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BUDGET **2012**

Changes from old age security to disability savings plans rules may affect you.

Budget breakdown

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The Department of Finance released its 2012 Federal Budget on March 29, 2012. Personally speaking, this year's budget seemed a little underwhelming – a couple of measures were introduced to curb certain advantages, a few other proposals seemed designed only to simplify current rules.

For this issue of *The MoneyLetter*, I will focus a bit more on the personal and corporate tax measures that would affect you, the individual.

Personal Tax Changes

Old Age Security

One area where change had been expected relates to seniors' retirement income.

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The age of eligibility for Old Age Security and Guaranteed Income Supplement ("OAS/GIS") will be increased from 65 to 67 years old starting April 2023, with full implementation in place by January 2029. This measure will not affect anyone who is 54 years of age or older as of March 31, 2012.

In addition, the ages for the allowance and the allowance for the survivor will increase to 66 from 62 starting April 2023 (currently, the age range is 60 to 64 years old). As of July 1, 2013, individuals will be allowed to voluntarily defer their OAS pension for up to five years in order to receive a higher actuarially-adjusted annual pension.

Group Sickness or Accident Insurance Claims

Currently, employer contributions to Group Sickness or Accident Insurance Plans regarding wage replacement benefits are not considered to be taxable benefits.

However, the budget proposes to change this so that contributions made after 2012 will now be taxable benefits, unless they are in respect of wage replacement benefits payable on a periodic basis.

Moreover, any benefits under the Plan will also be taxable if they are payable where there is no loss of employment income. And in case you are thinking of arranging for an earlier contribution in 2012 to avoid these rules, think again; the budget states that you will still recognize this taxable benefit in 2013.

Registered Disability Savings Plans

The budget contained numerous measures relating to Registered Disability Savings Plans ("RDSPs"). Here is a summary of these proposals:

☞ To permit, on a temporary basis, certain family members (such as parents, spouses, and common law partners) to become plan holders of an RDSP for adults who might not be able to enter into contracts.

This will be in place for a limited time starting the date of Royal Assent of the budget until the end of 2016.

☞ To introduce some changes to the repayment rules with respect to Canada Disability Savings Grants ("CDSGs") and Canada Disability Savings

Bonds ("CDSBs").

These are currently required to be repaid if received within 10 years of withdrawal from the RDSP, upon termination or deregistration of the plan or if a beneficiary ceases to be eligible or dies.

Instead, a proportional repayment rule would apply (as before, this does not apply if the beneficiary ceases to be eligible or dies). This would require that only $3.00 of any CDSGs or CDSBs received in the prior 10 years be repaid for every one dollar withdrawn from an RDSP.

Accordingly, if you make a small withdrawal from an RDSP, this would not necessarily require the full repayment of all assistance received in the previous 10 years.

This measure shall apply to withdrawals after 2013.

☛ Change the maximum/minimum withdrawals from RDSPs to be effective after 2013.

The maximum limit is proposed to be increased to the greater amount determined by the standard formula and ten per cent of the fair market value of plan assets, and the minimum annual withdrawal requirement will apply to all RDSPs – and not just a primarily government-assisted plan.

☛ To allow investment income earned in an RESP to be transferred on a tax-deferred basis to an RDSP after 2013. This "rollover" treatment would require that the plans have a common beneficiary, among other conditions.

Note that the amount of the investment income to be rolled over cannot exceed the available contribution room, which will be reduced accordingly by the amount of income rolled into it.

☛ To extend the period that an RDSP may remain open when a beneficiary no longer becomes eligible for the disability tax credit.

In order for this measure to apply, the plan holder must make an election in prescribed form on or before December 31 of the year following the first calendar year in which the beneficiary is no longer eligible for the Disability Tax Credit.

☛ This election will generally be valid until the end of the calendar year following that first full calendar year for which the beneficiary is no longer eligible for the disability tax credit.

This measure will apply to elections made after 2013.

Employee Profit Sharing Plans

The Federal Budget proposed a special tax payable by a specified employee on an "excess EPSP amount" – this measure is aimed to reduce the ability of business owners to split income with low-income family members and to minimize or defer income tax on profits.

This special tax will be levied on employees who have significant equity interest in their employer or who do not deal at arm's length with the employer.

An "excess EPSP amount" will be the portion of an employer's EPSP contribution (allocated by the plan trustee to a specified employee) exceeding 20 per cent of the specified employee's salary received in the year from the employer.

This tax payable will be equal to the top marginal combined tax rate (except for Quebec residents whose provincial component will be nil).

A new deduction will be introduced to ensure that an excess EPSP amount is not also subject to regular income tax.

A specified employee will not be able to claim any other deductions or credits in respect of an excess EPSP amount.

This measure generally applies to EPSP contributions made by an employer on or after March 29, 2012.

Note: the CRA does have the discretion to waive this tax.

Retirement compensation arrangements

The Budget proposes new prohibited investment and advantage rules for Retirement Compensation Arrangements ("RCAs") similar to those that currently apply to TSFAs, RRSPs and RRIFs.

An RCA is a type of employer-sponsored, funded retirement savings arrangement. These rules will apply to RCAs with beneficiaries who hold a significant interest in their employers.

The new measures prevent RCAs from engaging in non-arm's length transactions as well as proposing a new restriction on RCA tax refunds in circumstances where RCA property has lost value.

If RCA property has declined in value, the RCA tax will be refunded only in circumstances where the decline in value of the property is not reasonably attributable to prohibited investments or advantages, unless the CRA is satisfied that it is just and equitable to refund the tax. This measure will apply to contributions made on or after

March 29, 2012.

The prohibited investment rules apply to investments acquired, or that become prohibited investments, on or after March 29, 2012. The advantage rules generally apply also on or after March 29, 2012, subject to certain transitional rules.

Miscellaneous Measures

Here are a number of tax credits and other personal measures announced:

✓ Medical expense tax credit – For 2012 and later years, the budget expands the list of expenses eligible for the medical expense tax credit to include blood coagulation monitors and related supplies for use by individuals who require anti-coagulation therapy.

✓ Mineral exploration credit – The mineral exploration tax credit, equal to 15 per cent 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 on or before March 31, 2013.

This program, initially introduced in 2000, was previously extended and scheduled to expire on March 31, 2012.

Ontario Budget 2012: New and noteworthy

Two days before the release of the Federal Budget, the Ontario Liberals released their 2012 budget. Although not as lengthy and wide in scope as the Federal Budget, the Ontario budget did contain at least a couple of noteworthy measures, mostly in the corporate tax realm.

Corporate Tax Freeze

Back in 2009, the McGuinty government said it would incrementally reduce the Ontario general corporate income tax rate from 14 per cent (in 2009) down to 10 per cent by July 1, 2013.

However, that incremental reduction has been brought to a halt in this year's budget. Rather than continue with the reduction, the Ontario Government proposes to postpone the rate reductions which were scheduled for 2012 (down to 11 per cent) and 2013 (down to 10 per cent), and to maintain the corporate income tax rate at the current level of 11.5 per cent. This rate is proposed to remain until Ontario's budget is balanced, which the Ontario Government anticipates will happen in 2017-2018.

Corporate tax rates were not the only measure experiencing the cold weather. The Ontario Budget also proposes to temporarily freeze the Business Education Tax reduction plan as of 2013 (note: the rate reductions already in place will remain). Again, the Ontario Government anticipates that this freeze will thaw once the budget is balanced in 2017-2018.

Tax Avoidance in Ontario

Taking a cue from tax-avoidance legislation in Quebec, the budget proposes to engage with stakeholders and the Feds to consider measures to fight aggressive tax planning in Ontario by mitigating the impact of tax-avoidance transactions and identifying those who facilitate or participate in tax evasion schemes.

In addition, the Ontario government will also remain diligent in ensuring that income and losses are allocated to the province where the underlying economic activity has occurred.

Employer Health Tax

The Ontario Budget proposes to strengthen its administrative practice in using federal rulings to assist in determining whether an employee-employer relationship exists to ensure that employers pay their fair share of the Employer Health Tax (EHT). For EHT assessments issued after March 27, 2012, Ontario will no longer be bound by federal rulings on this issue for purposes of EHT.

Research & Development Review

Further to the findings of a federal panel on scientific research and experimental development tax credit system ("SRED"), Ontario announced it will continue to review the effectiveness of tax credits for research and development. The province also agreed with the federal panel that there is a need for greater federal-provincial collaboration in this area regarding tax support.

The federal government is reviewing recommendations that would reduce federal tax support and simplify the SRED tax credit program.

Retail Sales Tax Refunds and Rebates

The Ontario Budget proposes to shorten the Retail Sales Tax (RST) refund and rebate periods. Currently, you are entitled to apply for a rebate or a refund of RST until the time limits for claiming them have expired (e.g., a refund for RST paid in error must be made within four years of the payment), or June 30, 2014, whichever is earlier. The proposed amendment would require applications for rebates or refunds of RST to be made on or before December 31, 2012.

The current rebate and refund periods would continue for RST paid on insurance premiums or private transfers of used vehicles.

– Samantha Prasad

✓ **Cross border shopping** – Effective June 1, 2012, the budget proposes to increase the exemption to $200 from $50 for returning Canadian residents who are out of the country between 24 and 48 hours.

The budget similarly proposes to increase exemption levels for travellers who are out of the country for 48 hours or more to $800. This new threshold will replace the current 48 hour exemption of $400 and the current seven day exemption of $750.

✓ **Life insurance policy exemption test** – The budget proposes a number of changes that will apply to life insurance policies issued after 2013.

Charities

Generally, gifts by Canadians to foreign charities are not eligible for the charitable donation tax credit or deduction, although certain foreign charitable organizations may register as a qualified donee.

The budget proposes to provide the Minister with the discretion to grant qualified donee status to a foreign charity if the charity pursues disaster relief or urgent humanitarian aid, or its activities are in the national interest of Canada.

This measure will apply to applications made by foreign charities on or after the later of January 1, 2013 and Royal Assent.

The budget also proposes to increase the disclosure required by charities regarding political activities and to provide additional enforcement tools.

An additional proposal would grant the CRA the authority to suspend the tax-receipting privileges for one year to a charity that exceeds the limitations on political activities. This would also allow the CRA to impose similar penalties where a charity provides inaccurate or incomplete information in its annual information return (until the charity provides the required information).

These measures will also apply to registered Canadian amateur-athletic associations.

Tax Shelters

As tempting as tax shelters can sound, you should always ensure that the tax shelter is properly registered with CanRev, and that you get accurate tax advice.

So if you're considering investing in a tax shelter, note that the budget proposes new measures to encourage tax shelter registration and reporting.

Corporate Tax Changes

Eligible dividend designations

When the eligible dividend rules were introduced some years ago, one of the rules required that a corporation may designate a taxable dividend to be an eligible dividend if it notified each shareholder in writing before or at the time of the dividend being paid – no late designation was allowed.

Moreover, there were specific rules relating to an excessive eligible dividend being declared, so that the corporation could file an election to make the excess a taxable dividend to avoid the 20 per cent penalty tax.

In order to simplify these rules, the budget proposes to allow a corporation to designate (at the time it pays a taxable dividend) any portion of the dividend to be an eligible dividend.

The portion of the taxable dividend that is designated to be an eligible dividend will qualify for the enhanced dividend tax credit for eligible dividends, and the remaining portion will qualify for the dividend tax credit for non-eligible dividends.

Additionally, the CRA will now be allowed to accept a late designation of an eligible dividend if the corporation makes the late designation within the three-year period following the day on which the designation was first required to be made.

These measures will apply to taxable dividends paid on or after March 29, 2012. ❑

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