The Top 6 Canadian Private Client Tax Predictions for 2019

Kim G C Moody FCPA, FCA, TEP
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We're coming up to that time of year when tax writers flood the blogosphere with tax tips to consider before the end of the calendar year. While our firm is not completely immune to that (we'll be discussing some of these usual tips in an upcoming webinar), the purpose of this blog is not to recycle the standard considerations. Instead, we'll once again shine up our crystal ball and see what the future might bring for tax changes.

The next calendar year will likely see many tax changes in Canada and the United States. However, 2019 is a Canadian federal election year which likely means any dramatic and controversial changes will be pushed to post-election, however, we fully anticipate no shortage of promises or "goodies" to try and entice voters. Accordingly, the focus of this blog will be on predicting 2019 Canadian tax changes. However, I am mindful of some wise philosophers' comments on predictions. For example, the 6th century B.C. poet Lao Tzu stated: "*Those who have knowledge, don't predict. Those who predict, don't have knowledge."* More recently, author Edgar R. Fielder stated in his 1977 book *The Three Rs of Economic Forecasting-Irrational, Irrelevant and Irreverent*: "*He who lives by the crystal ball soon learns to eat ground glass."* Well, consider this a knowledge-less attempt at 2019 predictions where I'm sure to learn the taste of ground glass.

1. No Corporate or Personal Tax Rate Reductions

As regular readers of our blogs likely know, I believe that our Canadian personal tax rates are too high after the federal government decided to create a new tax bracket for "high income" earners (for income in excess of $200,000 – and indexed for each year thereafter) that increased the top personal tax rate by 4%. The result of this has been less than successful with the federal government not even coming close to raising the expected tax revenues from this new tax bracket. Surprise. When people feel that their income is unfairly taxed, they will enter into behaviour to try to defer or avoid such high rates. In the last 2+ years of the increased tax rates, our experience is that this measure has caused significant avoidance behaviour. It has also negatively impacted the ability of companies to attract skilled labor from abroad.

Notwithstanding, our current government does not appear interested in tax rate reductions, which is unfortunate. While Canada should not race to the bottom on personal or corporate tax rate reductions, it should be mindful of risks to our country's competitiveness – especially with US tax reform that occurred earlier this year. We cannot ignore the gorilla in the room.

My prediction: the November 21, 2018, economic update and the 2019 year will see no personal or corporate tax rate reductions.

2. Private Corporations and Their Shareholders Will Struggle Mightily With the New "Income Splitting" Rules – the "Tax on Split Income" ("TOSI")

Introduced as part of July 18, 2017, private corporation tax proposals and now law effective January 1, 2018, the 2019 year will include the first filings – both personal and corporate – that will be impacted by the new TOSI rules. This will be the "rubber hits the road" moment and business owners and their advisors who have ignored the rules for the last year or so will struggle mightily in applying the rules. This prediction doesn't take much talent. It's almost inevitable that the prediction will come true since the TOSI rules are practically incomprehensible and apply to a very broad audience. One of the only ways that our firm could make sense of the new legislation was to put such material into a flowchart format. Have a peek at our flowchart here.

My prediction: as stated, practitioners and business owners will struggle in applying these new rules. Without a change of government in the election, these rules won't change. With a change in government, there may be some hope for modifications or possibly a repeal of such rules.

3. No Comprehensive Tax Review / Reform

I have been very vocal over the years about the need for comprehensive tax review/reform. Many of my tax peers/colleagues have also been vocal. The last time Canada had comprehensive tax review/reform was from 1962 – 1966 as a result of The Royal Commission on Taxation or the so-called "Carter Commission" named after the leader of the Commission – Kenneth Carter. The result of the Commission was the release of its landmark recommendations in 1966. After much study and debate, many of the recommendations formed the basis for the 1972 tax reform. Canada and society in general have changed dramatically since 1972. Canada has responded to some of the changes with various amendments to the Income Tax Act over the years. Unfortunately, the Act has become a patchwork quilt of amendments that is extremely difficult to navigate with many provisions arguably outdated or in need of an update. However, our current federal government does not appear interested in engaging in comprehensive tax review/reform. Accordingly, I do not see this important need addressed.

My prediction: there will be no introduction of a new "Royal Commission" on taxation during 2019. However, if there is a change in the federal government as a result of the election, there might be a small chance that a new government would implement a comprehensive tax review/reform.

4. No Change to Capital Gains Inclusion Rates

In advance of many of the recent federal budgets, there is usually common concern and questions amongst the tax community as to whether or not capital gains inclusion rates will rise from its current 50% rate. I think this is simple to predict this year. Given that it's an election year in 2019, I don't think our current government wants to be associated with a capital gains inclusion rate increase. Such a measure would have wide-spread application and ultimately would influence voters, many of them negatively.

My prediction: no capital gains inclusion rate increase for 2019.

5. "Surplus Stripping" Amendments

July 18, 2017, private corporation tax proposals contained amendments to make it difficult to withdraw after-tax surplus from a corporation and not have such amounts taxed as a dividend. One can appreciate that these surplus stripping proposals had some solid footing in tax policy

(especially when you consider that the only way – by accounting definition – that you remove after-tax retained earnings from a corporation to its shareholders is through a dividend). As most readers know, the government thankfully backed down from the proposed surplus stripping amendments. The proposals were so technically deficient and poorly drafted that it needed a complete rethink. However, this is likely not the end of the story, and one can envision surplus stripping being attacked again soon. Do I think it will be in 2019?

My prediction: no, but it wouldn't surprise me if new and better thought-out proposals were released. However, I think the better bet is that such proposals would be released after the 2019 federal election. As part of the surplus stripping retreat, the government did promise that it would review current succession planning arrangements where businesses are transferred to non-arm's length parties. Currently, business succession plans to non-arm's length parties can be at a disadvantage compared to transfers of businesses to arm's length parties (since the lifetime capital gains deduction can often be utilized in arm's length transfers but restricted or unavailable in non-arm's length transfers). It would not surprise me if proposals to improve non-arm's length transfers were released in 2019.

6. **Principal Residence Exemption Amendments**

The taxation of capital gains (which previously were untaxed) was introduced as part of the 1972 tax reform. However, the reform included provisions that exempted an individual's gain from the disposition of his/her "principal residence" from taxation. These rules went largely unchanged until 1981 when amendments were introduced to require married couples to share the principal residence exemption. And in 2016, the principal residence exemption was again amended to restrict the claiming of the exemption for properties held by trusts.

The 2018 Report on Federal Tax Expenditures predicts that the principal residence exemption will cost the federal government $6.1B in 2019, a material amount. I believe that parliament never envisioned that the principal residence exemption would enable many millions of dollars of appreciation of a principal residence property to be sheltered from capital gains taxation – especially in metropolitans like Vancouver and Toronto. When you compare principal residence exemptions available in other countries – like the US – a case can be made that Canada is perhaps overly generous with its principal residence exemption. It's likely time for a review. However, many Canadians view the principal residence exemption as sacred. Will we see changes to the principal residence exemption in 2019?

My prediction: no. Not in an election year. But it wouldn't surprise me if a future government tackles this sacred tax exemption to restrict it.

Well, there you have it. My predictions, not yours. I'm sure I'll have to endure the taste of ground glass, but until that time, I intend to look into my shiny crystal ball and start planning to buy a new one next year.