2018 Federal Budget Highlights

February 27, 2018

Finance Minister Bill Morneau presented the highly anticipated 2018 Federal Budget this afternoon. Fortunately, there were no significant changes to investment income as there were no changes to capital gains rates, stock options, or the overall passive income tax rate.

Changes to investment income earned in a corporation

None of the anticipated changes that were originally included in the July 2017 proposal relating to investment income earned in a corporation were introduced. Instead, the government introduced these two measures. The new measures below are effective for tax years beginning after 2018.

Investment income impact on small business limit

The budget introduces a reduction in the small business limit for corporations, and its associated corporations, that earn passive investment income in excess of $50,000. For every $1 of investment income earned over $50,000, the small business deduction limit is reduced by $5. Once the corporation, and its associated corporations, earn $150,000 of passive investment income, no income will be taxed at the small business rate.

Passive investment income includes taxable dividends[1] but does not include any capital gains from the sale of assets used in the active business or incidental income. An example of how this grind works is shown here:

Active business income qualifying for the small business tax rate under new business limit ($)					
Business income	**Investment income**				
	50,000	75,000	100,000	125,000	150,000
50,000	NOT AFFECTED				0
75,000					0
100,000					0
200,000				125,000	0
300,000			250,000	125,000	0
400,000		375,000	250,000	125,000	0
500,000		375,000	250,000	125,000	0

Note: Assumes that the corporation has less than $10 million of taxable capital.[2]

There is no change in tax rates to venture capitalists and angel investors. For example - ABC Co. (a Canadian private corporation) runs an active business and uses the profits from that business to invest in shares of another Canadian active corporation. The capital gains realized on the sale of these shares will not impact ABC Co.'s small business deduction.

Refundable taxes changes

Prior to the budget, taxes paid by a corporation on investment income had a portion that was refundable to the corporation when dividends were paid. These dividends did not necessarily have to relate to the investment income that was earned. As a result, the corporation would get their refund of 38.33% on every dollar of dividend that was paid out. The taxpayer could receive this as an eligible dividend and could pay tax at the preferred rate of 39.34% as opposed to paying an ineligible dividend at the tax rate of 46.65%. These are the rates at the highest marginal tax rate. Under the new rules, the dividend has to be an ineligible dividend. An exception to this new rule is for eligible portfolio dividends. These can still flow through to individual shareholders.

[1] Dividends from non-connected corporations

[2] Table per 2018 "Tax Measures – Supplementary Information" issued February 27, 2018