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2011 Federal Budget

Canada's Economic Action Plan – The Next Phase

Minister of Finance Jim Flaherty delivered the Federal Budget on March 22, 2011, in times of both economic and political uncertainty in Canada. Budgets often contain measures to garner support from the opposition and with various measures for families, seniors, low income taxpayers and businesses; this is a budget of a minority government.

The Economic Action Plan has been central to the last two budgets, with the current budget billed as “The Next Phase” to that initiative. The government re-affirmed its commitment to economic expansion and job creation. With managed and focused spending initiatives, the government has projected a \$29.6 million deficit for 2011-2012, returning to a surplus position in 2015-2016.

This year's budget contained no new changes to personal or corporate income tax rates or to corporate tax rate reductions that were previously announced.

The following is a summary of the main tax measures contained in the 2011 Budget Speech.

Elimination of Corporate Tax Deferral on Partnership Income

Under current tax legislation a corporate member of a partnership will include its share of partnership income in the corporate tax year that includes the partnership year end. When the partnership year end is after the corporate year end, corporate tax on the partnership income is deferred.

The 2011 Budget contains tax measures to counter the increasing use of partnerships in a business group for the sole purpose of providing a corporate tax deferral. The proposed changes apply to a corporate partner (other than a professional corporation) that has a different year end than the partnership in which it has a right (together with affiliated and related parties) to receive more than 10% of partnership income (or assets on partnership wind-ups).

The budget proposed changes that would require a corporate partner to include an additional amount (i.e. an accrual of “stub period income”) for partnership income that relates to a partnership fiscal period that begins in the corporate tax year but ends in a subsequent corporate tax year. A new partnership stub-period income is calculated the following year, with a reversal of the prior year partnership stub period inclusion.

Since these tax changes can significantly affect cash flow, corporate partners are allowed to include the deferred partnership income over a five year period following the corporation’s first tax year ending after March 22, 2011. Complex transitional rules apply to this new tax measure and elections to change year ends may be permitted and/or required.

Multi-tiered partnerships were also affected by the government’s scrutiny of structures that allow a tax deferral. Under proposed budget changes, partnerships in a multi-tiered partnership structure would be required to have the same year end.

Accelerated Capital Cost Allowance for Manufacturing and Processing Equipment

The 50% CCA rate (straight line, subject to half year rule) on class 29 manufacturing and processing equipment is extended to eligible 2012 and 2013 equipment purchases.

Accelerated Capital Cost Allowance for Clean Energy Generating Equipment

The budget expands equipment eligible for the 50% per year declining CCA rate of Class 43.2 for clean energy generation equipment. Equipment qualifies if acquired on or after March 22, 2011 and is used to generate electrical energy in a process that derives all or substantially all of its energy from waste heat.

Stop-Loss Rules on the Redemption of a Share

Stop-loss rules generally reduce the loss on a share redemption by the tax-free dividends received on the disposition. For redemptions on or after March 22, 2011, the budget proposals extend the application of the stop-loss rules to deemed dividends received by corporations on redeemed shares, regardless of whether the company holds these shares directly or indirectly through a trust or partnership. Shares of a private company held by another private company are excluded in most situations.

Qualifying Environmental Trusts

The budget expands the definition of a qualifying environmental trust (which provide for the pre-funding of site reclamation and restoration) to include a trust established to cover costs associated with the abandonment of a pipeline.

Employee Profit Sharing Plans (EPSPs)

Out of concern of undue shifting of income to family members and CPP and EI avoidance, the Department of Finance says it will be reviewing existing rules.

Intangible Capital Expenses in Oil Sands Projects

The cost of oil sands leases and other oil sands resource property will now be treated as Canadian oil and gas property expense (COGPE), eligible for a 10% per year deduction instead of current treatment as Canadian development expenses (“CDE”), eligible for a per year 30% declining balance deduction.

Instead of being fully deductible in the year incurred, pre-production development expenses of oil sands mines will be treated as CDE, eligible for a per year 30% declining balance deduction.

Hiring Credit for Small Business

The 2011 Budget announced a temporary Hiring Credit for Small Business of up to \$1,000 on the excess of 2011 employment insurance premiums over those paid in 2010.

This one-time credit is available to employers with 2010 total employment insurance premiums of \$10,000 or less.

Mineral Exploration Tax Credit

The budget proposes to extend eligibility for the mineral exploration tax credit for one year to March 31, 2013, to flow-through share agreements entered into on or before March 31, 2012.

Charities

There are new tax measures for charities including: requirement that a qualified donee be disclosed on a publicly available CRA list; suspension of a donee’s receipting privileges or revocation of its qualified donee status; monetary penalties to charities issuing improper receipts; a registered Canadian amateur athletic association (“RCAAA”) have as its exclusive purpose the promotion of nation-wide amateur athletics; the extension to RCAAAs of current CRA requirements for registered charities regarding the public disclosure of information and CRA enforcement measures; and qualified donees required to issue a revised donation slip when property is returned to the donor.

Family Caregiver Tax Credit

Effective January 1, 2012, the budget introduces a new 15% non-refundable tax credit on a \$2,000 base amount. The credit will be indexed to inflation beginning in 2013. The credit is available to caregivers of infirm dependent relatives including spouses, common-law partners and minor children. The credit will be available through an enhanced amount for currently available dependant credits being the spousal, child, eligible dependent, caregiver and infirm dependant credits.

In addition, the threshold income amount where the Infirm Dependant Credit is phased out will be increased for 2012 so that the income phases out matches the spousal credit.

Medical Expense Tax Credit

The budget proposes to remove the current \$10,000 limit on the eligible medical expenses that caregivers can claim in respect of financially dependent relatives. This proposal applies to 2011 and later years.

Children's Arts Tax Credit

The budget introduces a new 15% non-refundable Children's Arts Tax Credit for children under 16 years of age at the beginning of the year. The credit is available starting in 2011 on up to \$500 of qualifying artistic, cultural, recreational or developmental activities. Special provisions apply to children under 18 years of age at the beginning of the year who are eligible for the Disability Tax Credit.

Volunteer Firefighters Tax Credit

The budget introduces a new tax credit which will apply to 2011 and later years. The budget allowed eligible volunteer firefighters to claim a 15% non-refundable tax credit based on an amount of \$3,000. Government offices that pay firefighters amounts for their services as volunteers will be required to report the amount as part of their annual remuneration.

Child Tax Credit - repeal limit per domestic establishment

Current rules provide that not more than one individual can claim the credit in the same home even if the home is shared by two families. The budget proposes to repeal the rule and will apply to 2011 and later years.

Tuition Tax Credit – Examination Fees

The budget proposes to amend the Tuition Tax Credit to recognize fees paid to an educational institution, professional association, provincial ministry or other similar institution to take an examination that is required to obtain a professional status recognized by federal or provincial statute, or to be licensed or certified in order to practice a profession or trade in Canada.

The measures will apply to eligible amounts paid in respect of examinations taken in 2011 and later years.

RESPs – Asset Sharing Among Siblings

Parents and grandparents who want to save for a number of related children and grandchildren may open family plans, which are subject to the same contribution limits that apply to other RESPs but provide additional flexibility for the subscriber by allowing the allocation of plan assets among the related children, subject to certain restrictions.

To provide subscribers of separate individual plans with the same flexibility to allocate assets among siblings as exists for subscribers of family plans, the budget proposes to allow transfers between individual RESPs for siblings, without tax penalties and without triggering repayment of Canada Education Savings Grants, provided that the beneficiary of a plan receiving a transfer of assets had not attained 21 years of age when the plan was opened.

These measures will apply to asset transfer that occurs after 2010.

RRSPs – Anti-Avoidance Rules

The budget proposes several changes to the RRSP rules to address concerns regarding the use of RRSPs in tax planning schemes.

The budget proposes to introduce the following rules similar to the anti-avoidance rules that currently apply to Tax-Free Savings Accounts (TFSA's):

- the advantage rules;
- the prohibited investment rules; and
- the non-qualified investment rules

Under the TFSA rules, an "advantage" may generally be described as a benefit obtained from a transaction that is intended to exploit the tax attributes of a TFSA. Benefits from "RRSP strip transactions" will be specifically included in the RRSP advantage concept. The amount of tax payable in case of a benefit will be the fair market of the benefit and, in case of a debt, the amount of debt.

The budget introduces a "prohibited investment" concept for RRSPs, based closely on the TFSA prohibited investment rules. Prohibited investment generally includes debt of the TFSA holder and investment in entities in which the TFSA holder has a significant interest or which the TFSA holder does not deal at arm's length. A special tax equal to 50% of the fair market value of the investment will apply to an RRSP holder on acquisition of a prohibited investment by his or her RRSP.

Examples of non-qualified investments include shares in private investment holding companies or foreign private companies, and real estate. Under the budget proposal, an RRSP holder will be subject to a special tax of 50% of the fair market value of a non-qualified investment.

Subject to two exceptions, these new provisions will apply to transactions occurring, and investments acquired, after budget day.

Individual

Individual Pension Plans (IPP)

Defined benefit Registered Pension Plans (RPPs) are sometimes established for one main income earner, generally an employee of a corporation that he or she controls. Sometimes a spouse or other family member is also added as a member of such a plan. The budget proposes two new tax measures that will apply to these plans.

The budget proposes that annual minimum amounts will be required to be withdrawn from the IPP, similar to current minimum withdrawal requirements from Registered Retirement Income Funds (RRIFs), once a plan member attains the age of 72.

The budget also proposes that contribution made to an IPP that relate to past years of employment will be required to be funded first out of a plan member's existing RRSP assets or by reducing the individual's accumulated RRSP contribution room before new deductible contributions in relation to the past service may be made.

For this purpose, an IPP will be a defined benefit RPP:

- with three or fewer members, at least one member is related for tax purposes to an employer that participates under the pension plan; or
- that is a designated plan, if it is reasonable to conclude the rights of one or more members under the plan exist primarily to avoid this new definition.

This measure will apply to IPP past service contributions made after budget day.

Registered Disability Savings Plan (RDSP) – Shortened Life Expectancy

RDSP beneficiaries who have shortened life expectancies will be allowed to withdraw annual withdrawals without triggering the 10-year repayment rule, subject to specified limits and certain conditions. This will apply after Royal Assent. An election to use the 2011 limit in 2012 will be available with the medical certification obtained prior to 2012.

Tax on Split Income

The “tax on split income” limits income splitting techniques that seek to shift taxable dividends and partnership income from a high income individual to a lower income minor.

The budget proposes to extend the tax on split income to capital gains realized by, or included in the income of, a minor from a disposition of shares of a corporation to a person who does not deal at arm's length with the minor, if taxable dividends on the shares would have been subject to the tax on split income.

This measure will apply to capital gains realized on or after budget day.

Donations of Publicly Listed Flow-through Shares

Flow-through shares are treated as having a cost of zero for the purpose of calculating any gain or loss on their disposition. As a result, when an investor holding only flow-through shares sells them, the full amount of the proceeds received is recognized as a capital gain for tax purposes. The exemption from capital gains tax on donations of publicly listed securities allows the donor to avoid the capital gains tax.

The budget proposes, in general term, to allow the exemption from capital gains tax on donations of shares of a class in which a taxpayer acquired shares issued pursuant to a flow-through share agreement entered into and after the budget day only to the extent that cumulative gains in respect of dispositions of shares of that class exceed the original cost of the flow-through shares.

The budget proposes that if a share, or a right to acquire a share, of a particular class of the capital stock of a corporation is issued to a taxpayer under a flow-through share agreement entered into on or after budget day, the exemption from capital gains tax on donations of publicly listed securities will be available in respect of a subsequent donation by the taxpayer of a share of that class only to the extent that the capital gain on the donation exceeds a threshold amount at the time of donation.

The proposed rules will apply where a taxpayer acquires shares issued pursuant to a flow-through share agreement entered into and on or after budget day.



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