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**FEDERAL BUDGET
COMMENTARY**

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BUDGET COMMENTARY

On March 29, 2012 federal Finance Minister Jim Flaherty introduced his 2012 budget entitled “Jobs Growth and Long-Term Prosperity”. The budget forecasts a deficit of \$24.9 billion for 2012, a \$4.7 billion improvement compared to what was forecasted in the 2011 federal budget. For 2013 the deficit is forecast to be \$21.1 billion, falling to \$10.2 billion for 2014 and to \$1.3 billion in 2015. Based on an improved economic outlook the government is forecasting a balanced budget commencing in 2016.

After a detailed review of departmental spending the Minister announced \$5.2 billion of expenditure restraints which will be fully realized by 2017.

According to the Minister the economic output in Canada is now well above the pre-recession levels, and more than 610,000 jobs have been created since the recovery began in 2009, the best performance in the G-7 countries.

Although there were no changes to the corporate or personal tax rates, beyond the previously announced corporate income tax reductions, the 2012 Ontario budget which was released on March 27, 2012 did include a proposal to cancel cuts to the Ontario general corporate income tax rate. As a result, the Ontario rate will remain at 11.5% when on July 1, 2012 it was expected to be reduced to 11%. The Ontario rate for Canadian controlled private companies (CCPCs) on the first \$500,000 of active business income will remain at 4.5%. Once Ontario returns to a balanced budget which is estimated to be in 2017-2018 the previously announced corporate income tax reductions would resume.

The main focus of this budget relates to innovation and research and development funding. The budget proposes \$1.1 billion over the next five years for direct research and development support, \$500 million for venture capital initiatives and \$205 million for a one year extension of a temporary hiring credit for small businesses. In addition, the budget includes steps for streamlining the scientific research and experimental development program and to increase funding for small and medium sized companies.

Other budget measures announced, some of which will be discussed in more detail on the following pages, include:

- age requirement changes for Old Age Security pension benefits commencing in April 2023;
- new rules for Retirement Compensation Arrangements;
- small number of new eligible medical expenses commencing in 2012;
- eligible dividends - new options for split dividend elections and late designations;
- changes to the GST/HST reporting options for small businesses;
- improved application of GST/HST relating to a number of health care services;
- increase in Duty-Free cross border shopping limit commencing June 1, 2012;
- phase out of the production of the penny commencing in the fall of 2012;

As was the case in the past two federal budgets, generally speaking this budget can be characterized as a cautious or timid budget that contains no major surprises or significant shifts in the government’s economic or fiscal policy.

PERSONAL TAX CHANGES

Personal tax rates

There are no individual tax rate or tax bracket changes in this budget.

Old Age Security and Guaranteed Income Supplement

Eligibility age

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

Age of eligibility for survivor benefits increasing

In line with the age increase for OAS/GIS eligibility, the ages at which the Allowance and the Allowance for the Survivor will increase to 62 to 66 years starting in April 2023. The current age range is 60 to 64 years.

Option to defer OAS pension

Starting on July 1, 2013, individuals will be allowed to voluntarily defer their OAS pension, for up to five years. These individuals will then receive a higher actuarially adjusted annual pension.

Group sickness or accident insurance plans

The budget proposes to treat employer's contributions to a group sickness or accident insurance plan as a taxable benefit in the year the contributions are made to the extent they are not in respect of a wage-loss replacement benefit payable on a periodic basis. This measure will not affect the tax treatment of private health services plans or certain other plans.

This measure applies to employer contributions made on or after March 29, 2012 relating to coverage after 2012.

Retirement compensation arrangements (RCA)

A RCA is a type of employer-sponsored, funded retirement saving arrangement. The budget proposes new prohibited investment and advantage rules for RCAs similar to those that currently apply to TFSAs, RRSPs and RRIFs. These rules will apply to RCAs with beneficiaries who hold a significant interest in their employers.

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

In addition, where RCA property has declined in values as a result of a prohibited investment or advantage, the RCA refund may be restricted. This measure will apply in respect of RCA tax on RCA contributions made on or after March 29, 2012.

Mineral exploration tax credit

The 15% mineral exploration tax credit helps companies raise capital for mining exploration by providing an incentive to individuals who invest in flow-through shares issued to finance exploration. The credit was scheduled to expire on March 31, 2012. The budget proposes to extend the mineral exploration credit for an additional year, until March 31, 2013.

Medical Expense Tax Credit

The list of expenses eligible for the Medical Expense Tax Credit will now include blood coagulation monitors for use by individuals who require anti-coagulation therapy, including certain associated items, when they are prescribed by a medical practitioner. This measure will apply to expenses incurred for 2012 and later years.

BUSINESS TAX CHANGES

Corporate tax rates

There are no changes to the corporate income tax rates or to the \$500,000 small business income limit of a CCPC.

Hiring credit for small business

The budget proposes a one-year extension of the temporary hiring credit for small businesses introduced in the 2011 budget. To be eligible, the employer's total 2011 Employment Insurance (EI) premiums must have been no greater than \$10,000. The maximum credit, based on the increase in its 2012 EI premiums over those paid in 2011, is \$1,000.

Eligible dividends - split dividend designation and late designation

The budget proposes that a corporation may designate all or a portion of a dividend it pays, at the time of the dividend payment, as an eligible dividend. This measure will simplify administrative compliance and eliminates the need to actually pay separate dividends.

Under the budget proposal, the Canada Revenue Agency will 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.

Accelerated Capital Cost Allowance (CCA) for clean energy generation equipment

Class 43.2 assets are eligible for an accelerated CCA deduction (50% per year on a declining balance basis). Continuing with the theme of prior budgets, the budget includes an enhancement to Class 43.2 with respect to waste-fuelled thermal energy equipment, and equipment of a district-energy system that uses thermal energy provided primarily by eligible waste-fuelled thermal energy equipment. In addition, it proposes to expand Class 43.2 to include equipment that uses plant residue, generally produced by the agriculture sector, for generation of heat and electricity.

These measures apply to assets acquired on or after March 29, 2012 that have not been used or acquired for use before this date.

Taxation of corporate groups

In the 2010 federal budget, the government announced that it was going to explore whether new rules for the taxation of corporate groups, including tax loss consolidation or loss transfer rules, should be considered to improve the functioning of the corporate tax system. This topic is still under discussion.

INDIRECT TAX CHANGES

GST/HST streamlined accounting thresholds

Most small businesses can elect to use the Quick Method of accounting to determine the amount of GST/HST to remit.

The budget proposes that the annual taxable sales threshold at or below which eligible businesses can elect to use the Quick Method will increase to \$400,000 (from \$200,000) of GST/HST-included taxable sales.

This measure will be effective for reporting or claim periods beginning after 2012.

GST/HST health measures

The budget proposes changes to improve the application of GST/HST to a number of health care services, including pharmacists' services, corrective eyewear and certain medical devices and drugs.

GST rebate for books

The budget proposes to allow charity and qualifying non-profit literacy organizations to claim a rebate of the GST and the federal portion of the HST they pay to acquire printed books to be given away.

This measure will apply to acquisitions and importations of printed books in respect of which tax becomes payable after March 29, 2012.

CHARITIES CHANGES

Engaged in political activities

A charity is allowed to engage in political activity as long as the activities represent a limited portion of its revenues. The government is concerned that charities may be exceeding these limitations. Further, there is currently no requirement for a charity to disclose the extent to which it receives funding from foreign sources for political activities.

As a result, legislative amendment will be made to enhance compliance and disclosure of political activities carried out by the charity.

These measures will apply following Royal Assent.

Funding political activities

Where a gift is made by a charity and it can reasonably be considered that the purpose of the gift is to support the political activities of a qualified donee, the gift will be considered to be an expenditure made by the charity on political activities.

These measure will apply following Royal Assent.

SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT INITIATIVES (SR&ED)

The budget proposes a few changes to the SR&ED initiatives which includes the following:

- The general SR&ED investment tax credit rate will be reduced to 15% from 20%, effective January 1, 2014. The rate for small CCPCs would remain at 35% and the current requirements for refundability will be maintained.
- Capital expenditures will be removed from the base of eligible expenditures for expenditures incurred in 2014 and subsequent years. All other expenditures such as salary and wages, materials, overhead expenses and contract payments remain eligible.
- The prescribed proxy amount will be reduced to 55% from 65% of direct labour costs commencing January 1, 2014.
- Only 80% of the arm's length contract payments will be used for purposes of calculating the SR&ED tax credits effective January 1, 2013.

OTHER LEGISLATION

The budget proposes to increase the travellers' exemption to:

- \$200 from \$50 for returning Canadian residents who are out of the country for 24 hours or more.
- \$800 for travellers who are out of the country for 48 hours or more. This new \$800 threshold will replace the current 48-hour exemption of \$400 and the current seven-day exemption of \$750.

The new exemption levels will be effective for travellers returning to Canada on or after June 1, 2012.
