Budget 2018: What it means for our industry and your business

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Budget 2018

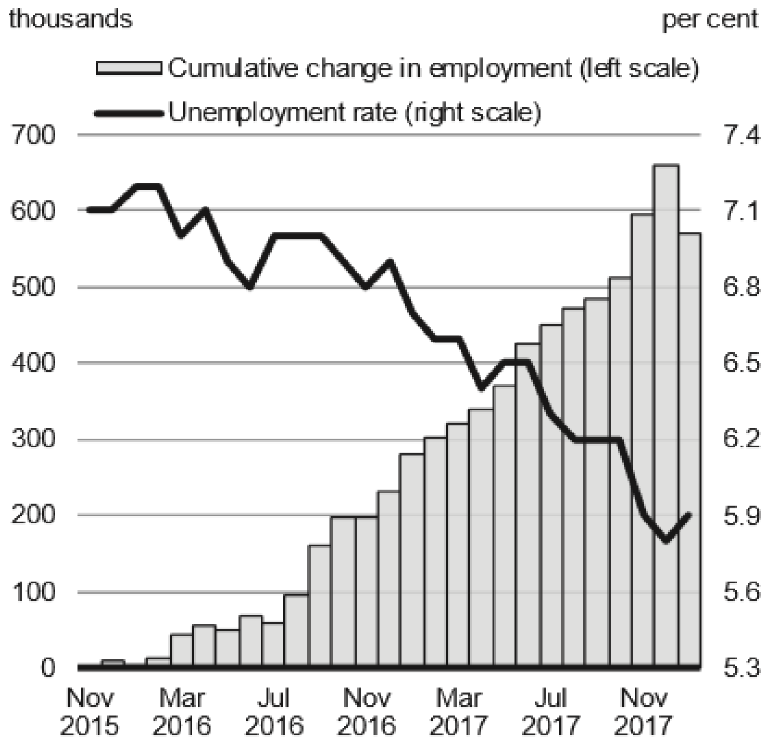
- **What it means for:**
  - **the Residential Construction Industry**
  - **You (*personal tax*)**
  - **Your Business (*corporate tax*)**

Economic Backdrop

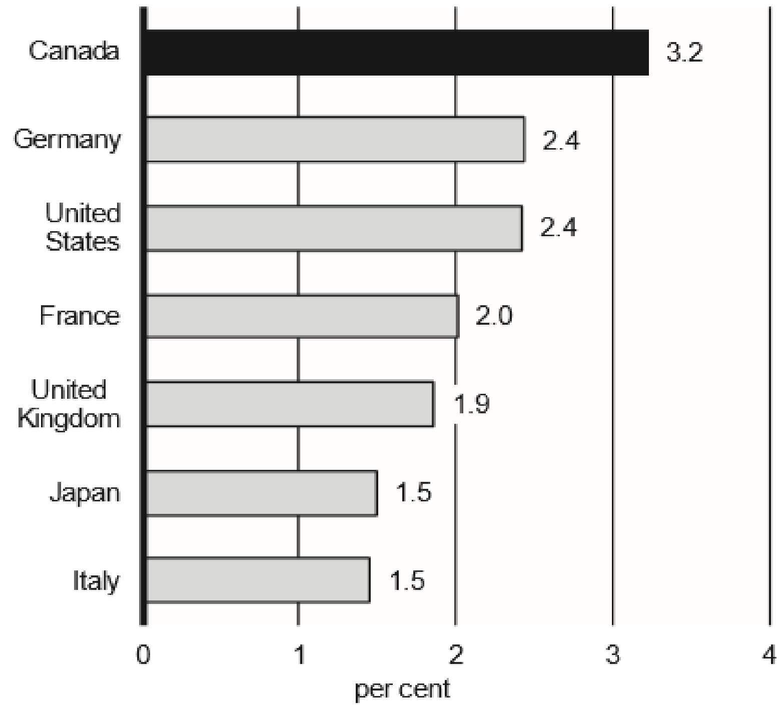
- **3% economic growth led G-7**
- **40-year low unemployment**

Economic Backdrop

Chart A1.1
Labour Market Since November 2015



Average Real Gross Domestic Product (GDP) Growth Since 2016Q2



Economic Backdrop

- Projections: growth dropping to 2% in 2018
- Government: higher revenues than expected
- Focus on debt-to-GDP ratio (deficits continue)
- Major risks: NAFTA, US Tax Cuts

Budget Big Picture

- "Steady as she goes"
- Check off platform boxes
- Looking ahead to 2019 – the "pre-election" budget
  - Significant fiscal room for new signature programs (if the government continue with deficit funding)

Housing Markets

- No further interventions or concerns
- “Housing Market Pressures Easing”
- “Tight supply conditions” remain an important factor affecting prices
- “Housing demand should continue to be supported by solid job and income gains, tempered by rising interest rates and recent mortgage rules changes”
- Household debt remains a vulnerability

National (Social) Housing Strategy

- **$40B over 10 years for affordable housing - 100,000 new units and repairing 300,000 units**
- **Other actions for those most vulnerable**
- **<u>Canada Housing Benefit</u> – for 300,000 households – major CHBA ask**

National (Social) Housing Strategy

- Rental Construction Financing Initiative increased to $3.75B until 2021
- NIMBYism
- Data and Analysis (e.g. CMHC work on supply)

Skilled Trades

- *Significant advocacy by CHBA on need to encourage/support recruitment*
- Pre-Apprenticeship Program
- Apprenticeship Incentive Grant for Women
- Women in Construction Fund
- Enhanced Canada Workers Benefit
- *CHBA has been active with BuildForce in its "Changing the Face of Construction" project*

Pan-Canadian Framework – Climate Change

- **$182-million investment to increase energy efficiency in homes and buildings**
  - **Codes and standards**
  - **a program to help industry find and test cost-effective, technical solutions**
  - **Support for expanded labelling**
- **$527M to home retrofit programs (ON, NB, NS)**

Final Walk-Back: Private Corporations

- **Passive Income Taxation – simplified administration, moved away from punitive tax**

- **In the end, the government is not proceeding in one area and ends up narrowing in two, including its passive investment income proposal, reducing it significantly.**

Presentation to Canadian Home Builders’ Association

Presented by: **Peter Bangs, Tax Partner**

Date: **March 2, 2018**

Federal Budget 2018

Highlights

- Focus on equality for women and growth
- Large spending initiatives (e.g. innovation/SRED)
- Continue to run deficits in $17-$20 billion range despite relatively strong economy
- Light on tax changes but some guidance on passive investments

Federal Budget 2018

PERSONAL TAX CHANGES

Summary – Personal Tax

- **No changes to personal tax rates**

2018 COMBINED PERSONAL TOP MARGINAL TAX RATES				
	Salary/Interest	Capital Gains	Canadian Dividends	
			Eligible	Non-Eligible
Federal	33.00%	16.50%	24.81%	26.30%
Alberta	48.00%	24.00%	31.71%	41.63%
British Columbia	49.80%	24.90%	34.20%	43.73%
Manitoba	50.40%	25.20%	37.78%	45.92%
New Brunswick	53.30%	26.65%	33.50%	46.88%
Newfoundland and Labrador	51.30%	25.65%	42.61%	43.81%
Nova Scotia	54.00%	27.00%	41.58%	47.33%
Ontario	53.53%	26.76%	39.34%	46.84%
Quebec	53.31%	26.65%	39.83%	43.94%
Prince Edward Island	51.37%	25.69%	34.22%	44.26%
Saskatchewan	47.50%	23.75%	29.64%	39.75%

Trust Filings

- Currently, if a trust did not earn income, or make distributions, the CRA (administratively) does not require the trust to file a tax return

- Budget 2018 proposes that all trusts will need to file returns each year for 2021 and subsequent taxation years

- Trust will be required to report the identity of all trustees, beneficiaries and settlors of the trust as well as any person who can exert control over trustee decisions

Trust Filings - Continued

- Exceptions for trusts which have been in existence less than 3 months or hold less than $50,000 of assets throughout the year
- To qualify for exemption, the assets must be restricted to deposits, government debt and listed securities
- Failure to file penalty $25 per day, up to $2,500
- If willingly don’t file/gross negligence, penalty equal to 5% of maximum FMV of trust property.

Canada Workers Benefit (CWB)

- **Formerly called the Working Income Tax Benefit, supplementing low income workers**

- **The current maximum refundable tax credit for an individual is $1,192. The amount is clawed back at 14% of income and is eliminated at approximately $21,000 of income.**

- **Budget 2018 proposes to increase the maximum benefit to $1,355 and $2,335 for families. The amount will be clawed back at 12% of income and will be eliminated at approximately $24,000 of income.**

Personal Tax Changes

WHAT DID NOT CHANGE

- Capital Gain Inclusion Rate
- Stock Option Deduction
- Home Buyer’s Amount $5,000 (Federal)
- Home Buyer’s Plan Withdrawal of RRSP (Max $25,000, 15 year repayment)

Canadian Home Builders' Association

CORPORATE TAX CHANGES

Summary – Corporate Tax

- **October 2017 proposed reduction of small business tax rate to 9%**

2018 SMALL BUSINESS RATES AND THRESHOLDSOLDS		
	Rate	Threshold
Federal	10.50%	$500,000
Alberta	12.00%	$500,000
British Columbia	12.00%	$500,000
Manitoba	10.00%	$450,000
New Brunswick	13.00%	$500,000
Newfoundland and Labrador	13.00%	$500,000
Nova Scotia	13.00%	$500,000
Ontario	13.50%	$500,000
Quebec	18.00%	$500,000
Prince Edward Island	14.50%	$500,000
Saskatchewan	12.00%	$600,000

Summary – Corporate Tax

- **No changes to general corporate tax rates**

2018 General Corporate Tax Rates	
	Rate
Federal	15.00%
Alberta	27.00%
British Columbia	27.00%
Manitoba	27.00%
New Brunswick	29.00%
Newfoundland and Labrador	30.00%
Nova Scotia	31.00%
Ontario	26.50% *
Quebec	26.70%
Prince Edward Island	31.00%
Saskatchewan	27.00%

Federal Budget 2018 – Corporate Tax Changes

- **Some very specific measures with little impact on CHBA members (CCA rates on clean energy equipment, health and welfare trusts, at-risk rules for tiered partnerships)**
- **Main point of interest for private companies was passive investment proposals**

Let’s take a step back… March 2017 Slide

- Government has stated that they are currently examining number of issues with private corporations:
  - Income sprinkling– reduction of high income earning individual by paying dividends to family members who are subject to lower tax rates (or not taxable).
  - Holding passive investments inside a private corporation and the ability to defer tax.
  - Tax advantage provided by capital gains to a corporation when compared to dividends paid by a corporation.

July 18, 2017 Proposals

- The Department of Finance consultation paper "Tax Planning Using Private Corporations" released on July 18, 2017, focused on changes in the following three key areas for Canadian Controlled Private Corporations (CCPCs):

    1) Income Sprinkling
    2) Holding Passive Investments Inside a Private Corporation
    3) Converting Income into Capital Gains

- The proposed changes were the most significant changes introduced in 45 years- and very confusing.

- Business and tax community were incensed!

Consultation Period and December Draft Legislation

- **Dept. of Finance received thousands of submissions including from the CHBA.**

- **The result of 75 day consultation period was a repeal of the conversion of income into capital gains legislation**

- **On December 13, 2017, the Minister of Finance released new draft legislation surrounding income sprinkling and the Tax on Split Income (TOSI) rules**

THE DECEMBER 13, 2017 UPDATE ON INCOME SPLITTING PROPOSALS

Bright-Line Tests

December revised proposals:

- **TOSI will not apply:**
  - **Where a business owner is age 65 or older and splits income with spouse (if it would be an excluded amount to him/her)**
  - **Where individual receives a capital gain from a disposition that qualifies for the Capital Gains Deduction (QSBC or QFFP)**
  - **Where shares are inherited from a deceased person by Will, if income or gain on shares would not be TOSI to the deceased**

Excluded Business Exception

- Two exemptions from the labour reasonability test also announced:

- An individual aged 18 or over will be exempt from TOSI if:

  – Works more than 20 hours per week in the current year (pro-rated where business operates for only a portion of year)

  – Has previously met above test for at least five years (this can be any five years; need not be continuous or recent. If test is met, then income can be split for a lifetime)

Excluded Shares Exception

Individual will be exempt from TOSI if individual:

1. **Is at least 25 years old by end of year and;**
2. **Owns 10% of the business (by votes and value)**

- **AND the corporation meets the following conditions:**
  1. **Earns less than 90% of its income from the <u>provision of services</u>, and**
  2. **It is not a professional corporation**

Excluded Shares Exception (cont'd)

What constitutes the provision of services?

- **Homebuilding should be okay but what about renovations and property management?**
- **What if one corporation has both services and non-services? How do you stream dividends?**
- **Hair salon versus pizza shop?**
- **Very little guidance given so far on this**

If don’t meet exceptions….

Reasonableness tests

- **Individual >25 will be subject to TOSI to extent dividend exceeds a reasonable return**
- **Finance has clarified “ reasonableness tests” and consider:**

Labour contributions/property contributions/risks assumed/historical payments and other relevant factors

- **Documentation will be key**

Budget 2018 – Income Sprinkling

- ***"Budget 2018 confirms the Government's intention to proceed with the following previously announced tax and related measures, as modified to take into account consultations and deliberations since their release":***

*** Income Tax Measures released on December 13, 2017 to address income sprinkling**

PASSIVE INCOME PROPOSALS

New Small Business Limit Grind

- July 18, 2017 proposals included changes to how passive investments would be taxed inside a corporation
  - Very complex and riddled with issues
  - A lot of negative feedback as tax rate could have exceed 70%

- Modified by press release in October 2017
  - Alluded to $50,000 passive income threshold
  - Mentioned "grandfathering" of investments held

- Budget 2018 proposal a positive change from initial proposals although NO GRANDFATHERING OF CURRENT INVESTMENT BALANCES

A. New Small Business Limit Grind

- In October 2017, proposed reduction to the small business tax rate on active income to 9%
  - In Ontario, combined provincial and federal will be reduced to 13.5%
- Preferential tax rate applies on active income up to $500,000
- Budget 2018 proposes to reduce the small business limit on a straight line basis for CCPCs having between $50,000 and $150,000 in investment income
- Small business limit is ground down $5 for every $1 of investment income over $50,000
- Will apply to taxation years that begin after 2018

New Small Business Limit Grind

Aggregate Investment Income	Small Business Limit Grind	Small Business Limit Remaining
$25,000	$0	$500,000
$50,000	$0	$500,000
$75,000	$125,000	$375,000
$100,000	$250,000	$250,000
$125,000	$375,000	$125,000
$150,000	$500,000	$0

New Small Business Limit Grind

- Calculation of investment income would include investment income of any other associated corporations
- Annual test based on corporation's prior year's adjusted aggregate investment income
- The business limit will work alongside the current rules relating to reduction in small business limit if taxable capital in excess of $10 million
- Reduction in a corporation's business limit will be the greater of the reduction under this measure and the existing reduction based on taxable capital

New Small Business Limit Grind

- "Investment Income" will be measured by new concept "adjusted aggregate investment income"

- Includes:
  - Interest, dividend and capital gains on investments
  - Non-active rental income
  - Capital gains (and losses) on disposition of property
  - Dividends from non-connected corporations
  - Income from savings in a non-exempt life insurance policy

New Small Business Limit Grind

- **Excludes:**
  - Capital gains (and losses) on disposition on property used in an active business in Canada by a CCPC or by a related CCPC
  - Capital gains on disposition of share of another CCPC that is connected with CCPC if certain tests met
  - Net capital losses carried over from other years
  - Dividends from connected corporations

B. Refundability of Taxes on Investment Income

- **Current Refundable Tax Regime:**
  - ➢ **Investment income taxed at roughly the highest personal tax rates in a corporation**
    - **(50.17% in Ontario, 38.33% on dividends)**
  - ➢ **A portion of that tax is refundable**
    - **30.67%, or the full 38.33% on dividends**
  - ➢ **Tax is refunded at a rate of $38.33 for every $100 of taxable dividends paid from the corporation to its shareholders**

Refundability of Taxes on Investment Income

- **To deal with perceived tax deferral advantages when paying out eligible dividends while still getting a refund of taxes, Budget 2018 proposes that there will be <u>two pools of refundable dividend tax on hand</u> (eligible and non-eligible)**

- **New restrictions on refundable taxes on the payment of dividends**

  – **Eligible Dividends (low rate) will only refund tax from eligible pool**

  – **Non-Eligible Dividends (high rate) will continue to refund from either pool**

General Planning Points

- Corporations continue to be good vehicles for saving for retirement
- Investments which do not generate significant “adjusted aggregate investment income” will have a lesser impact on the new small business limit grind
- May move to “cash” if loss of small business deduction is important
- May argue that investment income is “active business” income if funds are earmarked for a particular purchase
- Consider saving vehicles such as;
  - Exempt life insurance policies, Individual Pension Plans, Retirement Compensation Arrangements

General Planning Points

- Reinvesting earnings into active business assets and/or other related active business
- Review corporate asset ownership and impact on small business limit
- Consider taking advantage of lower capital gain rates versus higher dividend rates while you still can.

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For follow-up tax questions please contact Peter Bangs (peter.bangs@mnp.ca)

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