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Business

Budget

National

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Contents

About the budget

On February 27, 2018, Finance Minister Bill Morneau presented the government's 2018-2019 federal budget. This tax alert provides a summary of the tax measures proposed in the budget.

As expected, included in this year's budget is the draft legislation to address the perceived tax advantage enjoyed by business owners when investments are made through their private corporations instead of personally. The government's concerns around this matter were originally brought forward in the July 18, 2017 consultation paper, *Tax Planning Using Private Corporations.* Due to significant push-back from the business and tax communities in relation to this specific concept, the government assured effected taxpayers that any legislative response would include grandfathering. As discussed further below, the Budget 2018 proposals in relation to passive income revolve around a grind of the small business deduction based on associated company investment income and a new refundable tax pool concept. Other specific matters addressed in the July 18, 2017 consultation paper, specifically around income splitting, were previously addressed by way of draft legislation issued in December 2017.

There are no additional changes to the corporate tax rates from those previously announced in the fall economic statement for small business corporations. The budget also did not include any changes to the personal tax rates and tax brackets.

Despite speculation over the last couple of years, the government did not increase the capital gains inclusion rate or provide any specific measures related to the Scientific Research and Experimental Development (SRED) program.

The budget, however, did include measures to combat aggressive international tax avoidance (i.e., the use of so called "tracking arrangements" and the use of transactions involving partnerships and trusts to distribute tax-free distributions to non-resident shareholders). The government also indicated that it will continue to work with its international partners to improve international dispute resolution, and to ensure a coherent and consistent response to fight cross-border tax avoidance.

Proposed consultations on tax measures

Consultations on the GST/HST holding corporation rules

The government indicated in its budget that it intends to consult on a Goods and Services Tax/Harmonized Sales Tax (GST/HST) rule, commonly referred to as the "holding corporation rule," which generally allows a parent corporation to claim input tax credits to recover GST/HST paid in respect of expenses that relate to another corporation. More specifically, where a parent corporation is resident in Canada and is related to a commercial operating corporation (i.e., all or substantially all of the property of the corporation is for consumption, use, or supply in commercial activities) and the parent corporation incurs expenses that can reasonably be regarded as being in relation to shares or indebtedness of the corporation, the expenses are generally deemed to have been incurred in relation to commercial activities of the parent corporation.

The government intends to consult on the limitation of the rule to corporations and the required degree of relationship between the parent corporation and the commercial operating corporation. The government also intends to clarify which expenses of the parent corporation are incurred in relation to shares or indebtedness of a related commercial operating corporation, and therefore qualify for input tax credits under the rule.

Consultation documents and draft legislative proposals regarding these issues are expected to be released for public comment in the near future.

Previously announced measures

Budget 2018 also confirms the government's intention to proceed with the following previously announced tax and related measures:

- Measures confirmed in Budget 2016 relating to the GST/HST joint venture election;
- Income tax measures announced in Budget 2016 expanding tax support for electrical vehicle charging stations and electrical energy storage equipment;
- The income tax measure announced in Budget 2016 on information reporting requirements for certain dispositions of an interest in a life insurance policy;
- Technical income tax legislative amendments released on September 16, 2016, relating to a division of a corporation under foreign laws, and to the requirements to qualify as a prescribed share;
- The income tax measure announced in Budget 2017 to support the establishment of a tax-exempt Memorial Grant for First Responders (the Community Heroes benefit);
- The income tax measure announced on May 18, 2017 for additional tax relief for Canadian armed forces personnel and police officers;
- Remaining legislative and regulatory proposals released on September 8, 2017 relating to the GST/HST;
- The income tax measure announced on October 16, 2017 to lower the small business tax rate from 10.5 per cent to 10 per cent, effective January 1, 2018, and to 9 per cent, effective January 1, 2019, which was included in a Notice of Ways and Means Motion tabled on October 24, 2017, along with related amendments to the gross-up amount and dividend tax credit for taxable dividends;
- The income tax measure announced on October 24, 2017 in the Fall Economic Statement to provide for the indexing of the Canada Child Benefit amounts as of July 1, 2018 instead of July 1, 2020; and
- Income tax measures released on December 13, 2017 to address income sprinkling.

Budget 2018 also reaffirms the government's commitment to move forward as required with technical amendments to improve the certainty of the tax system.

Measures

Businesses

Business measures

Holding passive investments inside a private corporation

As part of the *Tax Planning Using Private Corporations* consultation paper that was released on July 18, 2017, the government announced that it intends to address the perceived tax advantages that a corporate owner is able to obtain by holding passive investments in a private corporation instead of holding them personally.

Active business income earned by private corporations is taxed at corporate income tax rates, which are generally lower than personal income tax rates, providing these corporations with more money to invest in order to grow their business. In addition, a small Canadian-controlled private corporation (CCPC) can benefit from a corporate income tax rate on qualifying active business income that is lower than the general corporate income tax rate. The intention of the lower small business tax rate is to enable small CCPCs, which may have difficulty obtaining capital, with more retained earnings to reinvest in their active businesses. Thus, when an individual uses earnings taxed at the lower corporate income tax rates to fund passive investments held within the corporation, an advantage can result because the amount of after-tax income available is larger than if the income was earned in the person's hands.

Business income retained in a corporation can also be used to finance passive investments. Under the current tax regime, additional taxes apply to passive investment income earned in the year. These additional taxes are intended to ensure that taxes payable by private corporations on investment income approximate top federal-provincial-territorial personal income tax rates. A portion of the tax on investment income is refundable to a corporation upon the payment of taxable dividends, and the income is then subject to personal income tax rates in the hands of the individual shareholders.

The government did not release draft legislation on passive income held through private corporations as part of the consultation paper instead, they outlined a couple of broad possible approaches to eliminate incentives to invest passively within a corporation and requested feedback from stakeholders as to the design considerations associated with each possible approach.

During the period of consultation, the government heard that its proposals could be very complex and can result in significant burdens on businesses. Consequently, the government proposes two new measures in this budget to limit the advantages from holding passive investments in a corporation, but in a more targeted and simpler manger than was proposed in its consultation paper:

1. Limiting access to the small business tax rate to small businesses, and
2. Limiting access to refundable taxes for larger CCPCs.

Limiting access to the small business tax rate to small businesses

The budget proposes to introduce an additional eligibility mechanism for the small business deduction, based on the corporation's passive investment income.

Under the proposal, if a corporation and its associated corporations earn more than $50,000 of passive investment income for the year, the amount of income eligible for the small business tax rate would be gradually reduced; the active business income would potentially be taxed at the general corporate income tax rate. More specifically, it is proposed that the small business deduction limit be reduced by $5 for every $1 of investment income above the $50,000 threshold (equivalent to $1 million in passive assets at a 5 per cent return), such that the business limit would be reduced to zero at $150,000 of investment income (equivalent to $3 million in passive assets at a 5 per cent return).

Note, this measure will affect CCPCs only to the extent that their business income exceeds the reduced business limit—as long as the reduced business limit remains above the active business income of the CCPC, all of that income would continue to be taxed at the small business tax rate.

The proposals differ from the approach outlined in the consultation paper because it does not directly affect taxes on passive income—the tax applicable to investment income, as well as refundable taxes and dividend tax rates will remain the same. This new approach also does not require the tracking of new and legacy pools of passive investments and will target only private corporations with more than $50,000 in passive investment income per year or approximately $1 million in passive investment assets (assuming an average 5 per cent return).

As previously announced, capital gains realized from the sale of active investments or investment income incidental to the business (i.e., interest on short-term deposits held for operational purposes) will not be taken into account in the measurement of passive investment income for purposes of this measure. In addition, incentives will be maintained such that Canada's venture capital and angel investors can continue to invest in Canadian innovation.

This measure will apply to taxation years that begin after 2018. Rules will apply to prevent transactions designed to avoid the measure, such as the creation of a short taxation year in order to defer its application and the transfer of assets by a corporation to a related corporation that is not associated with it.

Small- and medium-sized businesses have limited tools to survive cyclical downturns
Passive income retention provides a measure of protection for small- and medium-sized businesses—allowing them to continue operations and pay their employees and suppliers when times are lean. Without this tool, these community-based businesses face greater threat of failure or acquisition by a larger competitor. Businesses are now limited to keeping their passive investment earnings to under $50,000, or their business income becomes subject to higher tax rates.

Limiting access to refundable taxes on investment income

Under the current tax regime refundable taxes are applicable on investment income on passive investments of private corporations while that income is retained in the corporation. Some or all of these taxes are added to the corporation's refundable dividend tax on hand (RDTOH) account and are refundable at a rate of $38.33 for every $100 of taxable dividends paid to shareholders.

For income tax purposes, dividends paid by corporations are either "eligible" or "non-eligible":

- Non-eligible dividends—are generally paid from a corporation's active business income that has been subject to the small business tax rate (including non-eligible dividends received by the corporation) or from passive investment income. An individual who receives non-eligible dividends is entitled to the ordinary dividend tax credit (i.e., for federal purposes, proposed to be 10 per cent in 2018, and 9 per cent after 2018).
- Eligible dividends—are generally paid from a corporation's active business income that has been subject to the general corporate income tax rate (including eligible dividends received by the corporation). An individual who receives eligible dividends is entitled to the enhanced dividend tax credit (i.e., for federal purposes is 15 per cent).

Investment income earned by private corporations is generally paid as non-eligible dividends. However, a corporation may obtain a refund of taxes from its RDTOH account regardless of whether the dividends paid are eligible or non-eligible. As a result, the current system allows a corporation to receive an RDTOH refund on the payment of an eligible dividend (which entitles an individual receiving the dividend to the enhanced dividend tax credit) in situations where the corporation's RDTOH was generated from investment income that would need to be paid as a non-eligible dividend. This can provide a tax deferral advantage on passive investment income by allowing private corporations paying eligible dividends sourced from active business income taxed at the general corporate income tax rate to generate a refund of taxes paid on passive income.

The budget proposes that CCPCs will no longer be able to obtain refunds of taxes paid on investment income while distributing dividends from income taxed at the general corporate rate. Refunds of RDTOH will be available only in cases where a private corporation pays non-eligible dividends. An exception to this rule applies where an eligible dividend is paid to generate a refund of refundable tax assessed in relation to the receipt of an eligible dividend. To accommodate this exception, the RDTOH of a company will now be divided into two separate classes: an eligible RDTOH pool which arises from refundable tax assessable on eligible dividends received; and a non-eligible RDTOH pool which arises from refundable Part I and Part IV tax on everything else. Non-eligible dividends will generate dividend refunds out of either pool (but must come out of a non-eligible RDTOH pool first); however, eligible dividends can only generate dividend refunds to the extent of the eligible RDTOH pool.

These measures will apply to taxation years that begin after 2018. An anti-avoidance rule will apply to prevent the deferral of the application of this measure through the creation of a short taxation year.

Tax support for clean energy

Budget 2018 proposes to extend eligibility of Class 43.2 accelerated Capital Cost Allowance (CCA) rates by a further five years for qualifying clean energy properties acquired before 2025 (the existing rules restrict eligibility to acquisitions before 2020).

Artificial losses using equity-based financing arrangements

Budget 2018 proposes two amendments to tighten existing rules restricting deductions to corporations on certain dividends received on shares of a Canadian-resident corporation. Existing rules relating to “synthetic equity arrangements” and “securities lending arrangements”—which limit the deduction of dividend income where deductible “dividend compensation payments” are also paid by the dividend recipient to a counterparty—are enhanced to capture certain transactions and structures that have evolved to circumvent the existing set of rules.

Specifically for synthetic equity arrangements, Budget 2018 proposes changes that will prevent the “tax-indifferent investor” exception from applying where the tax-indifferent investor obtains all or substantially all of the risk of loss and opportunity for gain in respect of a Canadian share, in any way, including where the tax-indifferent investor has not entered into a synthetic equity arrangement or specified synthetic equity arrangement in respect of the share. These measures will apply to dividends paid, or payable, on or after Budget Day.

Further, Budget 2018 proposes to expand the “securities lending arrangement” (SLA) definition to ensure that taxpayers that enter into arrangements that do not meet the current technical definition of an SLA—but are substantially similar to an SLA—become subject to the same dividend deduction restrictions that otherwise apply to SLAs. These proposed changes will apply to dividend compensation payments made on or after Budget Day, except where the securities lending or repurchase arrangement was in place before Budget Day, in which case the amendments will apply to dividend compensation payments made after September 2018.

Stop-loss rule on share repurchase transactions

Budget 2018 proposes to tighten the stop loss rules first introduced in Budget 2011 with respect to share repurchases where shares are held as “mark-to-market” property. Specifically, the proposed measures expand the existing stop-loss rules to include a denial of the portion of the loss associated with the marked-to-market incremental share value, as that mark-to-market income in most cases is fully offset under a hedging relationship and therefore not taxed.

This measure will apply in respect of share repurchases that occur on or after Budget Day.

At-risk rules for tiered partnerships

The existing tax system provides a series of rules that restrict the ability of limited partners of a partnership to deduct partnership losses that exceed their “at-risk” capital invested in the partnership. It was widely understood that these rules are applied in simple partnership structures, but also in structures where the limited partner is, itself, a partnership (referred to as “tiered partnerships”). A recent Federal Court of Appeal ruling determined these rules did not extend to tiered partnerships in the manner that Finance believed it should. Accordingly, Budget 2018 proposes legislation to clarify the application of the limited partnership loss restrictions to situations where the limited partner is another partnership.

These changes will apply in respect of taxation years that end on or after Budget Day, including in respect of losses incurred in taxation years that end prior to Budget Day.

Health and Welfare Trusts

The current tax system contains two sets of rules for certain trusts established to provide health and welfare benefits to employees. Health and Welfare Trusts, have no legislated rules, but instead have been governed by Canada Revenue Agency (CRA) administrative policies since the 1960s. More recently, rules have been added in 2010 to the *Income Tax Act*, governing Employee Life and Health Trusts, which are similar in nature to Health and Welfare Trusts. These legislated rules governing Employee Life and Health trusts deal explicitly with certain issues that are common to both types of trusts, but are not otherwise dealt with in the CRA’s administrative rules for Health and Welfare Trusts.

Budget 2018 proposes that only one set of rules apply to these types of trust arrangements, and proposes that the CRA no longer apply their administrative policies with respect to Health and Welfare Trusts after the end of 2020. Further, the CRA’s administrative policies for Health and Welfare Trusts will not apply to trusts established after Budget Day.

The government has commenced a stakeholder consultation on these proposed changes and transitional issues, after which the government will propose draft legislation for these changes. Stakeholders are invited to provide comments to the government by June 29, 2018.

Reassessment Period – Requirements for Information and Compliance Orders

Under our current tax system, a taxpayer may normally be reassessed by the CRA within a finite period of time, after which, the tax year becomes statute-barred. Where the CRA issues a requirement for information to a taxpayer, the taxpayer may choose to contest the requirement in court which can cause delays in the reassessment process, essentially shortening the window in which the CRA has the ability to reassess. An existing “stop-the-clock” rule exists to accommodate these time delays but it applies only where the requirement to provide information includes foreign-based information. As no such “stop-the-clock” rule exists for requirements that do not include foreign-based information, the CRA is at a disadvantage in completing reassessments that are delayed by contested requirements for information.

Budget 2018 proposes to introduce a “stop-the-clock” rule for requirements for all information and compliance orders. This rule will extend the reassessment period by the period of time during which the requirement or compliance order is contested. This measure will apply in respect of challenges instituted after the legislation receives Royal Assent.

Personal

Personal tax credits

Canada Workers Benefit

Previously known as the “Working Income Tax Benefit,” Budget 2018 has reintroduced this benefit as the “Canada Workers Benefit.” The government has restructured the benefit, which will come into effect in 2019, with an additional commitment of $500 million per year.

The new Canada Workers Benefit will provide working, low-income Canadians with a benefit equal to 26% of each dollar of earned income that is in excess of $3,000, to a maximum of $1,355 for single individuals without dependents and $2,355 for couples and single parents. The benefit is structured so that it will be reduced at a rate of 12% of adjusted net income once an individual’s income reaches a certain threshold. For single individuals without dependents, the reduction will kick in once adjusted net income exceeds $12,820; for couples and single parents, the reduction will kick in once adjusted net income exceeds $17,025. These amounts will be indexed for inflation after the 2019 year.

Individuals eligible for the Disability Tax Credit

Further changes have been made with regards to individuals receiving the Canada Workers Benefit who are also eligible for the Disability Tax Credit. Beginning in 2019, the maximum benefit provided to such individuals will be increased to $700. The reduction thresholds have also been changed so that they will reduce at a rate of 12% once a threshold of $24,111 (for single individuals without dependents) and $36,483 (for families) has been exceeded. In the case that both partners in a family are eligible for the benefit, the benefit will reduce at a rate of 6% as opposed to 12%. As noted above, these amounts will be indexed for inflation after the 2019 year.

Accessing the benefit

The Canada Workers Benefit can be accessed by individuals through the completion of Schedule 6 on their personal tax returns. Should Schedule 6 not be completed, Budget 2018 also proposes to allow the CRA to determine whether the individual is eligible to receive the benefit and to assess their return as if the benefit had been claimed.

In the case that a couple has not completed Schedule 6 when filing their personal income tax returns, but CRA has subsequently determined that they would qualify for the benefit, the CRA will be able to designate which spouse receives the benefit.

With regards to eligible individuals who are students at a post-secondary institution, Budget 2018 also proposes to require that designated education institutions in Canada report certain prescribed information to the CRA regarding students’ enrollment in order to assist them in the administration of Canada Workers Benefit, as well as certain other measures such as the administration of the Life Long Learning Plan.

All of the above measures will become effective as of the 2019 taxation year.

Medical Expense Tax Credit

Budget 2018 has expanded the application of the Medical Expense Tax Credit (METC), allowing for certain eligible expenses incurred for an animal that is specially trained to assist patients with certain mental impairments. Currently, eligible expenses related to animals supporting patients who are affected with: blindness, profound deafness, severe autism, severe diabetes, severe epilepsy, or a severe and prolonged impairment that markedly restricts the use of the patient's arms and legs are allowed under the METC. This eligibility has now been expanded in respect of eligible expenses incurred after 2017 to include such eligible expenses for animals supporting patients with severe mental impairments. It has been noted that animals who are simply providing comfort and emotional support would not meet the eligibility requirement—the animal must be specially trained to perform tasks such as guiding disoriented patients or applying compression to a patient.

Should an animal meet the expanded definition above, the METC can be applied against the following eligible expenses:

- The initial cost of the support animal;
- The cost of the care and maintenance of the support animal; and
- The cost of training programs required for a patient to learn how to handle the support animal (including reasonable board and lodging expenses should full-time attendance be required at the training facility).

Registered Disability Savings Plan

Budget 2018 has extended the current temporary measures in place that allow for qualifying family members (parents, spouses, or common-law partners) of disabled adult individuals who do not have a legal representative in place to be the plan holder of the disabled individual's Registered Disability Savings Plan (RDSP).

These measures are required on the basis that the process for establishing a legal representative can be both costly and lengthy in certain provinces, and Budget 2018 will extend the temporary measures for an additional five years—thought to the end of 2023—while continuing to encourage that the provinces and territories develop streamlined processes for the establishment of a legal representative in order to meet the needs of RDSP beneficiaries.

Child Benefits

Foreign-born status Indigenous peoples

Currently, foreign-born status Indigenous peoples are eligible for the new Canada Child Benefit, which was introduced in July 2016. Despite their eligibility under this program, such individuals were not eligible for the predecessor programs to the Canada Child Benefit (i.e., the Canada Child Tax Benefit, the National Child Benefit supplement, and the Universal Child Care Benefit). Budget 2018 therefore proposes that foreign-born status Indigenous peoples be made retroactively eligible for these predecessor programs in the case that all other eligibility requirements have been met. The retroactive effect will apply from the 2005 taxation year to June 30, 2016.

Access to taxpayer information

As a result of Budget 2018, the Income Tax Act (ITA) will be amended to allow provincial and territorial access to taxpayer information gathered as part of the Canada Child Benefit program, to assist the provinces and territories in their administration of their social assistance payment programs as of July 1, 2018. It has also been noted that taxpayer information relating to the National Child Benefit supplement, with regards to prior benefit years, will continue to be shared after June 2018.

Charities

Inclusion of municipalities as eligible donees

Currently, when a charity revokes its charitable status, a 100% revocation tax is levied on the charity on the basis of the total net value of its assets. A charity is able to reduce this tax by making qualified expenditures to “eligible donees” (typically other registered charities in good standing dealing at arm’s length with the revoked charity). The purpose of this reduction is to ensure that the property of a revoked charity remains within the charitable sector.

In the case that it is not possible for a charity to locate an eligible donee that is willing to assume the property of the charity, Budget 2018 proposes that municipalities be considered eligible donees for the purposes of the revocation tax. The determination of whether a municipality is eligible to be considered an eligible donee will be made on a case by case basis by the Minister of National Revenue. It has been noted that this measure will apply to qualified expenditures for the purposes of the revocation tax made after February 27, 2018.

Universities outside of Canada

Budget 2018 has provided that universities outside of Canada who are considered to be eligible donees for the purposes of the charitable donation tax credit and deduction no longer need to be included on Schedule VIII to the *Income Tax Regulations* after February 27, 2018, due to the fact that such eligible donees are also listed on the Government of Canada’s website once they have been registered with the CRA.

Mineral exploration tax credit for flow-through share investors

Budget 2018 has proposed to extend the existing mineral exploration tax credit for an additional year, and flow-through share agreements entered into on or before March 31, 2019 will now qualify. This credit allows resource companies to “flow-through” the tax expenses associated with their Canadian exploration activities to their investors, who are then able to deduct those expenses in the calculation of their own taxable income. In order to provide an additional benefit, a 15% tax credit is then provided on such expenses. As a result of the existing “look-back” rule, the extension of this credit also means that funds raised on the basis of this credit during the first three months of 2019 can be spent on eligible exploration until the end of 2020.

Reporting requirements for trusts

In order to address the gaps that currently exist with respect to the reporting requirements for trusts, Budget 2018 has proposed to require that certain trusts be obligated to file a T3 return on an annual basis as of the 2021 and subsequent taxation years.

These new reporting requirements will apply to express trusts resident in Canada and non-resident trusts that are currently required to file T3 returns, save for the following exceptions:

- Mutual fund trusts, segregated funds, and master trusts;
- Trusts governed by registered plans;
- Lawyers' general trust accounts;
- Graduated rate estates and qualified disability trusts;
- Trusts that qualify as non-profit organizations or registered charities; and
- Trusts that have been in existence for less than three months or that hold less than $50,000 in assets throughout the taxation year (for this purpose, assets are confined to deposits, government debt obligations, and listed securities).

Should the new reporting requirements apply, the trust will now be required to report the following information on their T3 return:

- The identity of all trustees;
- The beneficiaries of the trust;
- The settlors of the trust; and
- The identity of all persons who have the ability (through the trust terms or a related agreement) to exert control over trustee decisions regarding the appointment of income or capital of the trust.

In order to support the CRA in administering these new reporting requirements, Budget 2018 has also provided additional funding of $79 million over a five-year period, and $15 million on an ongoing basis for the purposes of improving the CRA's audit and administration of trusts and trust returns.

In line with the new reporting requirements, Budget 2018 has also introduced new penalties. Should a trust fail to file a T3 return, in the case that a beneficial ownership schedule is required, a penalty of $25 per day of delinquency will be incurred—with a minimum penalty of $100 and a maximum penalty of $2,500. Furthermore, should the failure to file have been made knowingly, or due to gross negligence, additional penalties equal to 5% of the maximum fair market value of the property held by the trust during the year in question will result with a minimum penalty of $2,500 being incurred.

Sales and excise tax

GST/HST and investment limited partnerships

Budget 2018 follows through on the government's changes first proposed on September 8, 2017 relating to the application of GST/HST to investment limited partnerships, with some subtle changes with respect to timing. Under the proposals—as adjusted in Budget 2018—GST/HST will be payable on the fair market value of management and administrative services provided to an investment limited partnership rendered by the general partner on or after September 8, 2017, unless the general partner charged GST/HST in respect of those services before that date.

In addition, investment limited partnerships will be considered "investment plans" for GST/HST purposes and will be afforded the special HST rules currently applicable to investment plans effective January 1, 2019, with an elective option to advance the application of these special rules as of January 1, 2018.

Tobacco taxation

Budget 2018 proposes several adjustments to the taxation of tobacco, starting with an advancement in timing of inflationary adjustments applied to excise duties from the existing five-year interval, to annual adjustments commencing on the day after Budget Day and carrying onward on April 1 of every subsequent year.

In addition to the inflationary indexing intervals, an adjustment of excise duty rates by an additional $1 per carton of 200 cigarettes—and corresponding increase to other tobacco products—has been proposed.

Finally, inventories of manufacturers, importers, wholesalers, and retailers at the end of Budget Day will be subject to an inventory tax of $0.011468 per cigarette (subject to certain exemptions).

Cannabis taxation

Budget 2018 proposes a new federal excise duty framework for cannabis products, which will be implemented through amendments to the existing Excise Act, 2001. In addition, the rules of the *Excise Tax Act* concerning GST/HST will be amended as necessary to ensure cannabis products do not qualify as zero-rated products in the same manner as is the case for standard grocery items.

Consultation on the GST/HST holding corporation rules

The current GST/HST system includes a set of rules permitting a parent company to claim input tax credits to recover GST/HST paid in respect of expenses that can reasonably be regarded as being related to the shares or indebtedness of a related commercial operating corporation. This rule, commonly referred to as the "holding corporation rule," will be the subject of a consultation initiated by the government, seeking input with respect to the limitation of the rule to corporations and the required degree of relationship between the parent corporation and the commercial operating corporation. In addition, the government will seek to clarify the types of expenses that are in respect of shares or indebtedness of a related commercial operating corporation that will qualify for input tax credits.

Finance will be providing further documents and draft legislative proposals related to this matter for public comment in the near future.

International

International tax measures

Cross-border surplus stripping using partnerships and trusts

Currently, the *Income Tax Act* contains a targeted provision that hinders the ability of a non-resident shareholder from extracting surplus of a Canadian corporation in excess of the tax paid-up capital (PUC) of the shares, or to artificially increase such PUC. While the current cross-border anti-stripping rule contemplates the use of a partnership as an intermediary in such planning, it does not fully address the disposition of an interest in a partnership or trust that holds shares in a Canadian business, which if transferred itself, would be subject to the existing rules.

Taxpayers have developed more complex planning to avoid the application the surplus stripping rule through the sale of the partnership that holds shares of a Canadian corporation. The government is concerned with this planning, as well as similar planning using trusts, both in the context of the surplus-stripping rule and the corporate immigration rules.

As a result, effective Budget Day, it is proposed that the existing cross-border surplus stripping and corporate immigration regimes be amended to add a comprehensive “look-through” rule for such entities. The “look-through” rule will allocate the assets, liabilities, and transactions of partnerships and trusts to partners and beneficiaries on a relative fair market value basis in determining the application of these rules. For transactions prior to Budget Day—or for transactions on or after Budget Day that are inconsistent with the policy intent of the existing and proposed rules—the government indicates an intention to challenge taxpayers under the general anti-avoidance rule.

Foreign affiliates

Investment Businesses

In the context of a controlled foreign affiliate (CFA), income from property—or that deemed income from property under the rules—is taxable in Canada on a current basis as “foreign accrual property income” (FAPI). In certain cases, income that is otherwise defined as income from an investment business (and hence subject to the FAPI regime) is re-characterized as active business income where the CFA employs more than five full-time employees in the active conduct of such business (assuming other requirements are met).

Certain planning has evolved to avoid FAPI, with taxpayers pooling similar businesses, which would not otherwise meet the employee test on a stand-alone basis, into a single foreign affiliate with an aim of meeting the employee test. Under such arrangements, it is often the case that each taxpayer retains control over their respective assets, and returns thereon through a ”tracking arrangement”. It is the government’s view that such tracking arrangements act as an attempt to convert FAPI income into active business income.

Where a tracking arrangement exists, Budget 2018 introduces a measure to treat each underlying activity that accrues to a specific taxpayer as a separate business of the foreign affiliate. The taxpayer will have to evaluate each of these separate businesses in the context of the existing conditions-including the employee test-to determine whether such income may be subject to FAPI treatment.

It is intended that such measures will apply to taxation years of a taxpayer’s foreign affiliate that begins on or after Budget Day.

Controlled foreign affiliate status

As a further expansion of the above rule regarding investment businesses, where a tracking arrangement exists, but due to the number of participants in the arrangement the foreign affiliate is not a CFA to a particular taxpayer (in which case the FAPI rules would not ordinarily apply), it is proposed that the foreign affiliate be deemed a controlled foreign affiliate and that the FAPI rules in fact apply. Consistent with the investment business proposal, this measure will apply to taxation years of foreign affiliates beginning on or after Budget Day.

Trading or dealing in indebtedness

Business income from trading or dealing in indebtedness by a foreign affiliate would generally be considered FAPI income in the context of a CFA. Income from an investment business is also subject to the FAPI regime. These rules exempt certain regulated foreign financial institutions from the application thereof, however, the investment business exemption requires that the foreign affiliate maintain minimum capital requirements.

It is proposed that where the principal business of a foreign affiliate is trading or dealing in indebtedness, such affiliate must also satisfy a minimum capital requirement in order to avail itself of the exemption available to regulated foreign financial institutions.

This new measure will apply to the taxation years of foreign affiliates ending on or after Budget Day.

Reassessments

With application from taxation years ending after Budget Day, the normal reassessment period of a taxpayer is ended by three years relative to income arising from a foreign affiliate. The reassessment period is extended for transactions with non-arm's length non-residents, which may include transactions with a foreign affiliate but not all income earned by a foreign affiliate. Budget 2018 proposes to extend expand the extended reassessment period for income arising in connection with a foreign affiliate. The measure will apply to taxation years that begin after budget day.

Reporting requirements

Currently, a taxpayer that holds an interest in a foreign affiliate must provide specific reporting (Form T1134) within 15 months of year end. The original intention of this extended filing date was to provide enough time for the Canadian resident reporter to obtain the relevant financial information from the foreign jurisdiction, particularly in cases where the timeframes for preparation of financial statement information or tax filings were beyond the Canadian filing deadlines.

For taxation years ending after 2019, Budget 2018 proposes reduce the filing deadlines for Form T1134 from 15 months six months to be consistent with the corporate income tax filing.

Reassessment period – non-resident non-arm's length persons

Budget 2018 proposes an amendment to provide an additional three years to reassess a taxpayer for a prior year to the extent the reassessment relates to an adjustment to a loss carry back; where the adjustment to the loss is made as a result the adjustment of a transaction involving the taxpayer and a non-arm's length non-resident; such reassessment reduces the loss; and all or a portion of the loss had been carried back to a prior year.

This measure will apply to a taxation year in which a carried back loss is claimed, where such loss originated in a taxation year ending on or after Budget Day

Sharing information for criminal matters

To facilitate information sharing obligations under the various income tax treaties, tax information sharing agreements, and the *Convention on Mutual Administrative Assistance in Tax Matters* of which Canada is signatory to, the government intends to amend the various taxation statutes and other legislation necessary to allow for such sharing to occur. Such information sharing can relate not only to tax offences but also serious non-tax offences that if committed in Canada would constitute terrorism, organized crime, money laundering, criminal proceeds, or designated substance offences. Such amendments would come into force upon the amending legislation receiving Royal Assent.

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