2018 Federal Budget – What you need to know

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- Peter and Marlena were both in attendance during the Federal budget lockup and got a first-hand look at budget materials

Highlights:

- 50% capital gains maintained (not going to 70% as of now)
- New CRA Funding (90 million over the next 5 years) to focus on tax evasion and off-shore accounts
- Tax loopholes, continue to close, example, stop-loss rules with respect to share repurchase options (high level transactions)
- Small Business Tax Measures: proceeded with small business tax reduction (you have to add provincial tax on top, to maintain, non-eligible)

- Income sprinkling, will proceed, already effective for 2018, will severely limit the ability of certain business owners to income spilt, unless they make a substantial contribution to the business itself
- Passive investment portfolio – significant shift in how government plans to approach. Operating income is taxed at low tax rates, if they can retain and utilize/defer
- Unfair advantage (tax deferral). The proposed changes were very punitive, was going to be as high as 73%. Introduced new measures to tackle the same issue, more simple
- $50,000 of investment income in a particular year, access to small business tax rate will be limited. Taxation begins after 2018.
- There will be anti-avoidance rules in place in the event you try to change your year-end

Passive Investment Limits

- New rules limit the ability of Canadian controlled private corporations (CCPCs) to benefit from earning passive investment income
- Rules apply to investment income >**$50,000**
- CCPCs earning > $50,000 in passive investment income will have limited access to **small business tax rate**
- Effective Date: rules apply to taxation years that begin after 2018

Limiting Access to the Small Business Tax Rate

- CCPC's earning >$50,000 in passive investment income will see less access to the small business tax rate via the **small business deduction**
- For every **$1** of investment income earned above $50,000, the deduction limit will be reduced by **$5**
- The small business deduction will gradually reduce to zero when a CCPC earns $150,000 of investment income

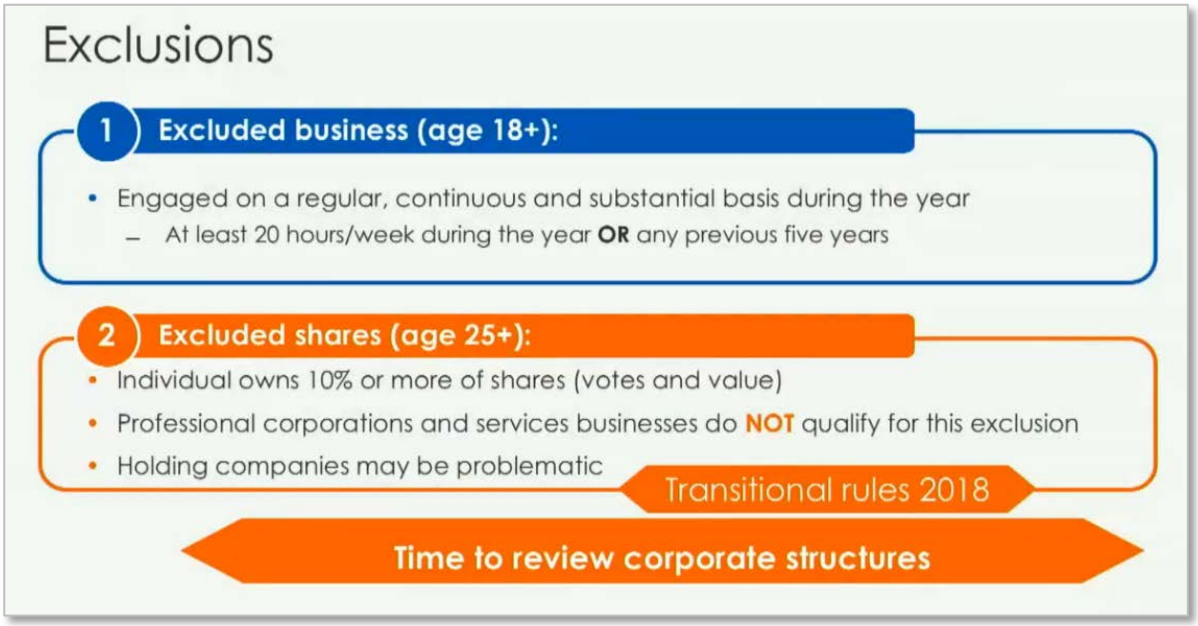
What sources of income contribute to $50,000 limit?	
Includes	**Excludes**
Interest Income Foreign Income Capital Gains (Taxable portion) Corporate Dividends (non-connected)	Incidental Income (e.g. short-term deposits) Capital Gains (sale of active investments)

- If you have existing investments, last year's proposal would grandfather investment income, but when the new rules kick in, you will not be able to take advantage of reduction at all. Recall, no longer subject to the 73% tax rate and the complexity is reduced

Q&A

- **Any surprises?**
  - Very little that directly affects advisors and investors (outside of the small businesses changes)
  - Backed down quite a bit from the substantial changes initially proposed
- **If a company has $5M invested in a mutual fund, what are their tax implications?**
  - Nothing really has changed from an advisor standpoint
  - It's when the corporate entity is doing its tax reporting, and accountant will look to the amount of income generating and that impact on the reduction
  - Trigger capital gains in 2018? Better to do so this year than next, if you're above the $50,000 limit of passive investment income
- **Government tax loopholes – any thoughts on what they are attacking next?**
  - Might go after income splitting, example spousal loans or loans to a family trust – hasn't yet been targeted. Opportunity prior to April 1st (CRA prescribed rate is now at 1% - will be going to 2% as of April 1st) so, explore those options now
- **Passive Investment Income - Rental income charge, OPCO included?**
  - Home owned by hold co, yes
  - If a business is operating out of a business, and owned by hold co, rented to the business, considered active income, continues to be beneficial
- **Passive income earned in hold co.**
  - Wrapped up in corporate group. Operating of hold co that owns the operating, we have to factor in the 50K limit and the 500K limit. Hold co passive income can impact the limit of op. co
- **Capital Gains, 50% - thoughts on going to 70%?**
  - Potential to be revisited. Could include the limit on the deduction on employee stock options.
  - Dividend income converted to capital gains, continuing to study
- **Any idea what additional CRA funding is looking to target?**
  - Tax evasion and tax avoidance, specifically focusing on affluent segment and particular emphasis on off-shore accounts. Funding to tax courts to enforce the laws.
- **Any response to US tax reform?**
  - "Deep dive on making sure our economy remains competitive" so at least aware that we are in a competitive environment

- **Income Sprinkling – how will eligibility be determined?**



- **Still benefits to a CPCC?**
  - Yes. Even if income is being taxed at general rate, which occurs when you don't have access to the reduction, is still deferrable.
- **Are unrealized capital gains from previous investments an issue?**
  - Only realized capital gains
- **If a hold co has $3M in earnings and 150K in interest income, how would the clawback work?**
  - Reduces access to small business reduction, but if you don't have active income, doesn't matter anyway
- **RDTOH balances – what happens to them?**
  - Remains in place, characterized as past income, and non-eligible RDTOH income in most cases.
  - A second RDTOH account will need to be set-up