2011 Federal Budget

June 6, 2011

Highlights of the key tax measures
that have a direct impact on you

An executive summary
from RBC Wealth Management Services

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On June 6, 2011, Federal Finance Minister Jim Flaherty re-introduced the Conservative government's 2011 budget. Budget 2011 was originally tabled in the House of Commons on March 22, 2011 but was not adopted before dissolution of Parliament on March 26, 2011. The new budget restates the commitments from the March 22 budget. Unless indicated otherwise, the re-introduced measures are proposed to be effective retroactively to March 22, 2011.

KEY HIGHLIGHTS OF THE RE-INTRODUCED BUDGET THAT MAY HAVE A DIRECT IMPACT ON YOU INCLUDE:

- No changes to personal or corporate tax rates, or changes in planned indexation of personal tax brackets and tax credits.
- Limited new spending measures, with a focus on making technical adjustments to close unfair tax loopholes that are perceived to be abusive.
- New rules to restrict the exemption from capital gains tax on the donation of flow-through shares to a charity.
- Limiting the ability to swap assets between RRSP/RRIF and non-registered accounts.
- Limits on the ability for a small business owner's corporation to deduct past service contributions for an Individual Pension Plan (IPP).
- A number of small targeted tax credits for individuals and their families.

Prior to implementing any strategies contained in this article, individuals should consult with a qualified tax advisor, accountant, 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 the 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 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.

DONATION OF FLOW THROUGH SHARES

Under current rules, donating publicly listed flow through shares to a registered charity generally results in the elimination of the capital gain on those shares. This is in addition to the ability to claim a deduction for flow through expenses as well as a donation tax credit for the value of the donated shares.

For example, Tom buys 100 flow through shares of ZRW Co for an original cost of $10,000. Tom then donates 100 flow through shares of ZRW Co when FMV is $8,000. Under the current rules, because of the deemed zero cost for flow through shares, the capital gain triggered on the disposition is $8,000. This $8,000 capital gain is exempt from tax because the publicly listed flows through shares are donated in-kind to charity.

Under proposed rules, a deemed capital gain may be triggered when flow through shares are donated. The exemption from capital gains tax will be available only to the extent that the actual capital gain ($8,000 in the above example) on the donation exceeds a threshold amount (the "exemption threshold") at the time of the donation.

In simplified terms, the exemption threshold is calculated using the original cost ($10,000 in the above example) less any cumulative capital gains realized on disposition of shares in the same class as the flow through shares. In other words, the deemed capital gain is equal to the lesser of the actual capital gain triggered on the donation or the exemption threshold amount.

To illustrate the impact of the proposed rules, here is a simplified example continued using the same example as above:

- Tom buys 100 flow through shares of ZRW Co for original cost of $10,000.
- Tom donates 100 flow through shares of ZRW Co when FMV is $8,000.

Under proposed rules, the exemption threshold is calculated as the original cost of $10,000 (ignoring the deemed zero cost for flow through shares). The deemed capital gain is calculated as the lesser of:

a) the capital gain on the donation ($8,000); and,

b) the exemption threshold ($10,000).

In this case, a deemed capital gain of $8,000 is triggered and is subject to capital gains tax on the in-kind donation. These rules apply to a donation of flow through shares acquired after March 21, 2011. It is not clear if these rules will apply to the donation of mutual fund units acquired from the conversion from a flow through limited partnership unit.

INDIVIDUAL PENSION PLANS (IPP)

An IPP is a defined benefit pension plan, typically for one person, and sometimes for that person's spouse and children if they are also employed by the business. One of the advantages of an IPP is the ability of the sponsoring company to make deductible contributions to the plan. Generally, past service contributions to the IPP may be permitted to capture years of service as if the person was a member of the IPP as far back as 1991.

A past service contribution consists of two parts: a transfer of assets from the member's RRSP into the IPP subject to a maximum amount calculated by reference to a formula (or alternatively, the giving up of unused RRSP contribution room), and a "top-up" contribution from the company that is deductible for corporate tax purposes.

For IPPs submitted to CRA for registration after March 22, 2011, the budget proposes that the cost of past service must first be satisfied by transfers from any RRSP assets belonging to the IPP member or a reduction in the member's unused RRSP contribution room (not limited to the formula amount) before deductible past service contributions from the company are permitted. This proposed measure may reduce or even eliminate the ability of the sponsoring company to make deductible past service contributions.

In addition, some taxpayers have established an IPP as a transfer vehicle for the commuted value of their pension under a defined benefit registered pension plan (RPP). This can result in much of the IPP value being considered a pension surplus and not subject to any withdrawal requirements under the existing tax rules for RPPs. This can allow the taxpayer to defer more of their retirement savings for a longer period than is generally possible for other RPP members or RRSP savers. To address this inconsistency, starting in 2012, the budget proposes that annual minimum amounts must be withdrawn from IPPs similar to current minimum withdrawal requirements from registered retirement income funds (RRIFs) from the year after a plan member attains the age of 71.

RRSPs/RRIFs – ANTI-AVOIDANCE RULES

The 2011 budget proposes (effective for transactions occurring after March 22, 2011) to enhance the existing RRSP/RRIF anti-avoidance rules to address concerns regarding the use of RRSPs/RRIFs in certain tax planning schemes, a number of which involved accessing RRSPs/RRIFs without including an appropriate amount in income. The rules are similar to the anti-avoidance rules that currently apply to Tax-Free Savings Accounts (TFSAs).

Specifically, the "advantage rules" impose a tax equal to the fair market value of the benefit received. An "advantage" may be described as a benefit obtained from transactions intended to exploit the tax attributes of an RRSP/RRIF and includes swap transactions between RRSPs/RRIFs and other accounts controlled by the RRSP/RRIF annuitant. The proposed rules will not apply to swap transactions undertaken before July 2011.

The budget also proposes to enhance two other anti-avoidance rules to RRSPs/RRIFs. The "prohibited investment rules" and the "non-qualified investment rules" impose a special tax equal to 50% of the fair market value of the investment on acquisition of a prohibited investment or non-qualified investment (or at the time that an investment becomes prohibited or non-qualified). Prohibited investments generally include debt of the RRSP/RRIF annuitant and investments in entities in which the RRSP/RRIF annuitant or a non-arm's length person has a "significant interest" (generally 10% or more) or with which the RRSP/RRIF annuitant does not deal at arm's length. Examples of non-qualified investments include shares in private investment holding companies or foreign private companies, and real estate. The special tax on prohibited investments and non-qualified investments may be refunded under certain circumstances. The proposed rules for non-qualified investments replaces the income inclusion and offsetting deduction components of the existing non-qualified investment rules, as well as the 1% per month tax imposed under the existing non-qualified investment rules.

REGISTERED EDUCATIONS SAVINGS PLANS (RESPs) - ASSET SHARING AMONG SIBLINGS

The budget proposes to allow transfers between individual 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. This proposal provides subscribers of separate individual RESPs with the same flexibility in allocating assets among siblings as presently exists for subscribers of family plans. This proposal will apply to asset transfers after 2010.

REGISTERED DISABILITY SAVINGS PLANS (RDSP) - WITHDRAWALS FOR BENEFICIARIES WITH SHORTENED LIFE EXPECTANCY

The budget proposes that the beneficiary of an RDSP plan will be able to withdraw funds without triggering the Canada Disability Savings Grant (CDSG) and Canada Disability Savings Bond (CDSB) repayments if the beneficiary's life expectancy is certified by a medical doctor to be 5 years or less, and the taxable portion of the withdrawals does not exceed $10,000 annually. Previously, withdrawals would trigger a full repayment of all CDSG and CDSB amounts received in the preceding ten years. This new rule will apply to withdrawals made only after the measure receives Royal Assent.

To take advantage of this new proposal, beneficiaries will be required to fill out a specific election form and submit it with a doctor's medical certification to the institution holding the RDSP. However, once such election has been made, generally, no further contributions will be allowed and no new CDSGs and CDSBs will be paid.

KIDDIE TAX ON CAPITAL GAINS RELATED TO PRIVATE COMPANY SHARES

The Income Tax Act contains a set of rules known as the split income rules (also referred to as "kiddie tax"). These rules apply in situations such as when a private corporation pays a dividend to a minor child (either directly or indirectly such as through a family trust), with the result that the dividend will be taxed in the child's hands at the top marginal tax rate preventing income splitting.

The kiddie tax rules did not apply on capital gains triggered and paid to minor children through certain advanced non-arms length reorganization strategies. The budget now proposes that capital gains triggered to minor children on non-arm's length dispositions (after March 21, 2011) will be treated as a dividend and be subject to the kiddie tax rules.

OTHER PROPOSED MEASURES

- **Increasing Support for Low Income Seniors** – Under proposed rules, seniors receiving Old Age Security (OAS) and qualifying for the Guaranteed Income Supplement (GIS) will received additional annual benefits of up to $600 for a single senior and $840 for couples starting July 1, 2011.
- **Education Tax Measures – Study Abroad** – The budget proposes to reduce the minimum course-duration requirement for the Tuition Tax Credit, Education Tax Credit and Textbook Tax Credit for Canadian students attending a foreign university full time from 13 consecutive weeks to three consecutive weeks. The budget also proposes that the 13 consecutive week requirement to be eligible for Educational Assistance Payments (EAPs) from a Registered Education Savings Plan be reduced to three weeks when the student is enrolled at a foreign university in a full-time course. These measures will apply to tuition fees paid for courses taken in 2011 and EAPs made after 2010.
- **Family Caregiver Tax Credit** – The budget introduces a new Family Caregiver Tax Credit that will be available to caregivers of dependants with a mental or physical infirmity, including, for the first time, spouses, common-law partners and minor children. The credit will result in a maximum federal tax savings of $300. The credit will apply beginning in 2012.
- **Medical Expense Tax Credit for Other Dependants** – Currently, an individual may claim up to $10,000 of eligible medical expenses for a "dependant" relative under the Medical Expense Tax Credit if the expenses exceed the lesser of 3% of the dependant's net income and a dollar threshold ($2,052 in 2011). The budget proposes to remove the $10,000 limit effective 2011.
- **Deferral of corporate tax** – The deferral of corporate tax using a partnership structure is proposed to be eliminated.
- **Stop-loss rules on the redemption of a share** – An extension of the stop loss rules is proposed to apply to reduce a loss triggered on the redemption of shares by a corporation when a deemed dividend is realized for redemptions that occur on or after March 22, 2011.
- **Children's Arts Tax Credit** – The budget proposes a new non-refundable $500 tax credit, beginning in 2011, for enrolling a child under age 16 in a supervised program associated with children's artistic, cultural, recreational or developmental activities. Either parent can claim the credit for each child. The credit would result in a maximum federal tax savings of $75 per child. An enhanced credit may be claimed for children under age 18 who are eligible for the Disability Tax Credit.
- **Tuition Tax Credit for Examination Fees** – The budget proposes to amend the tuition tax credit to recognize eligible examination and ancillary fees paid in 2011 and subsequent years to obtain an eligible professional status.
- **Mineral Exploration Tax Credit** – The eligibility for the mineral exploration tax credit of 15% will be extended to flow-through share agreements entered into on or before March 31, 2012.

Please contact your RBC advisor
for more information.