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2013 Federal Budget

2013 Federal Budget – March 21, 2013

A summary of the key tax measures that may have a direct impact on you.

On March 21, 2013, Federal Finance Minister Jim Flaherty delivered the majority goverment's 2013 federal budget.

Similar to last year's budget, many of the 2013 budget tax measures are aimed at tightening perceived loopholes or inequalities in various aspects of the tax system. The budget proposes a number of measures to address aggressive tax planning, clarify tax rules, and reduce international tax evasion.

Prior to implementing any strategies contained in this article, individuals should consult with a qualified tax advisor, legal professional or other applicable professional.

While it has been the long-standing practice of Canada Revenue Agency (CRA) to allow taxpayers to file their tax returns based on proposed legislation, a taxpayer remains potentially liable for taxes under current law in the event that a budget proposal is not ultimately passed. Therefore, if proposed legislation does not become law, it is possible that CRA may assess or re-assess your tax return based on existing legislation. It is recommended

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that you consult a professional tax advisor to assist you in assessing the costs and benefits of proceeding with specific budget proposals as they relate to you.

Personal Tax Changes

Lifetime capital gains exemption

The budget proposes to increase the lifetime capital gains exemption to $800,000 from $750,000 on capital gains realized on the disposition of qualified farm and fishing property and qualified small business corporation shares. This measure will apply to dispositions of qualifying property that occur on or after January 1, 2014. The budget also proposes to index the new limit to inflation beginning in 2015.

Non-eligible dividends

Canadian corporations may pay both "eligible" and "non-eligible" dividends. These dividends are taxed at preferential tax rates compared to some other types of income. Eligible dividends generally include dividends paid by Canadian public corporations and Canadian Controlled Private Corporations (CCPCs) that are subject to the general corporate tax rate. However, to the extent that the income of a CCPC is subject to tax at the small business rate, any dividends paid by the CCPC from that income would be considered a "non-eligible" dividend.

The budget proposes to reduce the dividend gross-up factor and the federal dividend tax credit applicable to non-eligible dividends paid after 2013, as follows:

	Pre-2014 Non-eligible dividends	Proposed 2014 Non-eligible dividends
Federal gross-up factor	25.00%	18.00%
Federal dividend tax credit on grossed-up amount	13.33%	11.02%
Proposed top marginal federal tax rate	**19.58%**	**21.22%**

These proposed changes will result in non-eligible dividends being taxed at a higher rate.

Leveraged insured annuities

The budget proposes to eliminate tax benefits from leveraged insured annuities (sometimes referred to as "triple back-to-backs"). A leveraged insured annuity (LIA) involves the use of borrowed funds in connection with the purchase of two contracts: a life annuity that provides fixed and guaranteed income to an investor until the death of an individual and a permanent life insurance policy that provides coverage for the entire lifetime of the individual whose life is insured. Permanent life insurance policies provide both insurance protection and a savings component. The income earned on the savings component of a permanent life insurance policy that is an "exempt policy", as defined in the Income Tax Act, grows on a tax sheltered basis.

The budget proposes for LIAs that income accruing in the life insurance policy will be subject to annual accrual-based taxation, no deduction will be allowed for any portion of a premium paid on the policy, and the capital dividend account of a private corporation will not be increased by the death benefit received in respect of the insurance policy.

This measure will apply to taxation years that end on or after March 21, 2013. Under a grandfathering rule this measure will not apply in respect of leveraged insured annuities for which all borrowings were entered into before March 21, 2013.

10/8 arrangements

A 10/8 arrangement involves investing in a permanent life insurance policy with a view to borrowing against that investment for the purpose of creating an annual interest-expense tax deduction for a long period of time (i.e., until the death of an individual whose life is insured under the policy). Under this arrangement, the individual takes the position that the interest expense on the amount borrowed is deductible while the interest income earned on the amount invested in the policy is not included in income (because the policy is an exempt policy for income tax purposes), creating a positive cash flow every year.

The budget proposes measures to ensure that tax benefits are not available in relation to 10/8 arrangements. Under the proposed measures:

- Interest which relates to a period after 2013 will not be deductible;
- Premiums under the policy related to a period after 2013 will not be deductible; and
- The capital dividend account will not be increased by the amount of the death benefit that becomes payable after 2013 under the policy which is associated with the borrowing.

In order to facilitate the termination of existing 10/8 arrangements before 2014, the budget also proposes to alleviate the income tax consequences on a withdrawal from an existing 10/8 arrangement if the withdrawal is made to repay a borrowing under the arrangement on or after March 21, 2013 and before January 1, 2014.

Synthetic dispositions

The budget proposes that taxpayers cannot use a "synthetic" disposition transaction to defer the tax consequences of disposing of a property. Generally, these arrangements involve the use of certain derivative contracts (such as forwards and put-call collars) to eliminate the future potential for gain or loss on that property. At the same time, the taxpayer receives other property that approximates what they would have received from selling the property today.

This measure will apply to new arrangements entered into on or after March 21, 2013 as well as any existing arrangements if their term is extended on or after this date. Anyone contemplating an "equity monetization strategy" should speak to their tax advisor about the impact of this proposal on that strategy.

Character conversion transactions

The budget proposes rules to prevent the conversion of income to capital gains for those investments involving forward agreements having a term of longer than 180 days. If a taxpayer's investment is affected, any returns taxed as income will be added to the investment's adjusted cost base (ACB) to prevent double taxation.

This measure applies to investments where the underlying forward agreements are entered into on or after March 21, 2013. This measure will also apply to forward agreements entered into before March 21, 2013 if the term of the agreement is extended on or after March 21, 2013.

Graduated rate taxation of trusts and estates

The budget announces the government's intention to consult on possible measures to eliminate the tax benefits that arise from taxing grandfathered inter vivos trusts (created before June 18, 1971), testamentary trusts and estates at graduated rates. This arises from a concern with potential growth in the tax-motivated use of testamentary trusts and the associated negative impact on the tax base. A consultation paper will be publicly released to provide stakeholders with an opportunity for comment.

First-time donor's super credit

The budget proposes to introduce a temporary First-time Donor's Super Credit (FDSC). The FDSC will supplement the Charitable Donation Tax Credit (CDTC) with an additional 25 percent tax credit for a first-time donor on up to $1,000 of cash donations. Accordingly, a first-time donor will be entitled to a 40 percent federal credit for donations of $200 or less, and a 54 percent federal credit for the portion of donations over $200 but not exceeding $1,000.

An individual will be considered a "first-time" donor if neither the taxpayer nor their spouse or common-law partner has claimed the CDTC or FDSC in any taxation year after 2007. The FDSC will be available in respect of donations made on or after March 21, 2013 and may be claimed only once in respect of any one taxation year from 2013 to 2017.

Deduction for safety deposit boxes

The budget proposes to make the cost of renting a safety deposit box from a financial institution non-deductible for income tax purposes. This measure will apply to taxation years that begin on or after March 21, 2013.

Labour-Sponsored Venture Capital Corporations tax credit

Labour Sponsored Venture Capital Corporations (LSVCC) invest primarily in small to mid-sized private firms which require funding for development or expansion. Currently a 15 percent federal tax credit is provided to individuals for the acquisition of shares of LSVCCs on investments of up to $5,000 each year, providing up to $750 in federal tax relief. The budget proposes to phase out the federal LSVCC tax credit by 2017, as follows:

Tax Year	LSVCC Federal Tax Credit
2013	15%
2014	15%
2015	10%
2016	5%
After 2016	NIL

Adoption expense tax credit

The adoption expense tax credit is proposed to be enhanced to allow additional adoption-related expenses (such as fees for a provincially required home study and mandatory adoption courses) to be eligible for the credit by extending the adoption period in which eligible adoption expenses may be claimed. This change will apply to adoptions finalized after 2012.

Business Tax Changes

Mineral exploration tax credit for flow-through share investors

The budget proposes to extend eligibility for the mineral exploration tax credit for flow-through share agreements entered into on or before March 31, 2014.

International Tax Changes

Non-resident trusts

Existing rules which prevents the use by taxpayers of non-resident trusts to avoid Canadian tax are proposed to be expanded and clarified, applying to taxation years that end on or after March 21, 2013.

Please contact us for more information about the topics discussed in this article.

International Electronic Funds Transfers

The budget proposes to require certain financial intermediaries, such as banks, credit unions, caisses populaires and trust companies, to report international electronic funds transfers (EFTs) of $10,000 or more to the CRA beginning in 2015.

Update to Foreign Income Verification Statement

CRA requires all Canadian resident individuals to report their foreign assets if the assets' cumulative cost exceeded C$100,000 at any time in the calendar year as part of their income tax return filings using Form T1135 – Foreign Income Verification Statement. The budget proposes that this form will be revised to require more detailed information, such as the names of specific foreign institutions and countries where offshore assets are located.

Stop International Tax Evasion Program

The CRA will launch the Stop International Tax Evasion Program which will reward an individual, meeting certain criteria, who provides information to the CRA that leads to the collection of more than $100,000 of federal tax with a payment of up to 15 percent of the taxes collected.

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