2013 FEDERAL BUDGET

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Tax highlights from the 2013 federal budget

Finance Minister James Flaherty tabled the 2013 federal budget on March 21, 2013. This is the seventh budget for Minister Flaherty and the second for this majority Conservative government. The budget projects a deficit of $25.9 billion for the soon-to-end 2012-2013 fiscal year, and forecasts deficits of $18.7 billion for the 2013-2014 fiscal year and $6.6 billion for the 2014-2015 fiscal year. The minister reiterated the government's previously stated position that the budget would return to a surplus position in 2015. The budget forecasts a surplus of $0.8 billion for the 2015-2016 fiscal year, followed by surpluses of $3.9 and $5.1 billion, respectively, in the two subsequent years.

The budget, or Economic Action Plan 2013 as it is referred to by the government, focuses on the five following areas:

- Connecting Canadians with available jobs.
- Helping manufacturers and businesses succeed in the global economy.
- Creating a new "Building Canada" plan to fund public infrastructure.
- Investing in world-class research and innovation.
- Supporting families and communities.

There were no increases to personal or corporate tax rates in the budget; however, there was considerable focus on measures that will increase tax "fairness" and close perceived tax "loopholes".

The following pages are a summary of the changes announced in the budget. Please note that these changes are still proposals until passed into law by the federal government.

PERSONAL TAX MATTERS

Personal income tax rates

There were no changes announced with respect to personal income tax rates in this budget, although tax brackets have been indexed by 2% to reflect the impact of inflation. The effective rates for 2013 and corresponding tax bracket thresholds are shown in the following table.

Taxable income range	2013 tax rates
$11,039 - $43,561	15%
$43,562 - $87,123	22%
$87,124 - $135,054	26%
$135,055 or more	29%

Adoption expense tax credit

Acknowledging that there are costs incurred by adoptive parents prior to being matched with a child, the budget proposes to extend the adoption period by redefining the time at which the adoption period begins. Currently, the adoption period begins on the date that the child is matched with the adoptive family. Effective for adoptions finalized after 2012, the budget proposes to begin the adoption period at the earlier of:

- the time that the adoptive parent makes an application to register with a provincial ministry responsible for adoption or with a provincially licensed adoption agency; or
- the time that an adoption-related application is made to a Canadian court.

First-time donor's super credit

In order to encourage charitable giving by new donors, the budget proposes a temporary one-time credit for first-time donors on up to $1,000 of monetary donations. An individual is a first-time donor if neither the individual nor the individual's spouse or common-law partner claimed a charitable donation tax credit, or this new credit, in any taxation year after 2007.

The new 25% super credit will be added to the existing charitable donation tax credit, resulting in a tax credit rate of 40% on the first $200 of donations and 54% on the next $800. The new credit applies to donations made after budget day and before 2018. The maximum limit of $1,000 applies to both individuals and couples, so that there is no doubling of the credit for couples. As this is a one-time credit, donors may want to carry forward and not claim smaller donations until the $1,000 threshold is reached.

Lifetime capital gains exemption

The budget proposes to increase the $750,000 lifetime capital gains exemption by $50,000 to $800,000. The new limit will be available for dispositions of qualified small business corporation shares, qualified farm property and qualified fishing property after 2013. The new higher lifetime limit will be available to all individuals, including those who had previously claimed the maximum exemption at the time. The $800,000 amount will be indexed for 2015 and subsequent years.

Deduction for safety deposit boxes

The budget proposes to eliminate the deductibility of fees paid to a financial institution for the rental of a safety deposit box. This measure will apply to taxation years that begin on or after March 21, 2013.

Dividend tax credit

The budget proposes to make changes to the non-eligible dividend regime to more accurately reflect the corporate income taxes that are paid on active business income and to improve tax integration. The current 25% gross-up on non-eligible dividends will be reduced to 18% and the current dividend tax credit rate of 13.33% of the grossed-up dividend will be reduced to 11%. This effectively increases the highest marginal federal tax rate on non-eligible dividends from 19.58% to 21.22%. These changes are applicable to non-eligible dividends paid after 2013.

Registered pension plans

The budget proposes to enable registered pension plan (RPP) administrators to make refunds of contributions in order to correct errors, without first seeking Canada Revenue Agency (CRA) approval. In order to qualify, the refund must be made before December 31 of the year following the year in which the erroneous contribution was made. The refund to an individual plan member will be income in the year received, while refunds to employers will reduce the RPP expense for the year to which the refund relates.

This measure will be effective in respect of RPP contributions made on or after the later of January 1, 2014 and the date of royal assent.

Labour-sponsored venture capital corporations tax credit

The budget proposes the phase-out of the federal labour-sponsored venture capital corporations (LSVCC) tax credit. The credit is currently equal to 15% of an investment in up to $5,000 of LSVCC shares. The phase-out will begin in 2015 when the credit will be reduced to 10%. It will be further reduced to 5% in 2016 and eliminated for 2017 and subsequent years. No new applications for registration of federal LSVCCs will be accepted after March 21, 2013.

Mineral exploration tax credit for flow-through share investors

The budget extends this credit for flow-through share arrangements that was scheduled to expire on March 31, 2013. The credit will continue to be available for flow-through share arrangements entered into on or before March 31, 2014.

Restricted farm losses

As a result of a recent decision by the Supreme Court of Canada, the budget proposes to amend the restricted farm loss rules to clarify that these rules will apply to restrict current deductibility of farming losses if farming is not the chief source of the taxpayer's income. In addition, the budget proposes to increase the annual limit of deductible restricted farm losses from $8,750 to $17,500. These measures apply to taxation years that end on or after March 21, 2013.

Foreign reporting requirements

Canadian residents must file form T1135 – foreign income verification statement with CRA if the person owns specified foreign property costing more than $100,000. Effective for 2013 and subsequent taxation years, the budget proposes to extend the normal assessment period by three years if:

- the taxpayer fails to report income from the specified foreign property on their annual income tax return; and
- form T1135 was not filed on time by the taxpayer, or a specified foreign property was not identified, or was improperly identified on form T1135.

In addition, for 2013 and subsequent years, the form and its related instructions will be modified to require more detailed information regarding each specified foreign property, including:

- the name of the foreign institution or other entity holding funds outside of Canada;
- the specific country to which the property relates; and
- the foreign income generated from the property.

CRA will begin reminding taxpayers of their obligation to file form T1135 on assessment notices if they have checked the "yes" box on their income tax returns indicating that they own specified foreign property with a cost of more than $100,000. CRA is also in the process of developing a system that would allow for the electronic filing of form T1135.

Extended reassessment period

The budget proposes to extend the normal three-year reassessment period for tax shelter participants where the tax shelter promoter has not filed the required information return on time. The reassessment period will be extended to three years after the date that the relevant information return is filed. This will be effective for taxation years that end on or after March 21, 2013.

Taxes in dispute and charitable donation tax shelters

CRA is generally prohibited from initiating collection action in respect of assessed income taxes, penalties and interest in cases where taxpayers have formally objected to the assessment. In order to discourage participation in charitable donation tax shelters deemed offensive by CRA that lead to prolonged litigation and delayed tax collection, the budget proposes to allow CRA to collect up to 50% of the disputed amount pending ultimate determination of the tax liability. This measure will apply to 2013 and subsequent taxation years.

Synthetic dispositions

A synthetic disposition occurs where a taxpayer enters into a transaction that eliminates all or substantially all of the risk for loss or opportunity for gain. In effect, the taxpayer economically disposes of the property but continues to own it for income tax purposes through the use of certain financial arrangements.

Where a synthetic disposition takes place, the taxpayer will be deemed to have disposed of the property at fair market value and to have immediately reacquired it at that cost. The taxpayer will also be deemed to not own the property for the purposes of various "holding period" tests in the Income Tax Act. These measures will apply to arrangements entered into on or after March 21, 2013.

Character conversion transactions

This refers to financial arrangements that attempt to convert ordinary income into capital gains, through the use of financial derivatives. These arrangements typically involve the use of forward contracts to buy or sell a capital property at a price linked to some other property or measure, such as the performance of an investment portfolio or index.

The budget proposes to treat the return from the derivative investment distinct from the disposition of the underlying asset. This will generally result in ordinary income treatment for the derivative-based return. This measure will apply to derivative forward agreements that have a duration of more than 180 days. In order to prevent double taxation, any income or loss will result in an adjustment to the adjusted cost base of the capital property.

Trust loss trading

The budget will introduce rules restricting the use of losses in trusts that are similar to the acquisition of control rules for corporations. The new rules will apply when a trust has been subject to a "loss restriction event". This will occur when a person or partnership becomes a majority interest beneficiary of the trust or when a group becomes a majority interest group of beneficiaries of the trust. This provision will apply to transactions that occur on or after March 21, 2013.

Non-resident trusts

The budget proposes to extend the deemed Canadian residence rules to non-resident trusts (other than immigration trusts) in situations where a Canadian resident taxpayer transfers or loans property to the trust and the property held by the trust may revert to the taxpayer or the taxpayer has influence over the trust's dealings with the property. This provision will apply to taxation years that end on or after March 21, 2013.

Graduated rate taxation of trusts and estates

A common estate planning strategy involves the use of testamentary trusts created in a deceased person's will to hold a beneficiary's inheritance. These trusts can be more tax efficient than receiving an outright inheritance because the trusts are subject to taxation at graduated rates, similar to individuals, and essentially allow for the splitting of income between the trust and the beneficiaries. The effects can be magnified in cases where deceased individuals with significant estates create multiple trusts. This tax benefit can be contrasted with inter-vivos trusts created during the person's lifetime, which are subject to taxation at the highest marginal rates applicable to individuals, which serves to prevent tax-motivated use of these trusts.

The budget indicates the Department of Finance's concern with the increasing tax-motivated use of testamentary trusts and the impact on the tax base. Accordingly, the budget announces that the government will consult on possible measures to eliminate the tax benefits arising from the use of these trusts. A consultation paper will be released to stakeholders for comment. No timing was announced.

CORPORATE TAX MATTERS

Corporate income tax rates

There were no changes proposed to any corporate income tax rates. The table below shows federal tax rates and the small business limit for 2013.

Category	2013 tax rates
General rate	15%
Manufacturing & processing rate	15%
Small business rate	11%
Small business limit	$500,000

Hiring credit for small business

The budget proposes a further one-year extension of the temporary hiring credit for small business introduced in the 2011 budget. The credit offers up to $1,000 to offset a small business's increase in 2013 Employment Insurance (EI) premiums over those paid in 2012. This credit will be available to employers whose EI premiums were $15,000 or less in 2012.

Temporary incentive for manufacturing and processing equipment

Manufacturing and processing (M&P) machinery and equipment acquired after March 18, 2007 and before 2014 are currently eligible for temporarily accelerated capital cost allowance (CCA). This temporary increase, from 30% to 50% straight-line (subject to the half-year rule), results in a full write-off of qualifying new M&P equipment costs over three years.

In order to provide further stimulus to the manufacturing sector, this budget proposes to extend applicability of the 50% straight-line method to acquisitions in 2015 and 2016. The half-year rule will continue to apply, resulting in a full write-off of the cost of qualifying M&P equipment over three years. Acquisitions after 2016 will be included in Class 43, subject to a 30% declining balance rate of CCA.

Scientific research and experimental development tax credit

The budget proposes several changes to the scientific research and experimental development (SRED) tax program to give CRA new resources and administrative tools to better respond to claims where the risks of non-compliance are high and eligibility for SRED credits is unlikely.

More detailed information will be required when taxpayers use third parties to prepare a claim. In particular, business numbers for each third party along with details about the billing arrangements, including the existence of contingency fees and the amount of fees payable, will be required. The claimant will have to certify if there was no third-party involvement in preparing the claim.

The budget proposes a new $1,000 penalty for all claims where the above-noted information is missing, incomplete or inaccurate. Where a third-party tax preparer is involved, the SRED claimant and the tax preparer will be jointly and severally liable for the penalty. This measure will apply to SRED claims filed on or after the later of January 1, 2014 and the date of royal assent.

Corporate loss trading

The budget proposes to introduce a new anti-avoidance rule to support the current legislative provision that restricts the deductibility of losses in cases where there has been an acquisition of control of a corporation. This measure will apply where a person or group of persons acquires shares of a loss corporation that have a value equal to more than 75% of the total value of the corporation, but they do not acquire voting control of the corporation.

If one of the main reasons that they do not acquire voting control is to avoid the loss restriction use rules, this provision will apply. This provision will be effective for shares acquired on or after March 21, 2013, unless the acquisition was pursuant to a written agreement entered into before that date.

Taxation of corporate groups

The budget indicates that the government has concluded its review of the taxation of corporate groups and that introducing provisions dealing with corporate groups, such as inter-corporate loss transfers and consolidated reporting, are not priorities at this time.

Leveraged insured annuities

Leveraged insured annuities use a combination of borrowed funds, lifetime annuities and life insurance policies to create a current interest expense deduction, reduced capital gains tax payable on death, receipt of tax-free growth within the policy and an increase to the capital dividend account of the corporation. The budget proposes to:

- subject the income earned in the life insurance policy to annual accrual taxation;
- deny deductibility of the life insurance premiums;
- deny an addition to the capital dividend account of the corporation of the life insurance proceeds received on death; and
- ascribe the amount of premiums paid for the annuity contract as the fair market value of the annuity for the purposes of the deemed disposition on death.

These measures will generally apply to taxation years that end on or after March 21, 2013, but will not apply to arrangements where all borrowings were entered into before budget day.

10/8 arrangements

10/8 arrangements use life insurance policies and borrowed funds to create an ongoing interest expense deduction, a tax deduction for a portion of the life insurance premiums paid and an increase to the capital dividend account of the corporation. The budget proposes to deny:

- the deductibility of interest paid or payable on the borrowing relating to a period after 2013;
- the deductibility of the life insurance premiums relating to a period after 2013; and
- the increase to the capital dividend account by the amount of the death benefit that becomes payable to the corporation after 2013 under the policy that is associated with the borrowing.

In order to facilitate the windup of existing arrangements before 2014, the budget proposes to alleviate the tax consequences of withdrawing from a policy under this arrangement to repay the borrowing, if the withdrawal is made on or after March 21, 2013 and before January 1, 2014.

Various other tax measures

The budget proposes various other measures that are applicable to specific industry sectors, large business enterprises, and international transactions. These proposed measures include:

- accelerated capital cost allowance provisions for clean energy generation;
- accelerated capital cost allowance provisions for mining companies;
- recharacterization of pre-production mining expenses from Canadian exploration expenses (CEE) to Canadian development expenses (CDE);
- amending the reserve for future services to ensure that it will not be available with respect to amounts received for the purpose of funding future reclamation expenses;
- phasing out the additional deduction available to credit unions over a five year period beginning in 2013;
- elimination of the international banking centre rules;
- extending the scope of the thin capitalization rules to Canadian resident trusts and to non-resident corporations and trusts that operate in Canada;
- strengthening measures to combat international tax evasion and to address international aggressive tax avoidance; and
- consulting on possible measures to stop "treaty shopping" and protect the integrity of Canada's tax treaties while preserving a business tax environment that is conducive to foreign investment.

OTHER PROPOSALS

Canada Job Grant

The budget proposes a new measure to stimulate employee training in order to increase and improve the workforce. The grant could provide $15,000 or more per person, including a maximum federal contribution of $5,000 with matching contributions by the provinces or territories and employers. Detailed design of the program will be negotiated with the provinces and territories over the next year in consultation with stakeholder groups, including employer associations, educational institutions and labour organizations.

Tariff relief

The budget proposes to permanently eliminate all tariffs on baby clothes and sports and athletic equipment (other than bicycles). Tariffs on affected goods range from 2.5% to 20%, and reductions apply to 37 tariff items. These reductions will be effective in respect of goods imported into Canada on or after April 1, 2013.

Excise duty tax on manufactured tobacco

Effective March 22, 2013, the budget proposes to increase the rate of excise duty on manufactured tobacco (chewing tobacco and fine-cut tobacco used in roll-your-own cigarettes) from $2.8925 to $5.3125 per 50 grams or fraction thereof. That is the equivalent of $21.25 per 200 grams, putting the excise duty on par with that charged on manufactured cigarettes.

Sales and excise tax measures

The budget proposes several measures dealing with GST and HST on:

- home and personal care services;
- reports and services for non-health care purposes;
- pension plans; and
- paid parking.

Electronic suppression of sales software

The budget proposes new monetary penalties and criminal offences to combat the use of software to hide sales in order to evade payment of income taxes and GST/HST. Penalties will range from $5,000 to $10,000 for the first infraction and from $50,000 to $100,000 for subsequent infractions. Criminal offences can result in fines of up to $1 million and imprisonment for a term of up to five years, or both. These measures will apply on the later of January 1, 2014 and the date of royal assent.

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