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"With this budget, built by and for all Canadians, we are tackling the challenge of equality head-on—asking tough questions, and beginning to provide solutions."

– Bill Morneau, Minister of Finance

The Honourable Bill Morneau, Minister of Finance, tabled the Liberal government's third budget on February 27, 2018 (Budget 2018).

Budget 2018 maintains the government's theme of building a stronger middle class, this year with a marked emphasis on gender equality. Budget 2018 includes the much-anticipated measures relating to the treatment of passive investment income earned in private corporations. The proposed measures are more modest and streamlined than originally outlined, reflecting some of the significant criticisms of small business owners and the tax community. There is notably no specific reaction to recent U.S. tax reforms, other than a commitment to conduct a detailed analysis of the U.S. changes over the coming months to assess any potential impacts on Canada. Budget 2018 stays the course when it comes to corporate tax rates.

There are changes to the foreign affiliate system to address the use of tracking interests to

satisfy the employee test or to avoid controlled foreign affiliate (CFA) status, an extension of the period in which the income relating to foreign affiliate transactions may be reassessed, and a much shorter timeline for filing foreign affiliate information returns. Transactions using partnerships and trusts to avoid cross-border surplus-stripping limitations are targeted. Trust reporting requirements have been expanded. Other changes address losses using equity-based financial arrangements and the application of the limited partnership at-risk rules to tiered partnerships. Budget 2018 also confirms the government's intention to proceed with its proposal to apply GST/HST to management and administrative services provided to an investment limited partnership by a general partner.

Budget 2018 projects deficits of $19.4 billion in 2017-18, $18.1 billion in 2018-19, $17.5 billion in 2019-20, $16.9 billion in 2020-21, $13.8 billion in 2021-22, and $12.3 billion in 2022-23.

In this Budget Briefing 2018, we summarize the more significant tax proposals included in Budget 2018.

In this Briefing

The following areas will be covered in this Budget Briefing:

- Business income tax measures
- International tax measures
- Trust income tax measures
- Sales and excise tax measures
- Administrative measures
- Outstanding tax measures

Business income tax measures

Passive income in private corporations

Developments prior to Budget 2018

In July 2017, the government released a consultation paper on tax planning using private corporations, along with draft legislative proposals relating to income sprinkling and the conversion of income into capital gains. The government also announced an intention to increase taxes on passive income earned in private corporations.

The consultation process resulted in significant criticism of the government's proposals. In a series of announcements by the government in October 2017, the government softened its approach by

- announcing reductions to the small business tax rate;
- stating that the income sprinkling measures would be simplified; and
- abandoning the proposals relating to the conversion of income into capital gains

On October 18, 2017, the government announced its intention to move forward with measures to limit the deferral benefits of earning passive income in private corporations. However, the measures would apply on a go-forward basis only, would preserve the ability to save for future business needs, and would include a passive income threshold of $50,000 per

year for future investments.

Budget 2018 passive income proposals

The government's approach to the taxation of passive income of private corporations in Budget 2018 marks a significant departure from the proposals that were put forward in July 2017. The government acknowledges feedback that its previous proposals were overly burdensome for small businesses. As a result, the government proposes two new, simplified measures that are designed to curb the deferral advantage that could be obtained from earning passive income in a private corporation. The first proposal targets the ability of small businesses to benefit from the small business deduction by reducing the business limit (i.e., the income eligible for the small business tax rate) for Canadian controlled private corporations (CCPCs) that have significant income from passive investments. The second proposal limits the refundable taxes that private corporations receive on the payment of certain dividends.

As of January 1, 2018, small business corporations are eligible for a tax rate deduction (known as the small business deduction) which results in a 10% federal income tax rate on up to $500,000 of qualifying active business income (the business limit). The rate will be further reduced to 9% as of 2019. The rules provide that the small business deduction is phased out on a straight-line basis for CCPCs that have between $10 million and $15 million of aggregate taxable capital employed in Canada. Under the first proposal, the availability of the small business deduction will be phased out for small business corporations (together with associated corporations) that earn more than $50,000 of passive investment income in a year (passive investment income below the $50,000 threshold will not affect eligibility for the small business deduction). This will be achieved by reducing the business limit by $5 for every $1 of investment income that exceeds the $50,000 threshold. For example, the business limit of a CCPC that earns $100,000 of passive income will be reduced to $250,000 [$500,000 – ($100,000 – $50,000) x 5)]. The business limit will be nil once a corporation earns $150,000 of investment income [$500,000 – ($150,000 – $50,000) x 5)].

This measure is much simpler than the previous proposal. The determination of the reduction of the business limit will be based on the investment income of a CCPC measured by a new "adjusted aggregate investment income" concept that will include certain additions and exclusions. Significantly, this concept acknowledges that some passive income should be excluded in determining the reduction of the small business deduction, such as capital gains realized from the sale of active business assets, and shares of connected small business corporations and investment income that is incidental to the business, such as interest earned on a short-term bank deposit that is held for operational purposes.

The second proposal limits the refundable taxes that private corporations receive on the payment of certain dividends. Currently, dividends paid by corporations can be classified as either "eligible" or "non-eligible." Non-eligible dividends are presumed to have been paid out of active business income that was subject to the small business deduction or from passive investment income. An individual that receives a non-eligible dividend is entitled to an ordinary dividend tax credit. Eligible dividends are presumed to have been paid from a corporation's active business income that was subject to the higher general corporate tax rate. Eligible dividends are entitled to an enhanced dividend tax credit, which is more favourable than the ordinary dividend tax credit. The difference in the taxation of eligible and non-eligible dividends in the hands of an individual is rooted in the concept of tax integration. Tax integration provides that an individual should pay the same amount of tax on income regardless of whether that income is earned directly by the individual, or indirectly through a corporation.

Currently, passive income earned in a corporation is subject to a refundable tax. This tax is

refunded from the notional “refundable dividend tax on hand” (RDTOH) account upon the payment of a dividend to a shareholder. Under the existing rules, a corporation that earns both investment income and active business income may claim an RDTOH refund by paying out an eligible dividend in circumstances where RDTOH was generated from investment income.

Budget 2018 proposes to ensure that only a payment of a non-eligible dividend entitles a corporation to an RDTOH refund. Budget 2018 proposes an exception to this rule in respect of RDTOH that arises from eligible portfolio dividends received by a corporation. In order to accommodate this exception two separate RDTOH accounts will be created: eligible RDTOH, and non-eligible RDTOH.

The eligible RDTOH account will track Part IV tax on eligible portfolio dividends. The non-eligible RDTOH account will track refundable taxes on investment income and Part IV tax on non-eligible portfolio dividends. A payment of an eligible dividend will entitle a corporation to a refund from the eligible RDTOH account, and a payment of non-eligible dividends will entitle a corporation to a refund from the non-eligible RDTOH account. A proposed ordering rule ensures that upon the payment of a non-eligible dividend, a private corporation must claim a refund from its non-eligible RDTOH account before it attempts to seek a refund from the eligible RDTOH account.

Both of these measures, if enacted, will apply to taxation years starting after 2018.

Synthetic equity arrangements, securities lending arrangements, and losses arising on the redemption of certain shares

Synthetic equity arrangements

In Budget 2018, the government continues to address perceived abuses of the deduction available where a Canadian corporation receives a dividend on the shares of another Canadian corporation.

Rules that currently apply to “synthetic equity arrangements” and other types of “dividend rental arrangements” are aimed at particular transactions that are perceived to be abusive. In part, these rules deny a deduction for dividends received by the legal owner of a share in certain circumstances where there is a contractual obligation to pay amounts determined by reference to such dividends to another person. Budget 2018 suggests that such arrangements may be considered “artificial” where both the dividend received by the owner of the share and the payment of any compensation or other contractual payment to a particular counterparty are deductible.

Under current rules, a dividend deduction will not be denied in respect of a “synthetic equity arrangement” where the taxpayer establishes that no “tax-indifferent investor” or group of “tax-indifferent investors” has all or substantially all of the risk or loss and opportunity for gain or profit in respect of the relevant share because of a synthetic equity arrangement or certain other agreements or arrangements entered into in connection with the synthetic equity arrangement. A tax-indifferent investor includes, for example, a tax-exempt person (such as a pension fund) or a non-resident person that does not carry on business in Canada.

The government is concerned that there continue to be transactions where the foregoing exception is satisfied, but where a tax-indifferent investor ultimately or indirectly has the risk of loss or opportunity for gain or profit in respect of the relevant share. As a result, Budget 2018 would amend the foregoing exception to clarify that it cannot be met where a tax-

indifferent investor obtains all or substantially all of the risk of loss and opportunity for gain or profit in respect of the relevant share in any way, including where the tax-indifferent investor has not entered into a synthetic equity arrangement or another agreement or arrangement entered into in connection with the synthetic equity arrangement.

The effect of this amendment would be to introduce uncertainty into ordinary commercial transactions where it is not possible to determine the economic exposure of a “tax-indifferent investor” to a particular share.

The proposed amendments, if enacted, will apply to dividends that are paid, or become payable, after February 27, 2018.

Securities lending arrangements

Budget 2018 notes that the government is concerned with the tax consequences arising from certain securities lending or repurchase transactions.

Budget 2018 proposes to expand the securities lending arrangement (SLA) rules to transactions that are substantially similar to those that currently fall within the SLA definition. Specifically, it is proposed that a “specified securities lending arrangement” will arise where a person transfers or lends a particular listed share to another person, it may reasonably be expected that the other person will transfer or return the transferred or lent share (or an identical share) to the person, and the person’s risk of loss or opportunity for gain or profit with respect to the share is not changed in any material respect. There is no requirement under the “specified securities lending arrangement” definition that the borrower make payments to the lender as compensation for distributions received by the borrower on the lent share. The rules that apply to SLAs will also apply to the new category of specified securities lending arrangements.

Budget 2018 also clarifies the treatment of compensation payments made under an SLA. A taxpayer that is a registered securities dealer is entitled to deduct up to two-thirds of a dividend compensation payment. Where an SLA is also a dividend rental arrangement, a taxpayer may deduct the entire dividend compensation payment. The proposed amendment clarifies that where an SLA is a dividend rental arrangement, all of the dividend compensation payment is deductible, regardless of whether the taxpayer is a registered securities dealer.

These proposed amendments, if enacted, will apply to dividend compensation payments that are made on or after February 27, 2018, unless the securities lending or repurchase arrangement was in place before February 27, 2018, in which case the amendments will apply to dividend compensation payments that are made after September 2018.

Stop-loss rules on share repurchase transactions

Budget 2018 introduces proposals that would further restrict the manner in which tax losses arise on the repurchase of shares held as mark-to-market (MTM) property by financial institutions.

As noted above, Canadian corporations are generally entitled to a deduction for dividends received or deemed to be received on shares of a Canadian resident corporation. Detailed provisions then restrict or reduce the amount of any loss that may be realized on the disposition of a share in respect of which tax-free dividends have previously been received or deemed to have been received.

The applicability of these rules to financial institutions holding shares as MTM property has a long history. Much of this history appears to be at odds with the policy rationale behind the proposals in Budget 2018.

In 1998, the Department of Finance stated that a financial institution could claim a loss on a redemption of shares held as MTM property to the extent that a deemed dividend caused proceeds of redemption to be reduced below the financial institution's original cost of the share. The stated policy rationale for this decision was that the amount of the deemed dividend had already been taxed in the hands of the corporation deemed to have paid the dividend, and should not be taxed again in the financial institution's hands.

Budget 2011 introduced a stop-loss rule applicable to such transactions that limited the amount of the loss previously recognized by the Department of Finance in 1998. The formula under which the allowable loss was calculated denied only a portion of the loss – the portion of the loss equal to past MTM income realized on the shares – was allowed.

Budget 2018 goes further by introducing stop-loss proposals that would deny the entire amount of any loss related to the receipt of a tax-deductible dividend on the redemption of a share held as MTM property. Contrary to the 1998 Department of Finance position, Budget 2018 states that the tax treatment of the dividend in the hands of the redeeming shareholder, rather than the corporation deemed to have paid the dividend, is the relevant tax policy consideration driving the proposed change.

The proposed amendment, if enacted, will apply to dispositions of shares occurring on or after February 27, 2018.

At-risk rules for tiered partnerships

A limited partner of a partnership is generally not entitled to a deduction for partnership losses in excess of the partner's amount "at risk" in respect of its partnership investment (such as cash actually invested in the partnership). Losses in excess of the at-risk amount (limited partnership losses) may be carried forward indefinitely and used to the extent that the partner's at-risk amount in the partnership is subsequently increased.

In *Green v. The Queen*, 2017 FCA 107 (*Green*), the Federal Court of Appeal held that the at-risk loss limitations did not apply to a "top tier" partnership that was, itself, a limited partner of another partnership. Specifically, in *Green* the Court found that business losses earned by lower-tier partnerships could be allocated to a top-tier partnership and would retain their source as business losses without any limitation under the at-risk rules; the at-risk rules would then apply in respect of the allocation of such losses to the limited partners of the top-tier partnership. As a result, the limited partnership losses arising from the operations of a lower-tier partnership could survive indefinitely and effectively be used in the future by the members of the upper-tier partnership without there necessarily being an increase in the at-risk amount in respect of the investment in the partnership that generated the loss.

Budget 2018 responds to *Green* by proposing amendments that ensure the limited partnership at-risk rules apply in tiered partnership structures. Specifically, where a partnership is a limited partner of another partnership, losses of the lower-tier partnership are only allocated to the upper-tier partnership to the extent of the upper-tier partnership's at-risk amount in the lower-tier partnership. Losses of the lower-tier partnership in excess of the at-risk amount are not preserved as limited partnership losses (although they remain reflected in the upper-tier partnership's adjusted cost base of its interest in the lower-tier partner).

If enacted, this measure will apply to taxation years that end on or after February 27, 2018. In addition, losses for any prior taxation year that were allocated to a limited partner that is another partnership will not be available to be carried forward to a taxation year that ends on or after February 27, 2018.

Extension of mineral exploration tax credit for flow-through share investors

Resource companies can renounce or “flow-through” certain expenses related to Canadian exploration activities to their investors via flow-through shares. The investors can then deduct those expenses in computing their own taxable income. In addition, investors in mining flow-through shares can take advantage of the mineral exploration tax credit, which provides an additional deduction of 15% of mineral exploration expenses incurred in Canada that are flowed-through to investors.

Currently, the mining exploration tax credit will no longer apply to flow-through share agreements entered into after March 31, 2018. Budget 2018 proposes to extend the eligibility for the mining exploration tax credit for an additional year so that it applies to flow-through share agreements entered into on or before March 31, 2019. Pursuant to a “look-back” rule in effect, expenses that are incurred in respect of funds raised under a flow-through share agreement can be renounced with an effective date in the year that the funds were raised for the expenses to be incurred in the following calendar year.

Tax support for clean energy

Classes 43.1 and 43.2 provide accelerated capital cost allowance (CCA) rates (30% and 50%, respectively) for investment in certain clean energy generation and conservation equipment. Budget 2017 expanded the accelerated CCA rates to geothermal equipment. The favourable measures currently in place are extended by Budget 2018.

Class 43.2 is available for property that is acquired prior to 2020. Budget 2018 extends the eligibility period for class 43.2 by five years, so that property can be eligible for class 43.2 treatment if it is acquired before 2025.

International tax measures

Cross-border surplus stripping using partnerships and trusts

Generally speaking, a corporation’s “paid-up capital” (PUC) is the amount that the corporation has received as consideration for the issuance of its shares (i.e., its corporate stated capital), as adjusted pursuant to various provisions of the ITA. PUC is a valuable tax attribute, especially for a non-resident shareholder, since PUC may be reduced and returned to such shareholder free of withholding tax.

The *Income Tax Act* (Canada) (ITA) contains anti-avoidance rules aimed at preventing transactions that artificially or inappropriately increase cross-border PUC. For example, if the shares of a Canadian “subject” corporation are transferred to another non-arm’s length Canadian “purchaser” corporation in exchange for shares, the PUC of the purchaser corporation’s shares is limited to the PUC of the subject corporation shares. If non-share consideration is also received, the PUC of the purchaser corporation’s shares is further

reduced (and a deemed dividend may result if the non-share consideration exceeds the PUC of the subject corporation shares).

Budget 2018 notes that the current rules do not address the situation where a non-resident person disposes of an interest in a partnership that owns shares of a Canadian subject corporation. The government suggests that taxpayers have attempted to exploit this fact by arranging to transfer the shares of a subject corporation to a partnership, followed by the transfer of the partnership to a purchaser corporation. The government indicates that it has similar concerns with variations on this planning using trusts, both in the context of the cross-border anti-surplus stripping rule and a similar corporate immigration rule.

In response to this concern, Budget 2018 proposes a comprehensive “look-through” rule that will allocate assets, liabilities and transactions of a partnership or trust to its partners or beneficiaries based on the relative fair market value of their interests. This concept will apply for the purpose of the cross-border anti-surplus stripping rule and the corporate immigration rule.

Budget 2018 does not provide detailed legislative amendments. However, once proposed and enacted, the measure will apply to transactions occurring after February 27, 2018.

Budget 2018 makes it clear that transactions occurring prior to February 27, 2018 remain subject to challenge on the basis of the general anti-avoidance rule (GAAR). In addition, Budget 2018 indicates that the use of discretionary or similar interests for the purpose of obtaining inappropriate results under the proposed method for allocating ownership to partners or beneficiaries, as well as any other planning that seeks to indirectly achieve inappropriate results under the anti-surplus-stripping rules, are subject to challenge using the GAAR.

Foreign affiliates

Budget 2018 proposes certain modifications to the foreign affiliate rules in the ITA in response to the government’s ongoing monitoring of developments in this area.

Pooling of activities to satisfy employee test

If a foreign affiliate carries on an “investment business” the income therefrom is generally considered income from property and “foreign accrual property income” (FAPI). FAPI earned by a CFA of a taxpayer is subject to immediate accrual in the hands of the Canadian shareholders, regardless of whether it is distributed.

Generally speaking, an investment business is a business the principal purpose of which is to earn income from property. The definition is aimed at businesses that give rise to income that is generally passive or mobile. In order to distinguish an investment business from a “genuine” foreign active business, certain exceptions to the investment business definition are provided.

One of the key aspects of the exceptions relates to the number of employees required to carry on the business. Generally speaking, in order to qualify for the exception, the foreign affiliate must require the services of more than five employees (or their equivalent) full time in the active conduct of the business.

Budget 2018 notes that, in certain circumstances, taxpayers whose foreign activities would not otherwise require more than five employees have “pooled” their activities in a single

affiliate and have arranged the affairs of the affiliate so that it has a single business requiring more than five employees. Investors maintain control over their “share” of the business by using equity or contractual arrangements that effectively track their contributed assets and the income generated on such assets. The government refers to this type of planning as “tracking arrangements.”

Budget 2018 indicates that the use of these tracking arrangements to avoid categorization as an investment business is not intended. As a result, Budget 2018 proposes to introduce a rule to deem activities to constitute a separate business where income from such activities accrues to the benefit of a specific taxpayer under a tracking arrangement. Where there is more than one deemed separate business attributed to a foreign affiliate, each such business must satisfy the employee test in order to qualify for the exception from the investment business definition.

No specific legislative amendments are proposed. However, once proposed and enacted, this measure will be effective for taxation years of a foreign affiliate beginning on or after February 27, 2018.

The government cautions that the Canada Revenue Agency (CRA) may continue to challenge tracking or similar arrangements on the basis that the activities constitute, as a factual matter, separate businesses, and may also apply existing anti-avoidance rules where appropriate.

Controlled foreign affiliate status

Budget 2018 notes that similar tracking arrangements may be used to avoid CFA status. Absent such status, FAPI earned by the affiliate will not be attributed to the Canadian shareholder. If a sufficient number of unrelated Canadian taxpayers collectively pool their investments in a single foreign affiliate, it could be possible to avoid CFA status, while retaining indirect control over each taxpayer’s assets using tracking arrangements.

Budget 2018 proposes to address this concern by introducing a rule that will deem CFA status to exist if the FAPI activities of a foreign affiliate accrue to the benefit of the taxpayer under a tracking arrangement.

No specific legislative amendments are proposed. However, once proposed and enacted, this measure will apply to taxation years of a taxpayer’s foreign affiliate that begin on or after February 27, 2018.

The government again notes that it remains open to the CRA to challenge tracking arrangements (or other similar arrangements), including through the use of existing anti-avoidance rules.

Trading or dealing in indebtedness

One of the exceptions to the investment business definition applies to regulated foreign financial institutions such as foreign banks, insurance companies, trust companies, and traders or dealers in securities. Pursuant to amendments in Budget 2014, in order to qualify for the exception for regulated financial institutions, the relevant Canadian taxpayer must be similarly regulated and must satisfy certain minimum capital requirements.

A separate rule deems certain income of a foreign affiliate from trading or dealing in indebtedness to be income from property (and therefore FAPI) unless, among other

requirements, the foreign affiliate is a regulated foreign financial institution and the Canadian taxpayer is similarly regulated. In order to ensure consistency with the investment business definition, Budget 2018 proposes to apply similar minimum capital requirements to the Canadian taxpayer.

Once proposed and enacted, this measure will apply to taxation years of a taxpayer's foreign affiliate that begin on or after February 27, 2018.

Foreign affiliate reporting – T1134s due on filing due-date

Taxpayers are subject to information reporting requirements in respect of their foreign affiliates. This information is reported on Form T1134. T1134s are generally due for each foreign affiliate within 15 months after the end of the taxpayer's taxation year.

Budget 2018 proposes to align T1134 reporting with the taxpayer's general filing due-date. In other words, for corporations, T1134s will be required to be filed within six months of the end of the taxpayer's taxation year.

This measure will impose a significant compliance burden on taxpayers with multinational operations. T1134 reporting often requires the collection of significant financial information, much of which is not required to be collected or reported in the foreign jurisdiction within the six-month period proposed. In addition, taxpayers burdened with their domestic reporting obligations will now also have to deal with collecting the relevant foreign information and completing T1134 reporting.

Perhaps in recognition of the increased compliance burden, this measure, once proposed and enacted, will apply to taxation years of a taxpayer beginning after 2019.

Combatting aggressive international tax avoidance

Budget 2018 provides an update on Canada's participation in the OECD/G20's Base Erosion and Profit Shifting (BEPS) Initiative. For further information on the BEPS initiative please see our BEPS resource page. The government notes its commitment to working with international partners to improve dispute resolution, and to ensure a "coherent and consistent response" to fight international tax avoidance. Budget 2018 points to the following developments:

- Strengthening the controlled foreign corporation rules by addressing tracking arrangements in Budget 2018.
- Intending to address treaty abuse in its tax treaties (including enacting and ratifying the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* as a "high priority").
- Adoption of the revised OECD Transfer Pricing Guidelines (with additional guidance to be published during 2018).
- Adoption of country-by-country reporting requirements (and exchange of reports with other tax authorities with whom Canada has a bilateral exchange agreement or with whom an exchange relationship has been activated under the OECD multilateral competent authority agreement).
- The spontaneous exchange of information on certain tax rulings with other tax

administrations as part of a co-ordinated international effort to counter harmful tax practices.

- The provision of $38.7 million to the CRA to expand its offshore compliance activities through the use of improved risk assessment systems and business intelligence, and to facilitate the hiring of additional auditors. This will, according to the government, allow the CRA to appropriately leverage information received by the CRA as a result of the recent implementation of the OECD/G20 Common Reporting Standard that allows jurisdictions to automatically exchange information on financial accounts held by non-residents.

Extended reassessment periods

Budget 2018 proposes to give the CRA additional time to make reassessments relating to foreign affiliates, regarding the years to which a loss is carried back, and situations where a taxpayer challenges either the CRA's issuance of a requirement for information or an application for a compliance order:

- Budget 2018 proposes a three-year extended reassessment period in respect of income arising in connection with a foreign affiliate of a taxpayer. Although existing rules provide a three-year extension in respect of transactions involving the taxpayer and a non-arm's length non-resident person, the government is concerned that it does not apply in all relevant circumstances. The broader scope of the proposed extension is intended to ensure that the CRA has an opportunity to properly examine all activities in respect of foreign affiliates that are relevant to the Canadian tax base. This measure, once proposed and enacted, will apply to taxation years of the taxpayer beginning on or after February 27, 2018.
- Budget 2018 proposes to address the situation where the CRA reassesses to reduce or eliminate a loss in a taxation year resulting from a non-arm's length transaction with a non-resident but the CRA, under current rules, cannot reassess the taxation year to which that loss was carried back because the reassessment period has elapsed. Budget 2018 proposes to give the CRA six years after the normal reassessment period to reassess the year to which the loss was carried back in such circumstances. This measure, once enacted, will apply in respect of a taxation year to which a carried back loss is claimed, where such loss arises in a taxation year that ends on or after February 27, 2018.
- Where a taxpayer contests a requirement for information or an application for a compliance order, such period will not be included when computing the time limit for the CRA to reassess. This "stop-the-clock" rule is similar to the existing rule that applies for purposes of requirements for foreign-based information. This measure, once enacted, will apply to challenges instituted after Royal Assent.

Trust income tax measures

Additional filing and reporting requirements for certain trusts

In response to what the government views as significant gaps in current trust reporting

requirements, Budget 2018 announces additional filing and reporting requirements will be introduced (proposed legislation was not released). A trust resident in Canada will be required to file a tax return every year regardless of whether it has tax payable or distributes a portion of its income. In addition, the scope of what needs to be reported in certain trust returns will be expanded. Trusts resident in Canada and non-resident trusts that are required to file a return will be required to list all trustees, beneficiaries and settlors of the trust, as well as anybody who has the ability to exert control over trustee decisions. The expanded filing and reporting requirements will not apply to a number of categories of trusts, including mutual fund trusts, segregated funds and master trusts and trusts governed by registered plans.

In order to support the new requirements, new penalties will be introduced for failure to file a return with the additional information. A basic penalty will range from a minimum of $100 to a maximum of $2,500 with an additional penalty equal to 5% (with a minimum of $2,500) of the fair market value of the property held by the trust during the year where the failure to file was made knowingly, or due to gross negligence.

Once proposed and enacted, the new reporting requirements and penalties will apply to returns required to be filed for 2021 and subsequent taxation years.

Health and Welfare Trusts

The CRA has historically published its administrative position on the qualification requirements for Health and Welfare Trusts along with detailed guidance on computing taxable income of such trusts. In 2010, Employee Life and Health Trust rules were added to the ITA that are virtually identical to the CRA's administrative guidance on Health and Welfare Trusts, except that the legislation explicitly deals with certain issues that are not dealt with in the CRA's administrative guidance. In order to ensure consistency and certainty, Budget 2018 proposes that only one set of rules apply to Health and Welfare Trusts – the set of rules currently in the ITA. As such, the CRA will not apply its administrative positions with respect to Health and Welfare Trusts after the end of 2020. Transitional rules are contemplated to convert the conversion of existing Health and Welfare Trusts into Employee Life and Health Trusts.

Sales and excise tax measures

GST/HST and investment limited partnerships

On September 8, 2017, the government released legislative proposals relating to the application of the goods and services tax (GST) and harmonized sales tax (HST) to investment limited partnerships.

The September 8, 2017 proposals provide that GST/HST is applicable on the fair market value of the management and administrative services provided by the general partner to an investment limited partnership where consideration becomes due or is paid before September 8, 2017. Budget 2018 eliminates the retrospective nature of the proposal and provides that the GST/HST applies to management and administrative services rendered by the general partner on or after September 8, 2017, unless GST/HST was charged by the general partner before that date. Budget 2018 proposes that the GST/HST be generally payable on the fair market value of management and administrative services in the tax year in which these services are rendered, but does not clarify how the fair market value should be determined, or specify what should be included in the fair market value. The new rules

can also cause timing issues as, in certain cases, general partners will have to remit GST/HST to the CRA before actually receiving any payments from the partnership. Further, as the amount of GST/HST remitted to the CRA is based on the fair market value of the service at the time the service was rendered, due to timing differences, the amount of GST/HST remitted may not match the GST/HST that would have been payable on the amounts actually paid to the general partner for these services. Budget 2018 also proposes to make investment limited partnerships "investment plans," thus extending the GST/HST rules applicable to investment plans to investment limited partnerships. These measures will be effective January 1, 2019. In addition, the proposals would provide GST/HST relief to investment limited partnerships with non-resident investors where certain conditions are met. Budget 2018 also provides an ability for investment limited partnerships to make an election to be subject to the GST/HST rules applicable to investment plans as of January 1, 2018.

Consultations on the GST/HST holding corporation rules

Under the existing "holding corporation rule," a parent corporation is generally allowed to claim input tax credits to recover GST/HST paid in respect of expenses that relate to another corporation. The rule does this by deeming certain expenses of a commercial operating corporation to have been incurred in relation to commercial activities of the parent corporation. Budget 2018 announces that the government intends to consult on certain aspects of the holding corporation rule, particularly 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. The government also intends to clarify which expenses qualify under the rule. Budget 2018 indicates that consultation documents and draft legislative proposals will be released for public comment in the near future.

Cannabis taxation

Budget 2018 proposed a new excise duty framework for cannabis products under the *Excise Act, 2001*. The duty will apply to all products available for legal purchase, including fresh and dried cannabis, cannabis oils, and seeds and seedlings for home cultivation. The excise duty will generally apply to cannabis products that contain tetrahydrocannabinol (THC), the primary active compound of cannabis. The cannabis taxation program will be administered by the federal government on behalf of most provincial and territorial governments on a co-ordinated basis. Seventy-five per cent of the taxation revenues from a combined $1 per gram / 10% of the price of the product, whichever is higher, excise duty rate will flow to participating provinces and territories, with the federal government receiving the remaining 25%.

Administrative measures

Increased funding for the CRA and Tax Court of Canada

Budget 2018 provides additional funds to both the CRA and the Courts Administration Service in a number of areas including the following:

- the development of an electronic platform for processing trust returns ($79 million over a five-year period and $15 million on an ongoing basis);
- the pursuit of both domestic and international cases that have been identified through

enhanced risk assessment systems ($90.6 million over five years);
- the enhancement of security measures that protect the confidentiality of taxpayer information ($30 million over five years); and
- an investment in the Courts Administration Service in order to provide support for new front-line registry and judicial staff, most of whom are expected to support the Tax Court of Canada ($41.9 million over five years, and $9.3 million per year ongoing).

Improving customer service

Budget 2018 indicates that the government will conduct a comprehensive review of the CRA to ensure services are delivered in a client-centred way, and that Canadians interacting with the CRA feel like valued clients. Budget 2018 proposes funding to hire more agents, monitor feedback and provide more training to staff to ensure information is more accurate. In addition, Budget 2018 proposes to strengthen digital services in order to deliver a more user-friendly experience.

Sharing information for criminal matters

Budget 2018 indicates the government will enhance its ability to share tax information with its international partners concerning criminal matters. It also proposes to allow police officers to obtain taxpayer information concerning the *Excise Tax Act* for an investigation or prosecution (which can currently be done with respect to information under the ITA). Amendments to a number of acts will be proposed.

Outstanding tax measures

Budget 2018, in accordance with the government's customary disclosure of previously announced measures, confirms the government's intention to proceed with the previously announced tax and related measures, as modified to take into account consultations and deliberations since their release, including the following:

- measures confirmed in Budget 2016 to expand the scope of the GST/HST joint venture election, which had been promised in previous budget proposals;
- the measure announced in Budget 2016, on information-reporting requirements for dispositions of an interest in a life insurance policy;
- the legislative proposals released on September 16, 2016, relating to technical amendments to the ITA;
- the legislative and regulatory proposals to amend the *Excise Tax Act* released on September 8, 2017, relating to the GST/HST; and
- measures released on December 13, 2017 to address income sprinkling.

If you have any questions or require additional analysis on Budget 2018, please contact any member of our National Tax Department.