
Business Report

**2011 Federal Budget
June 2011**



2011 Federal Budget Overview

On June 6, 2011, the Honorable Jim Flaherty, Minister of Finance, re-introduced the federal Budget which essentially contains all of the same tax measures as the Budget tabled on March 22, 2011. Although it completes the government's tax relief and spending provisions announced in last January's "Economic Action Plan" to help stimulate the economy, it is a more restrained Budget than the past few years. The Budget contains no major surprises or significant shifts in government economic or fiscal policy. Specifically, it does not propose to raise taxes or cut major transfers for health care, education or pensioners. Instead, the Budget relies on cuts to defense spending and foreign aid, along with future departmental spending freezes, to attempt to reduce the deficit by 2015.

While the Budget does not propose changes to corporate or personal tax *rates*, it does include proposals to offer targeted tax relief, and to close certain tax "loopholes," that will affect both businesses and individuals.

Personal Tax Measures

New Personal Tax Credits

Budget 2011 proposes to introduce several new non-refundable personal tax credits applicable to taxation years after 2010. The new personal tax credits include a Children's Arts Tax Credit, which is similar to the Children's Fitness Credit, of up to \$ 75 per child, a Family Caregiver Tax Credit to support caregivers of dependants with a mental or physical infirmity of up to \$ 300 per eligible dependent, and a Volunteer Firefighters Tax Credit of up to \$ 450.

RRSP Anti-Avoidance Rules

Budget 2011 proposes several amendments to the Registered Retirement Savings Plan (RRSP) rules to address certain Government concerns regarding RRSP related tax planning. The measures target so-called "RRSP strips" (i.e., schemes which purport to enable RRSP annuitants to access RRSP funds without including an amount in income). Additionally, the proposals expand existing RRSP anti-avoidance rules by introducing rules similar to the advantage, prohibited investment, and non-qualified investment rules that currently apply to Tax-Free Savings Accounts.

Tax on Split Income – Capital Gains

Budget 2011 generally proposes to extend the tax on split income (i.e., kiddie tax) to capital gains realized by, or included in the income of, a minor from a disposition of shares 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 kiddie tax. Capital gains that are subject to this rule will be treated as dividends, and thus no capital gains exemption can be claimed where this provision applies.

Miscellaneous Personal Tax Measures

Budget 2011 also proposes to:

- Remove the \$ 10,000 limit on eligible expenses that can be claimed under the Medical Expense Tax Credit in respect of a dependent relative;
 - Repeal the rule that limits the number of Child Tax Credit claimants to one per domestic establishment;
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- Expand 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 (ancillary fees and charges paid in respect of occupational, trade or professional examinations will also be eligible for the credit);
 - Reduce the minimum course-duration requirement that a Canadian student at a foreign university must meet in order to claim the Tuition, Education and Textbook Tax Credits to 3 consecutive weeks from 13 consecutive weeks;
 - Allow transfers between individual Registered Education Savings plans (RESPs) for siblings, without tax penalties and without triggering the repayment of Canada Education Savings Grants (CESGs), provided that the beneficiary of a plan receiving a transfer of assets had not attained 21 years of age when the plan was opened (related amendments will be made to the *Canada Education Savings Regulations*);
 - Allow Registered Disability Savings Plan (RDSP) beneficiaries who have shortened life expectancies to withdraw more of their RDSP savings by permitting annual withdrawals without triggering the 10-year repayment rule, subject to specified limits and certain conditions;
 - Require an annual minimum amount to be withdrawn from "individual pension plans" (IPPs) once a plan member attains the age of 72 (an IPP will be defined as a defined benefit Registered Pension Plan with three or fewer members if at least one member is related (for tax purposes) to an employer that participates under the pension plan or that is a designated plan);
 - Require an individual who receives the Canada Child Tax Benefit (CCTB) to notify the CRA of a marital status change before the end of the month following the month in which the change in status occurs; and,
 - Increase the advance payment threshold for the CCTB to \$ 20 per month and for the GST/HST Credit to \$ 50 per quarter.

The Government also plans to review the existing rules for Employer Profit Sharing Plans (EPSP's) to determine whether technical amendments are required. The Government stated it will undertake consultations to seek the views of stakeholders before any amendments are made to the EPSP rules.

Business Tax Measures

Partnerships – Deferral of Corporate Tax

Applicable to taxation years of a corporation that end after March 21, 2011, in computing income for a taxation year of a corporation that has a significant investment in a partnership that has a fiscal period that differs from the corporation's taxation year, Budget 2011 generally proposes to require the corporation to include partnership income that accrued during any portion of the partnership's fiscal period that falls within the corporation's taxation year. Transitional relief will be provided such that additional income realized in the first year of application of the new rules will generally be brought into a corporation's income over a five-year period starting in the taxation year following the first taxation year in respect of which the new rules apply (generally, the percentage of income included over the six-year period including the first year in which the rules apply is: 0% / 15% / 20% / 20% /20% /25%).

The proposed rules only apply to a corporate partner (other than a professional corporation) for a taxation year if the partner (together with affiliated and related parties) was entitled to more than 10% of the partnership's income (or assets in the case of a wind-up of the partnership) at the end of the last fiscal period of the partnership. Under the proposed rules, a one-time election will be made available to allow a partnership to change its fiscal period where certain conditions are met (the election will allow a partnership to align their fiscal period with the taxation year of one or more corporate partners). Also, if a partnership has one or more partnerships as members, all of those partnerships will be required to adopt a common fiscal period.

The proposed rules include several technical measures. For example, a corporate partner will generally be permitted to reduce the amount of its stub-period accrued partnership income by the amount of its share of "Designated Resource Expenses" incurred by the partnership in the stub period at the maximum rate at which such expenses would otherwise be deductible if the partnership's fiscal period had ended on the same day as the partner's taxation year. Also, special rules will apply to "Multi-tier Alignment Income" (MTAI) of a corporate partner that has an interest in a multi-tier partnership.

Stop-Loss Rules on the Redemption of a Share

Generally, under current stop-loss rules, the amount of a loss otherwise realized by a corporation on a disposition of shares is reduced by the amount of deductible dividends received, or deemed to have been received, on those shares on or before the disposition. Applicable to redemptions that occur after March 21, 2011, Budget 2011 proposes to extend the application of these stop-loss rules to any dividend deemed to be received on the redemption of shares directly or indirectly held by a corporation, other than dividends deemed to be received on the redemption of shares of a private corporation that are held by a private corporation (other than a financial institution).

Capital Cost Allowance Measures

Budget 2011 extends Class 29 accelerated capital cost allowance (CCA) treatment, for two years, to eligible machinery and equipment acquired before 2014. Class 29 provides for a CCA rate of 50 per cent on a straight-line basis (subject to the application of the "half-year rule").

Budget 2011 also proposes to expand Class 43.2 (clean energy equipment) to include equipment that is used to generate electrical energy in a process in which all or substantially all of the energy input is from "waste heat". Eligible equipment will include electrical generating equipment, control, feed-water and condensate systems, and other ancillary equipment. Eligible equipment will not include buildings or other structures, heat rejection equipment (such as condensers and cooling water systems), transmission equipment or distribution equipment. Systems will not be eligible if they use chlorofluorocarbons or hydro chlorofluorocarbons.

Oil Sands Projects

Effective for acquisitions made after March 21, 2011, Budget 2011 proposes that the cost of oil sands leases and other oil sands resource property be treated as Canadian oil and gas property expenses (COGPE), which is deductible at a rate of 10% per year on a declining balance basis. Under current rules, the cost of acquiring oil sands leases and other oil sands resource property is generally treated as Canadian development expenses (CDE), which is deductible at a rate of 30% per year on a declining balance basis. Budget 2011 also proposes that development costs, such as the cost of drilling production wells, be treated as CDE. Under current rules, development expenses incurred for the purpose of bringing a new oil sands mine into production in reasonable commercial quantities are treated as Canadian exploration expenses (CEE), which can be deducted in full in the year incurred. The current CEE treatment will be maintained for expenses incurred before March 22, 2011 and for expenses incurred before 2015 for new mines on which major construction began before March 22, 2011. For other expenses, the transition from CEE treatment to CDE treatment will be phased in on a gradual basis.

Mineral Exploration Tax Credit

Budget 2011 extends the mineral exploration tax credit by one year so that it will apply to flow-through share agreements made after March 2011 and before April 1, 2012 where the expenses are incurred by the corporation, or deemed under the look-back rule to be incurred, by December 31, 2012. The look-back rule will accommodate expenses incurred to the end of 2013.

Charities

Budget 2011 includes several measures related to the charitable sector, including extending certain regulatory requirements that currently apply to registered charities to the following qualified donees: registered Canadian amateur athletic associations; municipalities in Canada; municipal and public bodies performing a function of government in Canada; housing corporations in Canada constituted exclusively to provide low-cost housing for the aged; universities outside of Canada, the student body of which ordinarily includes students from Canada; and certain other charitable organizations outside of Canada

that have received a gift from Her Majesty in right of Canada. Budget 2011 includes several measures generally intended to enhance transparency and accountability in the charitable sector and to provide greater certainty to donors.

From a donor perspective, Budget 2011 also proposes to:

- Restrict the exemption from capital gains tax on donations of shares issued pursuant to a flow-through share agreement entered into after March 21, 2011 so that the exemption only applies to the extent that cumulative capital gains in respect of dispositions of shares of that class exceed the original cost of the flow-through shares;
- Permit CRA reassessments to disallow a taxpayer's claim for a credit or deduction in any case where property is returned to a donor; and,
- "Clarify" that the charitable donations tax credit or deduction is not available to a taxpayer in respect of the granting of an option to a qualified donee to acquire a property of the taxpayer until such time that the donee acquires property of the taxpayer that is the subject of the option.

Budget 2011 further proposes that tax recognition in respect of a donation of a non-qualifying security (NQS) be deferred until such time, within five years of the donation of the NQS, as the qualified donee has disposed of the NQS for consideration that is not, to any person, another NQS.

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