Federal budget 2019

This year's federal budget, titled *Investing in the Middle Class*, didn't introduce measures that directly impact life insurance products, living benefits products or segregated funds. Personal and corporate tax rates were unaffected as well. From an advisor's perspective, the biggest highlight from the budget may be that the Department of Finance ("Finance") is developing proposals to better accommodate intergenerational transfers of businesses.

The budget did, however, introduce two new types of annuities that certain registered plans would be permitted to provide. The budget also introduces a set of measures designed to close certain perceived tax loopholes that may affect mutual funds and the insurance and financial planning industry.

Intergenerational business transfers

The budget states that Finance is developing proposals to help better accommodate intergenerational transfers of businesses "while protecting the integrity and fairness of the tax system".

No details were released on what these measures could be, but they could have a significant impact on a business owner's succession and estate planning. The measures could be structured to facilitate intergenerational business transfers that occur either at death or during the lifetime of the business owner, or both.

Generally, individuals are deemed to dispose of their capital property on death for tax purposes for fair market value consideration. In the case of business owners, this means their shares of corporations, partnership interests or business assets. There's a tax-deferred transfer to a spouse on death, however, transfers to children are generally taxable. Farmers and fishers enjoy an intergenerational rollover of their farm or fishing property, or shares of a family farm or fishing corporation, provided certain criteria are met. This is the case for both *inter vivos* transfers as well as those that occur at death. Other business owners don't have this benefit and, as a result, they transfer their ownership interests in their businesses to their heirs on a taxable basis. The proposals Finance is developing could address this inequity.

In the case of *inter vivos* transfers, the measures could also address a potentially unfair anti-avoidance tax rule all business owners face that gives them dividend tax treatment upon selling shares of their businesses to a non-arm's length corporation (for example, a corporation owned by a family member), but lower capital gains tax treatment when their shares are sold to an arm's length corporation.

Two new types of annuities for registered plans

Registered plan holders may purchase an annuity to provide a stream of income in retirement, subject to certain conditions. An annuity purchased with registered funds must commence by the end of the year in which the annuitant is 71 years of age. With the view of increasing flexibility in retirement planning, the budget proposes to permit two new types of annuities for certain registered plans:

1. Advanced life deferred annuities (ALDA)
2. Variable payment life annuities (VPLA)

Draft amendments for these rules will be released for public comment and are to apply to the 2020 and subsequent taxation years.

Advanced life deferred annuities

An ALDA will be a type of annuity purchased under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) or a defined contribution registered pension plan (RPP).

The commencement of the annuity payment from an ALDA may be deferred until the end of the year in which the annuitant is 85 years of age, which would allow clients greater control over their income levels in retirement. Limits on purchasing an ALDA include:

- The annuity premium may not exceed 25% of the value of all property held in the qualifying plan at the end of the previous year including any amounts from the qualifying plan used to purchase ALDAs in previous years.
- A lifetime dollar limit of $150,000 from all qualifying plans – the limit will be indexed to inflation for years after 2020, rounded to the nearest $10,000.

Variable payment life annuities

PRPP and defined contribution RPP administrators will be permitted to establish a separate annuities fund under the plan to provide VPLAs.

Payments from the VPLA must be equal, except to the extent they are adjusted for the following:

- Adjusted annually to reflect changes to the Consumer Price Index, not to exceed 2% per year.
- Reduced on the death of the annuitant or the annuitant's spouse or common-law partner.
- Annual adjustment to reflect the investment performance of the annuities fund.
- Annual adjustment to reflect the mortality experience of the pool of VPLA annuitants.

A VPLA must commence payments by the end of the year in which the annuitant is 71 years of age or the end of the calendar year in which the VPLA is acquired. Only transfers from a member's account will be permitted. A minimum of 10 retired members are required to establish a VPLA plan, with the expectation of at least 10 retired members will participate on an on-going basis.

Measures to close tax loopholes

The budget introduces measures affecting mutual funds and individual pension plans which are intended to make the tax system fairer.

Mutual funds trusts

The budget includes new measures that would deny mutual fund trusts a deduction in respect of:

- The portion of an allocation made to a unitholder on a redemption of their units of the mutual fund trust that is greater than the capital gain that would otherwise have been realized by the unitholder on the redemption, subject to certain conditions. This rule specifically targets situations where a mutual fund trust has allocated capital gains from the disposition of fund assets in excess of the unitholders redemption capital gain, allowing for the potential creation of a capital loss to offset the capital gain allocated from the fund – leading to an inappropriate deferral of the taxation of the excess amount for remaining unitholders.

- An allocation made to a unitholder on a redemption in certain situations to target the conversion of ordinary income to capital gains for remaining unitholders when redeeming unitholders hold their units on income account and remaining unitholders holder their units on capital account.

These measures will apply to taxation years of mutual fund trusts that begin on or after March 19.

Mutual fund corporations

The character conversion rules were first introduced as part of Budget 2013 to curb the use of a "derivative forward agreement" to convert ordinary income into capital gains. As part of these rules, there was an exception for certain commercial transactions (merger and acquisition transactions). Alternative character conversion transactions have been developed by tax professionals which attempt to plan around the commercial transaction exception. Budget 2019 introduces an additional qualification to meet the commercial transaction exception that looks at the main purpose of the transaction. Generally, this measure will apply to transactions entered into on or after March 19.

Individual pension plans

Individual pension plans ("IPPs") are registered plans which provide retirement benefits to owner-managers in respect of their employment. If an individual terminates membership in a defined benefit registered pension plan, there's a tax-deferred rollover available of the pension's commuted value to another defined benefit plan sponsored by another employer or up to 50 per cent of the commuted value to their RRSP or similar registered plan. Planning to obtain a rollover of 100 per cent of the commuted value has been created where individuals set up a corporation and an IPP to receive all the pension's commuted value. To prevent this type of planning, the budget proposes to prevent tax-deferred transfers of assets from a former employer's defined benefit plan to an IPP, by preventing the IPP from providing retirement benefits in respect of past years of employment that were pensionable under a defined benefit plan of another employer. These measures apply to pensionable service credited under an IPP on or after March 19.

Other notable items from the Budget 2019

Other measures that Budget 2019 proposes to introduce include:

- Increase the Home Buyer's Plan withdrawal limit to $35,000 from $25,000. As a result, a couple will potentially be able to withdraw $70,000 from their RRSPs to purchase their first home.

- Limit the stock option deduction for high-income individuals employed at "large, long-established, mature firms" through the use of an annual cap on the deduction. Full details of this measure will be released before summer of 2019.

- Remove certain limitations that prevent a registered disability savings plan from remaining open while the beneficiary is ineligible for the disability tax credit. The assistance repayment amount is also modified based on the beneficiary's age. This measure will apply after 2020.

- Confirmation of the Government's intention to proceed with measures announced in:

    - Budget 2016 on information reporting requirements for certain dispositions of an interest in a life insurance policy.
    - Budget 2018 to facilitate the conversion of Health and Welfare Trusts to Employee Life and Health Trusts
    - Budget 2018 to implement enhanced reporting requirements for certain trusts to provide additional information on an annual basis

- New Canada Training Credit, being a $250 refundable tax credit to provide financial support to help pay for up to half of eligible tuition and fees associated with training.