The Navigator

RBC WEALTH MANAGEMENT SERVICES

2012 Federal Budget – March 29, 2012

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

On March 29, 2012, Federal Finance Minister Jim Flaherty delivered the majority government's 2012 federal budget.

Key highlights of the budget:

- 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.
- Changes to the Old Age Security (OAS) and Guaranteed Income Supplement (GIS) programs to gradually increase the age of eligibility from 65 to 67 and allow for the voluntary deferral of OAS for up to five years.
- An update to the life insurance policy exemption test that may result in a reduction of the income that is permitted to grow on a tax-sheltered basis within an exempt policy.
- A number of new measures to enhance the Registered Disability Savings Plan (RDSP).

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 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

Old Age Security changes

Age of eligibility - Starting on April 1, 2023, the budget proposes to gradually increase the age of eligibility for Old Age Security and Guaranteed Income Supplement from 65 to 67 years of age. Thus, individuals who were born on March 31, 1958 or earlier (currently 54 years of age or older) will not be affected. Those who were born on or after February 1, 1962 will have an age of eligibility of 67. Those born in between these dates will be eligible at the times indicated in the following table.

	Born in 1958	Born in 1959	Born in 1960	Born in 1961	Born in 1962
Month of Birth	OAS/GIS Eligibility Age				
Jan.	65	65 + 5 mo	65 + 11 mo	66 + 5 mo	66 + 11 mo
Feb. – Mar.	65	65 + 6 mo	66	66 + 6 mo	67
Apr. – May	65 + 1 mo	65 + 7 mo	66 + 1 mo	66 + 7 mo	67
June – July	65 + 2 mo	65 + 8 mo	66 + 2 mo	66 + 8 mo	67
Aug. – Sept.	65 + 3 mo	65 + 9 mo	66 + 3 mo	66 + 9 mo	67
Oct. – Nov.	65 + 4 mo	65 + 10 mo	66 + 4 mo	66 + 10 mo	67
Dec.	65 + 5 mo	65 + 11 mo	66 + 5 mo	66 + 11 mo	67
Note: mo = months.					

A long notification and phase-in period is being provided to ensure that individuals have significant notice to adjust their retirement plans.

Voluntary deferral of OAS - For individuals eligible for OAS starting on July 1, 2013, the budget proposes allowing individuals to postpone receiving their OAS payments for up to five years. Those who take their OAS at a later time will receive a higher OAS payment calculated on an actuarially neutral basis, as is done with the Canada Pension Plan (CPP).

Life insurance policy exemption test updated

Permanent life insurance policies (whole life and universal life) provide both an 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 changes to the exempt policy rules.

A life insurance policy is an exempt policy when the savings accumulating in the policy do not exceed the savings in a theoretical benchmark policy. This comparison then allows the insurance company to determine the premiums permitted to ensure the policy remains an exempt policy so that the savings component grows tax-sheltered. The assumptions used for the benchmark policy, against which a policy is tested, have been in place for the last 30 years. The budget proposes an update to the assumptions used for the benchmark policy to reflect increased life expectancy, current industry practices, and the current economic environment. These changes may result in a reduction of the maximum amount of premiums paid and the savings component that is permitted to grow on a tax-sheltered basis within an exempt policy.

Over the coming months, the Government will undertake consultations with key stakeholders on the proposed changes. Amendments to the tax provisions arising from these consultations will apply to life insurance policies issued after 2013. It is expected that policies issued on or before December 31, 2013 will not be affected by these proposed measures.

Registered Disability Savings Plan changes

RDSP plan holder - Currently, a plan holder of an RDSP for an adult can only be the beneficiary him or herself, his or her legal representative or, in certain circumstances, the parent of the beneficiary. The budget proposes that, temporarily, a qualifying family member, described as a spouse, common-law partner, or parent, will be allowed to be a plan holder of an RDSP for an adult who may not have the capacity to enter into a contract. This measure will apply from the date of Royal Assent to the end of 2016.

RDSP maximum and minimum withdrawals - The budget proposes to increase the maximum annual limit for withdrawals from RDSPs that are Primarily Government Assisted Plans (PGAPs), where Canada Disability Savings Grants and Canada Disability Savings Bonds exceed private contributions. The budget also proposes to extend the minimum annual withdrawal requirement that currently only applies to PGAPs to all RDSPs. A minimum amount will be required to be withdrawn from all RDSPs the year the beneficiary attains 60 years of age. These measures will apply after 2013.

RDSP- rollover of RESP investment income - The budget proposes to allow investment income earned in an RESP to be transferred on a tax-free (or rollover) basis to an RDSP, after 2013. The plans must share a common beneficiary and other qualifying conditions must be met. The amount of RESP investment income rolled over may not exceed and will reduce the beneficiary's available RDSP contribution room.

Termination of RDSP following cessation of eligibility for the disability tax credit - Under current rules where a beneficiary's condition improves such that he or she does not qualify for the Disability Tax Credit (DTC) for a taxation year, then the RDSP must be terminated. The budget proposes to extend the period for which an RDSP may remain open for four additional years when a beneficiary becomes ineligible for the DTC, under certain conditions. This measure will apply after 2013. A transitional rule applies to RDSPs that would have been terminated under the current rules before 2014.

Employees Profit Sharing Plans

Employees Profit Sharing Plans (EPSPs) are trust arrangements that enable employers to share profits with employees. However, EPSPs have been used increasingly as a means for some business owners to direct profits to family members in order to reduce or defer the payment of income tax on these profits. To discourage excessive employer contributions, the budget proposes to introduce a special tax payable by a "specified employee" on an "excess EPSP amount".

Under the *Income Tax Act*, a "specified employee" generally includes an employee who has a significant equity interest in their employer or who does not deal at arm's length with their employer. An "excess EPSP amount" will be the portion of an employer's EPSP contribution, allocated by the trustee of the EPSP to a specified employee that exceeds 20 per cent of the specified employee's salary received in the year from the employer. The "excess EPSP amount" will be subject to a special tax equal to the top federal and provincial marginal tax rates of the specified employee's province of residence (other than when the specified employee is resident in Quebec, when only the federal rate will apply). Also, the specified employee will not be able to claim any other deductions or credits in respect of an excess EPSP amount.

This measure will apply in respect of EPSP contributions made by an employer on or after March 29, 2012, other than contributions made before 2013 pursuant to a legally binding obligation arising under a written agreement or arrangement entered into before March 29, 2012.

Retirement Compensation Arrangements

A Retirement Compensation Arrangement (RCA) is a type of employer-sponsored, funded retirement savings arrangement. The budget proposes to introduce new "prohibited investment" and "advantage" rules to directly prevent RCAs from engaging in non-arm's length transactions. These rules will be based very closely on existing rules for Tax-Free Savings Accounts and Registered Retirement Savings Plans. As well, the budget proposes a new restriction on RCA tax refunds in circumstances where RCA property has lost value related to prohibited investments or advantages.

The prohibited investment rules will apply in respect of investments acquired, or that become prohibited investments, on or after March 29, 2012. The advantage rules will generally apply on or after March 29, 2012 subject to special transitional rules.

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, 2013.

Business Tax Changes

Eligible dividends – split dividend designation and late designation

If a dividend is an "eligible dividend", for example, a dividend paid out of income that was taxed at the general corporate income tax rate, the shareholder qualifies for an enhanced dividend tax credit (DTC).

Under current rules, the enhanced DTC for eligible dividends is available only if, at the time the dividend is paid, the corporation notifies each shareholder in writing that the dividend is designated as an eligible dividend. The designation applies to the entire dividend.

The budget proposes that for dividends paid after March 28, 2012, a corporation can designate, at the time it pays a taxable dividend, all or a portion of the dividend to be an eligible dividend and qualify for the enhanced DTC. This proposed measure will eliminate the need to designate and pay separate eligible and non-eligible dividends which will simplify administrative compliance.

Further, the Minister of National Revenue will be allowed to accept a late eligible dividend designation if the corporation makes the designation within three years after the day the designation was first required to be made.

Scientific Research and Experimental Development (SR&ED)

The budget proposes several measures to streamline and improve the SR&ED tax incentive program, including shifting from indirect tax incentives to more direct support for innovative private sector businesses.

Other Tax Changes

Cross-border shopping

Effective June 1, 2012, the budget proposes to increase the exemption to $200 from $50 for returning Canadian residents who are out of the country between 24 and 48 hours. The budget similarly proposes to increase exemption levels for travellers who are out of the country for 48 hours or more to $800. This new threshold will replace the current 48-hour exemption of $400 and the current 7-day exemption of $750.

Gifts to foreign charitable organizations

The budget proposes to modify the registration rules for foreign charities that wish to issue tax receipts to Canadians. Foreign charitable organizations that receive a gift from the Government of Canada may apply if they pursue activities related to disaster relief, urgent humanitarian aid or activities in the national interest of Canada.

Please contact your RBC advisor

for more information.

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