, the entire commuted value of their accrued benefits to another DB pension plan of another employee or a far lesser amount (often only 50%) to the employee's own RRSP.

To get around this, some employees would set up a newly incorporated CCPC and immediately set up an IPP to receive the transfer of the full commuted value from their former employer's pension plan.

To stop this "inappropriate planning," the Budget proposes to prohibit IPPs from providing retirement benefits for past years of employment that were pensionable service under a DB pension plan of a prior employer. Any assets so transferred on or after March 19, 2019 will be considered to be a non-qualifying transfer that is required to be included in the employee's income.

Donations of Cultural Property

To encourage Canadians to donate cultural property of "outstanding significance" and "national importance" to certain designated institutions in Canada, such as museums and public art galleries, the government provides a special tax incentive to encourage donations of cultural property to these institutions "to ensure that such property remains in Canada for the benefit of Canadians." The enhanced tax incentives include the donation tax credit (for individuals) or deduction (for corporations), which can be used to reduce or eliminate the donor's tax liability for a year (with a five-year carryforward of unused amounts).

Donating property triggers a deemed disposition, which could result in a capital gain. Under the current law, however, the capital gain that may be realized on donation of certain cultural property is not taxable. To qualify, the donated property must be of "outstanding significance" by reason of its close association with Canadian history or national life, its aesthetic qualities or its value in the study of the arts or sciences. In addition, it must be of "national importance" to such a degree that "its loss to Canada would significantly diminish the national heritage."

A recent court decision[2] related to the export of cultural property interpreted the "national importance" test as requiring that a cultural property have a direct connection specifically with Canada's cultural heritage, as opposed to being solely of "outstanding significance" but of foreign origin.

To address this concern, the Budget proposes to amend the law to remove the requirement that property be of "national importance" in order to qualify for the enhanced tax incentives for donations of cultural property, for donations made on or after March 19, 2019.

[2] *Heffel Gallery Limited v. The Attorney General of Canada* (2018 FC 605). The case was appealed to the Federal Court of Appeal (A-223-18, Attorney General of Canada v. Heffel Gallery Limited et al.), which heard the appeal on February 7, 2019. No decision has been rendered as of Budget day.

Mutual Funds

In 2013, tax changes were introduced which eliminated a mutual fund's ability to use a forward contract to convert ordinary income to a capital gain. But the government remained concerned that a couple of structures currently used by mutual funds (including exchange traded funds) may not have been technically caught by the rules introduced in 2013.

As a result, the Budget proposes an expansion of this anti-avoidance rule in two ways. The first is directed at the use of a very specific multi-fund structure used to convert ordinary income to capital gains. The second is directed at funds that allocate income to specific unitholders.

These changes are limited in application and will not impact the majority of retail mutual funds.

Enforcement and Administration

Finally, the Budget announced that the CRA will be devoting more funds to address tax non-compliance in real estate transactions. Using advanced risk assessment tools, analytics and third-party data, as well as through obtaining information from the provinces and territories, the CRA is continuously enhancing its ability to detect — and take action — whenever it finds real estate transactions where the parties have failed to pay the required taxes, be it income tax on a sale or GST / HST on a purchase.

The Budget proposes to provide the CRA with $50 million over five years, to create four new dedicated residential and commercial real estate audit teams in high-risk regions, notably in British Columbia and Ontario. These teams will work to ensure that tax provisions regarding real estate are being followed, with a focus on ensuring that: taxpayers report all sales of their principal residence on their tax returns; any capital gain derived from a real estate sale, where the principal residence tax exemption does not apply, is identified as taxable; money made on real estate "flipping" is reported as business income; commissions on real estate transactions are properly reported; and builders of new residential properties remit the appropriate amount of GST / HST. The government expects to collect $68 million from this initiative over five years.

Jamie.Golombek@cibc.com

Jamie Golombek, CPA, CA, CFP, CLU, TEP is Managing Director, Tax & Estate Planning with CIBC Financial Planning and Advice in Toronto.

Debbie.Pearl-Weinberg@cibc.com

Debbie Pearl-Weinberg, LLB is Executive Director, Tax & Estate Planning with CIBC Financial Planning and Advice in Toronto.