# Weekly Updates Issue # 653

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## 1. Weekly Markets Changes

**[March 2, 2018]**

| S&P TSX | S&P 500 | Dow Jones | NASDAQ | CAD/USD | Gold | WTI Crude |
|---|---|---|---|---|---|---|
| 15,384.59<br>-253.9 -1.62% | 2,747.30<br>-56.05 -2.04% | 24,538.06<br>-771.9 -3.05% | 7,257.87<br>-79.52 -1.08% | $0.7757<br>-1.37c -1.74% | $1,322.75<br>-5.95 -0.45% | $61.25<br>-2.30 -3.62% |

## 2. In 2017, Canadian economy grew more than twice as fast as 2016

**[March 2, 2018]** The Canadian economy expanded at a pace of 1.7% over the final three months of 2017, a rate that was below the rapid growth seen in the first half of the year, Statistics Canada reported Friday.

The agency's latest numbers for real gross domestic product showed the economy grew 3% for all of 2017, which was a much stronger pace than 2016 when growth was 1.4%.

The fourth-quarter expansion of 1.7% came in higher than growth in the third quarter, which was revised to 1.5% from 1.7%.

Growth in the fourth quarter was driven by a 2.3% increase in business investment compared with the third quarter, and a 0.5% quarter-over-quarter rise in household spending, the report said.

For all of 2017, the agency said household spending easily made the biggest contribution to growth, followed by inventory and business investment. Exports also grew for the second-straight year with gains in both goods and services.

"Much of this growth was attributable to the first two quarters of 2017, with deceleration observed toward the end of year," the report said.

Avery Shenfeld, managing director and chief economist of CIBC Capital Markets, said in a Friday statement that Q4 GDP growth "matched our call for a below-consensus 1.7% pace, and Q3 was revised down two ticks to 1.5%."

But he's not disappointed, given "final domestic demand—what Canadians are buying—remained hot at a 3.9% pace in Q4, matching Q3," he adds. "Q4 was better than it looks on the surface given the health in domestic demand."

The 3% figure for 2017 matches the projection by private-sector economists that was included in Tuesday's federal budget. The budget predicts real GDP growth of 2.2% in 2018 and 1.6% next year.

Statscan revised its real GDP numbers upward for the first and second quarters of 2017.

For the first quarter, the estimate was increased to 4% from 3.7%. For the second quarter, revised growth was 4.4%, up from its initial reading of 4.3%.

By industry throughout 2017, the report said the growth was "widespread" with 18 of the 20 sectors showing increases.

Goods-producing industries expanded 4.6%, compared to two-straight annual contractions of 0.5% in 2016 and 1.7% in 2015. The biggest contribution to growth from the goods-producing industries in 2017 came from natural resources extraction, which expanded 7.8%.

Services industries expanded 2.8% last year for their highest pace of growth since 2011. It was led by a 7.5% boost from the wholesale-trade sector.

## 3. Morneau, WTO weigh in on Trump's planned tariffs

**[March 2, 2018]** Finance Minister Bill Morneau says he has told his American counterpart that Canada believes its steel and aluminum exports should be exempt from new tariffs on steel and aluminum that are planned by President Donald Trump.

Morneau told a Montreal business audience Friday that he had a "constructive" discussion on Thursday with U.S. Treasury Secretary Steven Mnuchin.

Morneau said Canada is a "staunch and permanent ally" of the United States and shouldn't be affected if Trump declares a matter of national security to override trade rules and raise U.S. tariffs on steel and aluminum.

Trump said Thursday that he plans to announce a 25% tariff on steel and a 10% tariff on aluminum that would go into effect next week.

It isn't yet known if Trump will exempt Canada, which is the largest steel and aluminum exporter to the United States.

Morneau declined to say whether he believes Trump's action might unleash a global trade war.

**WTO concerned about U.S. plans**

The World Trade Organization warned Friday that U.S. President Donald Trump is risking an economically damaging trade war if he goes ahead with plans to impose steep tariffs on steel and aluminum imports.

Roberto Azevedo, the director-general of the Geneva-based WTO, said the agency was "clearly concerned" at the U.S. plans and warned that "a trade war is in no one's interests."

"The potential for escalation is real as we have seen from the initial responses," he said in comments emailed to The Associated Press by a WTO spokesman.

Azevedo said the WTO, the body that oversees global trade, "will be watching the situation very closely."

By taking on Trump's remarks directly, Azevedo is signalling a tougher stance toward the U.S. leader. The Brazilian-born lawyer has often treaded delicately when referring to Trump's leadership of the world's largest economy—even reacting cautiously when Trump criticized the WTO on the campaign trail.

His more muscular language follows a flurry of worries from key U.S. trading partners in Europe over Trump's tariff plans.

The European Union is already thought to be considering retaliatory tariffs, roughly one-third of which would target steel, one third agriculture, and one third other products.

## 4. Budget shows feds are behind on infrastructure spending

**[March 2, 2018]** New figures in this week's federal budget suggest billions of dollars from the Liberal government's vaunted infrastructure program now won't be spent until after Canadians go to the polls next year.

The sluggish pace of federal infrastructure spending has been a persistent burr under the saddle of a government that rode to power on a promise to ramp up spending for roads, bridges, community centers, transit and water systems to stimulate the economy.

Tuesday's budget showed more than $3.8 billion from Phase 1 of the plan—which was supposed to be spent by the end of the month—won't be totally out the door until at least 2021.

The second phase of spending, which is still subject to negotiations with the provinces and territories, has also seen its funding moved around. The government now says more than $3 billion won't be spent until at least 2025, with the majority of that spending to take place in 2028.

And that might not be the end of it, since the budget also warns that further adjustments may have to be made over time.
A spokesman for Infrastructure Minister Amarjeet Sohi says the new numbers reflect when the government expects to receive expense claims from cities and provinces, a process that often creates a lag between when work takes place and when the federal money is spent.
In some cases, the government won't receive receipts until after a project is completely finished. In other cases, projects are delayed because of labour strife, bad weather or other factors beyond Ottawa's control.
Sohi spokesman Brook Simpson said the budget changes reflect that reality.
"It is not a reflection of project activity, which is well underway on the majority of the more than 4,000 projects Minister Sohi has approved, and which the Bank of Canada has noted are contributing to the country's economic growth," Simpson said.
The Liberals hope to sign funding agreements by the end of this month for $33 billion in upcoming infrastructure spending overseen by Sohi. Provinces are pushing for more leeway in how they use the money, fearing they lack the fiscal capacity to match federal spending, which is why they want to use Liberal funding for projects already on the books rather than do more as the federal government wishes.
Sohi announced last month that the federal government would pick up more of the cost for projects in small communities—60%, up from 50%— and cover 75% of costs for Indigenous projects, partly to find provinces some of that fiscal wiggle room.
The Liberals have also told provinces they have until the end of the month to allocate unspent cash from a fund set up by the previous Conservative government.
The budget shows that just over $1 billion from Conservative funds is being delayed until after next year's election, with a further $2.4 billion scheduled for beyond 2023.
Big city mayors asked Finance Minister Bill Morneau to speed up the pace of affordable housing money to help them deal with a backlog of repairs. That didn't happen, leading Brock Carlton, CEO of the Federation of Canadian Municipalities, to say the budget dropped the ball on the housing file.
"There is a missed opportunity here to kick-start the social housing repair dollars so they're later on in the cycle, and we needed them up early now," Carlton said.
"The problem is now. The crisis is now."

The budget did add $1.25 billion to a loan program to help finance construction of affordable rental units, adding to the $2.5 billion unveiled in Budget 2016.
The Liberals predict the new money will go further than the original injection: potentially 14,000 units over three years versus the 10,000 units over five years predicted in Budget 2016.
The Canada Mortgage and Housing Corporation opened the first $625 million in loans under the program to bids last year, and the head of the agency has said it was over-subscribed by a factor of five.

## 5. Trump's steel, aluminum tariffs unwelcome even among supporters

**[March 2, 2018]** The Trump administration is being lobbied hard to spare Canada from planned tariffs on steel and aluminum, with even supporters of the U.S. president decrying the idea of penalties on the northern neighbour as ill-conceived and counter-productive.
News that Donald Trump is considering broad tariffs on the global steel and aluminum industry prompted members of his own party to warn of fractured alliances, rising costs for consumers, and unintended economic and geopolitical consequences.
He says final details are coming next week.
So far, he's evincing a damn-the-torpedoes attitude:" Trade wars are good, and easy to win," the president tweeted Friday, arguing that the U.S. import-export deficit means it can afford to slow global trade.
But past and present U.S. military figures, a usually Trump-friendly editorial board, a supportive union, fellow Republicans and even companies that would otherwise benefit from tariffs, have urged Trump not to impose them on the U.S.'s No. 1 seller: Canada.
That includes the editorial page of the Wall Street Journal. Normally a Trump cheering corner, the opinion section of the pro-business newspaper ran an editorial titled," Trump's Tariff Folly: His Tax On Aluminum and Steel Will Hurt the Economy and His Voters."
It noted that Canada supplies more steel to the U.S. by orders of magnitude than China— the supposed target of this tariff.
" The tariffs will whack that menace to world peace known as Canada, which supplies 16% [of U.S. steel imports]," said the paper.
" Canada buys more American steel than any other country. […] Mr. Trump is punishing our largest trading partner in the middle of a NAFTA

renegotiation that he claims will result in a much better deal. Instead he is taking a machete to America's trade credibility.

" Why should Canada believe a word he says?"

Trump is hearing the same from the military.

The ostensible excuse for these tariffs is that foreign steel undermines U.S. national security, making emergency measures legitimate. Trump plans to use a provision in U.S. law that allows the president to impose tariffs if it's a security matter. His administration has indeed declared it a security issue, and Trump says he's leaning toward bigger penalties than many expected—a 25% global tariff on steel and 10% on aluminum.

But Trump's own defense secretary, James Mattis, undermined the case for tariffs in a letter released several days ago. He said the military had more than enough steel for its needs, expressed concern broad tariffs would hurt key allies, and urged that any tariffs be narrowly focused.

Numerous Republican politicians have also urged the president to narrow his focus, from the broad tariff plans he has signaled.

The administration has been hearing this for months.

As it prepared its national-security study, witness after witness suggested Canada be exempted like it was from U.S. steel actions in the early 2000s and 1980s. Meanwhile, not one witness specifically called for tariffs on their northern neighbour.

A retired U.S. army brigadier-general, John Adams, an expert on the defense-industrial complex, testified that he supported tariffs, with one exception:" The one supplier in whom I have complete confidence is Canada." He added that Canada should bolster its monitoring of dumped imports.

Two of the people in the room with Trump when he announced his tariffs Thursday, and who mostly support his action, expressed similar pro-Canada views.

Michael Bless, chief executive of the Century Aluminum Company, said in his submission to the U.S. government:" As a contiguous, friendly neighbor, Canada is a safe and reliable source of supply. In Century's view, [these penalties] can be effective without applying it to Canada."

John Lapides, president of a fourth-general family aluminum mill, said in his submission to the Department of Commerce study:" We are in favor of international trade. Canada, for example, produces ingot and the slabs used for hot rolling essential to U.S. rolling mills and the downstream value chain."

Both were in the cabinet room with Trump for the tariff announcement.

Other companies made such submissions to the U.S. government.

Bob Prusak, chief executive of Magnitude 7 Metals, testified that he opposed sanctions relief for anyone, with one exception:" Other than Canada."

Marco Palmieri of Novelis North America said the aluminum industries of the U.S. and Canada are intertwined, Canada plays a vital role in U.S. aluminum manufacturing efforts, and that," to ensure the viability of the U.S. aluminum industry, the Department should exclude Canada from any remedy recommendation made in its final report."

The United Steelworkers union strongly favours tariffs—but not in Canada. The politically active union has members in both countries, and its president, Leo Gerard, is originally from Ontario.

Its written submission called for a Canadian exemption. Its statement following Trump's preliminary announcement repeated the demand.

" All this BS," Gerard said in an interview, when asked earlier this week about the prospect of Canada being targeted." Canada should just be excluded—period. We have an integrated economy. And if it gets undone, America will pay a heavy price."

Several countries, including Canada, have hinted at retaliation if the U.S. imposes tariffs.

Some trade-watchers say that's the biggest danger here: not simply that prices might rise for goods in the U.S., and fall on commodities elsewhere, but that turning national-security excuses into a trade weapon will prompt other countries to follow suit, and lead to escalating feuds that tear at the post-Second World War trading order.

## Will China follow through on retaliation threats?

China had no immediate reaction Friday to U.S. President Donald Trump's vow to impose high tariffs on steel and aluminum, which he followed up by insisting that trade wars "are good, and easy to win."

Chinese leaders have threatened in the past to retaliate if Trump raises trade barriers, but now need to weigh whether to back up those threats with action and risk jeopardizing U.S. market access for smartphones and other exports that matter more to their economy than metals.

"China will definitely respond. It doesn't want to be seen as weak. But it will be relatively restrained," said economist Louis Kuijs of Oxford Economics. "They don't want to be seen as a party that is wrecking the international trading system."

Global stock markets fell sharply Friday over worries of a possible trade war following Trump's announcement that he will levy tariffs of 25% on steel and 10% on aluminum.

Beijing has accused Trump of undermining global trade regulation by taking action over steel, technology policy and other disputes under U.S. law instead of through the World Trade Organization.

Chinese officials have appealed to the White House since last March to avoid hurting both sides by disrupting aluminum trade. Their tone hardened after Trump launched a probe in August of whether Beijing improperly pressures companies to hand over technology and in January raised duties on Chinese solar modules and washing machines.

"China will take necessary measures to defend its interests," a Commerce Ministry official, Wang Hejun, said in a statement this week.

Japan and South Korea, both U.S. allies and major exporters of steel and aluminum, said they would ask for exemptions from the tariff hike, which Trump justified in part on national security grounds.

"We don't think imports from Japan, an ally, have any effect at all on U.S. national security," said Japan's trade and industry minister, Hiroshige Seko, at a news conference.

A South Korean trade envoy, Kim Hyun-chong, met with Trump's chief economic adviser, Gary Cohn, and Commerce Secretary Wilbur Ross to "strongly demand" they keep the impact on South Korean companies to a minimum, according to a trade ministry statement.

The president of the European Union's governing body, Jean-Claude Juncker, said the 28-nation trade bloc will retaliate if Trump follows through.

"Risks of trade wars are rising, but should be contained for now," said Cesar Rojas and Ebrahim Rahbari of Citigroup in a report. "We expect U.S. major trade partners' reaction to be moderate, including by taking cases to the WTO."

Adding to the political stakes in China, Trump's announcement came ahead of next week's meeting of its ceremonial legislature, the year's most prominent political event. Action against American companies or goods would compete for attention with the National People's Congress, which the ruling Communist Party uses to showcase its economic plans.

Beijing has an array of high-profile targets for retaliation including suppliers of soybeans, the biggest American export to China. A curb on purchases could hurt farm state voters who supported Trump.

"We've clearly heard from the Chinese [that soybeans] are definitely one of the largest things that could be targeted," said Jake Parker, vice-president for China operations for the U.S.-China Business Council.

However, Parker said, soybeans might be held for use later on a bigger issue such as the "301" investigation into Beijing's technology policy, which could have a broader impact.

Trade makes up a smaller share of China's economy than it did a decade ago. But export-driven industries support millions of jobs, raising the potential political cost of any disruption.

The United States, China's second-largest trade partner after the EU, buys about 20% of Chinese exports but allows Beijing to run multibillion-dollar surpluses that offset its deficits with other partners.

Last year, China exported goods worth $2.80 to the United States for every $1 of American goods it bought, according to Chinese data. Its trade surplus of $275.8 billion with the United States was equal to 65% of its global total.

"That makes China the more vulnerable partner in this," said Kuijs.

Also Friday, the Commerce Ministry expressed "grave concern" about a trade policy report sent to the U.S. Congress by the White House this week that accuses China of moving away from market principles. It pledges to prevent Beijing from disrupting global trade.

The ministry said Beijing has satisfied its trade obligations and appealed to Washington to settle market access and subsidy disputes through negotiation.

## 6. Highlights from budget 2018

**[February 27, 2018]** From this year's federal budget, your business owner clients will most want to know about clarified rules for passive investment income, which are effective for 2019.

Combined with the changes to income sprinkling, the changes to passive investment income rules are expected to save the government $925 million a year by 2022-23, reveals the budget.

And, while the budget offered no direct response to the competition from a stateside corporate tax cut, it did say that "over the coming months, the Department of Finance Canada will conduct detailed analysis of the U.S. federal tax reforms to assess any potential impacts on Canada."

A main theme in the budget was help for working women and women in business. The government says it will make $1.4 billion available over three years in new financing for women entrepreneurs through the Business Development Bank, as well as $250 million over three years through Export Development Canada for financing and insurance for women-owned and women-led businesses.

The government will also spend $1.2 billion over five years and $344.7 million a year afterward for a new employment insurance parental sharing benefit that would provide additional "use-it-or-lose-it" benefits for non-birthing parents of eligible two-parent families, mainly to encourage women to re-enter the workforce.

The government's projected deficits are roughly in line with October projections. The new outlook shows a $18.1-billion shortfall for 2018-19 that's expected to gradually shrink to $12.3 billion in 2022-23, including annual $3-billion cushions to offset risks.

### Highlights

Courtesy of an EY tax alert and PwC analysis, here are other budget highlights to share with clients:

- **Proposed new reporting requirements for trusts.** Effective 2021, trusts must report the identity of all trustees, beneficiaries and trust settlors.
- **Medical expense tax credit.** This credit will be enhanced to include eligible expenses incurred after 2017, relating to psychiatric service animals. "Expenses will not be eligible if they relate to an animal that provides only comfort or emotional support," notes PwC.
- **Mineral exploration tax credit.** The credit, equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors, will be extended to flow-through share agreements entered into before Apr. 1, 2019. The credit was scheduled to expire on Mar. 31, 2018.
- **Canada workers benefit (CWB) to replace working income tax benefit (WITB).** The budget proposes to strengthen the WITB by introducing the CWB, a refundable tax credit, effective 2019. The maximum benefit will be $1,355 for single people without dependants (an increase of $170 in 2019) and $2,335 for families. In addition, the disability supplement will be increased to $700 in 2019.

EY notes the CWB will be reduced for single individuals with income in excess of $12,820, and families with income of more than $17,025. The credit will be fully eliminated for those with incomes in excess of $24,111, and families with incomes in excess of $36,483.

Access to the CWB will also be improved: the budget proposes to allow CRA to determine a person's eligibility for the benefit even when not specifically claimed, effective 2019 and later years.

EY also points out who's not eligible for the CWB. That includes people with no dependants who are enrolled as full-time students at certain institutions for more than 13 weeks in a tax year.

Further, says EY, "Budget 2018 proposes that designated educational instructions be required to report to the CRA prescribed information regarding students' enrolment after 2018."

- **Contributions to enhanced portion of Quebec pension plan (QPP).** Quebec's government recently announced that the QPP would be enhanced in a manner similar to the CPP enhancement announced in

2016. To provide consistent treatment of CPP and QPP contributions, the budget proposes to amend the Income Tax Act to provide a deduction for employee contributions to the enhanced portion of the QPP. This measure will apply to the 2019 and subsequent taxation years.

Says EY: “For individuals who are employees, a tax credit will continue to apply to the employee share of the contributions to the base (i.e., existing) QPP. For self-employed individuals, this measure will ensure the individual is able to deduct both the employee and employer share of contributions to the enhanced portion of the QPP.”

- **RDSP permitted plan holders.** The Income Tax Act includes a temporary measure for certain family members to be plan holders of a registered disability savings plan (RDSP) for adults who might not be able to enter into contracts, due to doubts about the capacity of such adult individuals. The measure is set to expire at the end of 2018, so the budget proposes to extend it by five years to the end of 2023.

Adds EY: “If a qualifying family member becomes a plan holder of an RDSP before the end of 2023, they can remain as the plan holder after 2023.”

**Other budget measures to note**

- To help crack down on tax cheats, the government will spend $90.6 million over five years to address cases that have been identified both domestically and internationally.
- Ottawa is moving to improve tax rules to prevent what it said was typically Canadian banks and other financial institutions from gaining a tax advantage by creating artificial losses through sophisticated financial instruments. The move is expected to generate roughly $2.5 billion for the government over five years.
- The government says it will clarify the application of at-risk rules for limited partnerships to prevent unintended tax advantages.
- A total of $155.2 million over five years will be allocated for a new Canadian Centre for Cyber Security, while another $116 million over five years is allocated for the RCMP to create a National Cybercrime Co-ordination Unit.
- Spending of $75 million over five years, with $11.8 million a year afterward, aims to bolster Canada’s trade ties with China and Asia.

The budget says it will obtain feedback form pensioners, workers and companies affected by insolvencies that involve substantial unfunded pension liabilities.

The budget also confirmed it will proceed with previously announced measures, including income sprinkling rules, which were clarified in December 2017, and the lowering of the small business tax rate to 10% on Jan. 1, 2018 (from 10.5%) and to 9% on Jan. 1, 2019.

Other measures going ahead are the indexation of the Canada child benefit starting July 1, 2018, and the reduction in the gross-up factor for non-eligible dividends to 16% (from 17%) for 2018 and to 15% for 2019 and subsequent years.

Says EY: "The effective dividend tax credit (expressed as a percentage of the grossed-up amount of a non-eligible dividend) will be reduced from 10.5% to 10% for 2018 and 9% for 2019 and subsequent years."

### Changes to funny money

The budget includes an initiative to seek authority to remove legal tender status from Canadian bank notes. This authority would match the authority the government already has for coins issued by the Royal Canadian Mint.

"The Bank of Canada supports this initiative because it can help [us] ensure that bank notes used by Canadians are current, in good condition, easy to use and difficult to counterfeit," says the central bank in a release.

Affected notes are the $1, $2, $25, $500 and $1,000—but Canadians don't need to worry about these notes losing their value.

Once authority is granted, the Bank of Canada says it "will provide clear information to Canadians on how to redeem the affected bank notes," which would involve a period during which notes can be redeemed through financial institutions.

The central bank adds, "After this period, the notes can be redeemed directly through the Bank of Canada."

## 7. All about the Liberals' EI Parental Sharing Benefit

**[February 27, 2018]** The Trudeau Liberals took baby steps in their bid to reshape the social safety net Tuesday with a new, "use-it-or-lose-it" leave option for new parents and a modest increase in the value of a rebranded tax benefit for low-income workers.

The government's third budget—coming on the heels of two that created an income-tested child benefit and a long-term funding commitment to child care—promised new parents the ability to share either five or eight additional weeks of leave following the birth of a child, provided they also share the job of caring for the baby.

Measures proposed Tuesday would give eligible two-parent families, including adoptive and same-sex couples, five additional weeks if they've opted for the traditional 12-month parental leave, or eight weeks under the new 18-month option introduced late last year.

There won't be any boost in benefits for the extra weeks off, unlike the higher benefits provided under a similar program in Quebec. Nor will eligibility rules be changed to follow Quebec's lead, as experts had urged the Liberals to do.

The government hopes the measures will push more non-birthing parents to take more time to care for a newborn, allowing mothers to get back into workforce sooner. The budget document notes that women accounted for 92% of parental benefits paid through EI during the 2015-2016 fiscal year, the most recent numbers available, suggesting a wide gender divide when it comes to caring for an infant.

How many non-birthing parents take the leave may be small given how the Liberals have set up the program, said Angella McEwen, an economist with the Canadian Labour Congress.

The option isn't expected to come into effect until June 2019, just ahead of a federal election where parties will be currying political favour with middle-class families trying to foot the bill for raising children.

The budget also promises to allow new mothers and those on sick leave to keep more of their employment insurance benefits if they work just a few hours every month.

The government doesn't expect the working-while-on-claim provisions—long a pilot project that the budget makes permanent—to change the number of Canadians working while on maternity leave. The budget document says the measure is targeted at low-income households facing a financial squeeze that requires them to work.

In an article posted by BenefitsCanada.com, Nora Spinks, chief executive officer of the Vanier Institute of the Family, says the benefit will mean that work and family is about parents and caregivers—and not just about women.

"It's going to mean policies and programs may need to be adjusted to include the new diversity, in terms of dads on parental and paternity leave […]," she says in the article, noting that some of the messaging around benefits may need to shift. "The good news is they've recognized the diversity of families today, and so any employer that has a diversity and inclusion initiative, it makes it much easier for them to say, 'We're providing gender equity for leaves and benefits.'"

The next question for employers will be what level of top-up benefit they're going to provide, Spinks adds. "We don't have a good baseline of data on who's topping up. We do know that Quebec tends to top up more because it's much easier for an employer to top up when the replacement rate is 75 per cent and the top up is only 20 or 25, as opposed to trying to top up when it's 40 or 45."

### Canada Workers Benefit

The Liberals are also targeting low-income workers with a rebranded benefit—dubbed the Canada Workers Benefit—that will enrich and expand eligibility at a cost of $1 billion. For workers earning at or below the poverty line, the changes will mean an extra $170 a year to a maximum of $1,355 for unattached workers, and $2,335 for couples or single parents.

The Liberals estimate that 300,000 more workers will take advantage of the benefit, but not until the 2019 tax year, meaning the refunds won't actually arrive until 2020.

But the measure lacks real teeth to make a serious dent in poverty rates, said economist Armine Yalnizyan, who noted that the changes may affect how much families receive in provincial and housing benefits. The tax refund will also be delivered annually—a potential problem for low-income families that often budget month-to-month.

"It definitely doesn't lift that many people above the poverty rate," Yalnizyan said. "You definitely can't call it an anti-poverty measure."

Workers are targeted in other areas of the budget: extra benefits to employees who lose out on pay, vacation and severance when an employer files for bankruptcy; a promise to review the rules around protecting pensions; $90 million over three years to speed up processing of EI claims; and an extra $127.7 million over three years to make sure Canadians with EI questions can get through to someone at a call centre.

Paying for all the new measures will mean a bump in EI premiums paid by both employers and employees. The increase will come into effect in the fiscal year beginning in April, and continue an upward trend after taking into account new measures in Tuesday's budget.

## 8. Post-budget passive income strategies

**[February 27, 2018]** It's what small business owners have been waiting for ever since the federal government released its July proposals: clarity on how passive income will be treated.

While tax experts say the new rules are clearer and simpler, there are disadvantages.

The Canadian Federation of Independent Business points out in a release that some businesses will lose access to the small business tax rate for past investments. That's because the $50,000 to $150,000 threshold encompasses

all passive income, regardless of whether the asset was acquired before or after Budget Day.
The government's changed tack was largely unexpected, says Matthew MacAdam, partner and leader for tax services in Nova Scotia at Grant Thornton.
"I don't think the business world was necessarily [ready for this]—all indications were that it was going to go a different route," he says.
He says he feels for clients who transferred passive assets into their corporations ahead of the budget, "thinking they were doing themselves a favour," only to realize today that their passive income will cause the corporation to lose some of its small business deduction starting in 2019.

## Rental income: passive or active?

CRA said in 2016 that "the specified investment business rules make it clear that if a corporation's only business is […] to earn income from renting out real property, it is not eligible for the small business deduction."
Matthew MacAdam of Grant Thornton points out that if a professional owns a property and rents out extra space to an unrelated party (e.g., a doctor renting office space to an accountant), that income is considered passive.
Aaron Schechter, tax partner at Crowe Soberman LLP in Toronto, says that private corporations with large accrued gains will bear the brunt of the new rules. "If they liquidate those investments in a particular year, they can find themselves without access to the low corporate tax rate for the year in question."
Since the new rules take effect in the 2019 tax year, Schechter says it may be possible to act now.
"If the corporation plans to liquidate [their passive] investments in the next year or two, and they're also earning business income, then it may make sense to take the hit this year," he says. "But if they have long-term holdings, it probably pays just to hold on to those investments and liquidate them slowly so there's no grind down of the small business deduction limit." He adds that a future government may reduce the corporate tax rate or change the rules again, reducing the tax hit of realizing gains in the distant future.
Besides, Schechter says, the majority of people who hold passive investments in their corporations do so for long-term purposes, not short-term.

## Choosing passive investments

MacAdam says the $50,000 passive income threshold only encompasses taxable income, so "if you shifted your investment strategy to [earn] less interest and more capital gains, then your threshold may go a little bit further."
He adds that clients could consider tax-efficient investments such as those that

generate return of capital (e.g., systematic withdrawal plans), non-dividend-earning stocks and ETFs that don't make annual distributions.

"You can say these rules, to some degree, also impact the investment choices that some Canadians are making," says MacAdam. He emphasizes, however, that the tax tail shouldn't wag the investment (or business) dog.

"In some cases, the proper business decision is to have that war chest of passive investments to be able to fund a downturn or make the next acquisition or grow the business," he says. "It's those businesses you feel concern for, because you don't want see situations where businesses are forced to make decisions solely on tax motivations."

### Active investments exempted

In positive news, the new measures will not encompass capital gains from the sale of active investments.

Schechter defines "active investments" as assets "used in your active business," and provides two examples.

"If you have a piece of real estate, like a building used in your operations, and you decide to sell it, ordinarily, the capital gain on that asset would have been considered to be passive income. They're going to exclude that from the passive income [pool] so it won't count toward the grind down of the small business deduction limit."

Another example: if you sell shares of a subsidiary, "that also will not grind down your small business deduction limit."

Schechter says there's no brightline test to differentiate active and passive assets. "I don't know if the government needs to address what is going to be considered to be an active asset unless they start seeing abuses, […] and I can't think of a way a company would be able to circumvent these rules."

He also points out that the rules prevent one person from setting up two different corporations, one to hold active assets and the other to hold passive investments "and be able to circumvent the rules."

## Have a nice and fruitful week!