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Canadian tax alert
2013-2014 federal budget highlights

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Budget highlights

The Minister of Finance, James M. Flaherty, presented the 2013-2014 budget in the House of Commons this afternoon. This year's budget continues to focus on economic growth in this challenging global economy, with an emphasis on job creation and skills training, infrastructure investment and support for the rebounding manufacturing and processing (M&P) sector.

Mr. Flaherty indicated that while Canada's economy continues to grow, recovery is fragile. He indicated that the government is on track to return to balanced budgets by 2015-2016. The deficit for the 2012-2013 fiscal year is estimated at $25.9 billion. The deficit is projected to fall to $18.7 billion in 2013-2014 and continue to decline to $6.6 billion in 2014-2015, and in 2015-2016 a small surplus is predicted.

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- With the right tax policy, we believe that Canada can be more productive and globally competitive. The key lies in creating a tax ecosystem capable of fostering innovation and investment while supporting the objective of a balanced budget.
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The federal debt-to-GDP ratio is estimated to be approximately 33.5% for 2012-2013. This ratio is projected to grow slightly in 2013-2014 and then decline to 28.1% by 2017-2018. Inflation of 1.3% is predicted for 2013; for the subsequent 4 years, an inflation rate of 2% is predicted, resulting in an average annual rate of 1.8% for the 2013-2017 period. Unemployment is expected to continue to decline over the next five years from 7.1% in 2013 to 6.4% in 2017.

The following is a summary of the tax highlights contained in the budget.

Measures concerning business

- The budget proposes to extend the temporary accelerated capital cost allowance (CCA) rate of 50% for manufacturing and processing (M&P) machinery and equipment by an additional two years. This extension will apply to M&P machinery and equipment acquired in 2014 or 2015.
- The budget proposes to include both biogas production equipment that uses additional types of organic waste and a broader range of cleaning and upgrading equipment used to treat eligible gases from waste in Class 43.2 which is eligible for accelerated capital cost allowance. The changes apply to assets acquired on or after March 21, 2013 that has not been used or acquired for use before this date.
- The budget proposes to require that additional information concerning Scientific Research and Experimental Development (SR&ED) Program tax preparers and billing arrangements be included on the

SR&ED program claim form. A proposed penalty of $1,000 per claim is applicable where a form does not provide the requisite information. This measure will apply to claims filed on or after the later of January 1, 2014 and the day of Royal Assent.

- The budget proposes that, subject to certain exceptions, starting in 2015, the treatment of pre-production mine development expenses be transitioned from Canadian exploration expenses (CEE), deductible in full, to Canadian development expenses (CDE), deductible at a rate of 30% per year on a declining-balance basis. After 2017, 100% of these expenses will be treated as CDE.
- The budget proposes to phase out the additional accelerated CCA available for most mining assets over the 2017 – 2020 calendar years. The phase-out is not applicable to certain assets acquired prior to 2018, and assets used in mining for bituminous sands and oil shale, for which the phase-out will be complete in 2015.
- The budget proposes to clarify that the reserve for future services under paragraph 20(1)(m) cannot be used for amounts set aside to meet future reclamation obligations. This measure will generally apply to amounts received on or after March 21, 2013.
- Beginning in 2013, the budget proposes to phase out, over five years, the additional deduction, available only to credit unions, that provides a preferential income tax rate for income that is not eligible for the small business deduction. The deduction will be eliminated by 2017.
- The budget proposes to amend the restricted farm loss (RFL) rules to clarify that a taxpayer's farming losses will be fully deductible against other sources of income only if the other sources of income are secondary to farming. In addition, the budget proposes to increase the RFL limit to $17,500 of deductible farm losses annually. These measures will apply to taxation years ending on or after March 21, 2013.
- The budget proposes to introduce rules to eliminate tax benefits realized through the use of leveraged insured annuities (LIA). Under these new rules, life insurance policies deemed to be LIAs will be subject to tax on accrued income, will not be allowed a deduction for premiums paid on the policy, and will not be able to increase the capital dividend account of a private corporation by the death benefit received from the policy. In addition, for purposes of a deemed disposition on death, the fair market value of an annuity contract assigned to a lender in connection with an LIA policy will be deemed to be equal to the total premiums paid under the policy. These new measures will apply to taxation years that end on or after March 21, 2013.
- The budget proposes to introduce measures that will deny the income tax benefits resulting from the investment in a life insurance policy for the purposes of borrowing against that investment to generate an annual interest expense deduction. These measures will apply after 2013.
- The budget proposes to introduce an anti-avoidance rule that will deem there to be an acquisition of control of a corporation with loss pools where control has not otherwise been acquired, but where shares with a fair market value (FMV) of more than 75% of the FMV of all the shares of the corporation have been acquired by a person (or group of persons), and it is reasonable to consider that one of the main reasons that control was not acquired was the avoidance of the existing loss trading restrictions that apply on an acquisition of control. This measure will apply to the acquisition of shares of a corporation on or after March 21, 2013. Some exceptions apply in certain situations where a written agreement existed prior to March 21, 2013.
- After exploring the issue of the taxation of corporate groups, the government has decided that the introduction of a formal system of corporate group taxation will not be considered at this time.
- The budget proposes that, beginning in 2015, certain financial intermediaries will be required to report international electronic funds transfers (EFTs) of $10,000 or more to the Canada Revenue Agency (CRA). The reporting requirements will mirror those imposed under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act.
- The budget proposes, upon Royal Assent to streamline the process under which requirements for information and documentation are issued to third parties by the CRA for the purpose of verifying compliance by unnamed persons.
- The budget introduces the Stop International Tax Evasion Program. Under this program, individuals providing information to the CRA concerning major international tax non-compliance involving foreign property and/or transactions completed wholly or partially outside of Canada will be eligible for a taxable award of up to 15% of any federal tax collected (excluding interest and penalties), provided that the information results in total additional assessments or reassessments exceeding $100,000 in federal tax.

- For 2013 and later years, the budget proposes a number of changes concerning the Foreign Income Verification Statement (Form T1135) which includes a system to permit electronic filing of the form. The budget proposals include a requirement to report additional information in respect of each specified foreign property and an extension of the normal reassessment period for a taxation year of a taxpayer by three years if the taxpayer fails to report income from a specified foreign property on their annual income tax return and either the Form T1135 is filed late, or a specified foreign property is reported incorrectly on the form.
- For years beginning after 2013, the budget proposes to expand the scope of the thin capitalization rules to Canadian-resident trusts and non-resident corporations and trusts that carry on business in Canada. In the case of non-resident corporations and trusts carrying on business in Canada, a 3:5 debt-to-assets ratio is proposed. It is also proposed that the rules apply to partnerships of which such entities are members.
- The budget proposes to repeal the International Banking Centre rules for years that begin on or after March 21, 2013.
- The budget contains an announcement of the government's intention to consult on possible measures that will prevent what is perceived to be treaty shopping. Stakeholders will be provided with an opportunity to comment on possible measures.

Measures concerning individuals

- In recognition of the fact that adoption expenses must often be incurred before adoptive parents are matched with a child, the budget proposes to extend the adoption period in respect of which eligible expenses may be claimed in the 15% adoption expense tax credit back to the time of the filing of an application to register with a provincial ministry responsible for adoption or a licensed adoption agency or a Canadian court. This measure will apply to adoptions finalized after 2012.
- A temporary first-time donor's super credit is introduced which provides an additional 25% tax credit to a first-time charitable donor, on monetary donations of up to $1,000. A first time donor is an individual other than a trust who has not claimed a charitable donations tax credit for a prior taxation year ending after 2007 and whose spouse or common-law partner has not made such a claim. This credit is to be shared between spouses/common-law partners. It will be available for donations made on or after March 21, 2013 and may be claimed once for taxation year 2013 or a subsequent taxation year before 2018.
- Effective for taxation year 2014, the lifetime capital gains exemption (LCGE) for dispositions of eligible property will be increased by $50,000 to $800,000. For taxation years after 2014, the LCGE will be indexed to inflation.
- Applicable for taxation years beginning on or after March 21, 2013, the cost of renting a safety deposit box will not be deductible.
- The non-eligible dividend gross-up factor will be adjusted from 25% to 18% and the dividend tax credit (DTC) will be adjusted from 2/3 to 13/18. This change results in increased personal tax on non-eligible dividends and will apply to such dividends paid after 2013.
- Refunds of erroneous registered pension plan (RPP) overcontributions will be permitted to be made by RPP administrators without the approval of the CRA under certain limited circumstances. This measure will be applicable in respect of RPP contributions made on the later of Royal Assent date and January 1, 2014.
- The normal reassessment period in respect of a participant in a tax shelter or a reportable transaction, where an information return in respect of the tax shelter or reportable transaction is not filed on a timely basis, will be extended to three years after the date that the relevant return is actually filed. This measure will apply to taxation years that end on or after March 21, 2013.
- CRA collection actions will be permitted for 50% of disputed tax, interest or penalties in respect of the disallowance of a deduction or tax credit for a tax shelter that involves a charitable donation. This measure will apply to amounts assessed for the 2013 and subsequent taxation years.
- The mineral exploration tax credit will be extended for one year to flow-through share agreements entered into on or before March 31, 2014.

- The 15% labour-sponsored venture capital corporations tax credit will be phased out, and will be fully eliminated for the 2017 and subsequent taxation years, as follows: credit will be 15% for 2013 and 2014, 10% for 2015, 5% for 2016.
- Where a taxpayer enters into a "synthetic disposition transaction", being an agreement that effectively eliminates all or substantially all of the taxpayer's risk of loss and opportunity for gain or profit in respect of a property, a disposition and reacquisition of the property, both at fair market value will be deemed to have occurred. Further, where a taxpayer is deemed to have disposed of and reacquired a property under these rules, the taxpayer will be considered not to own the property for the purposes of the stop loss rules or the foreign tax credit provisions. This measure will apply to agreements entered into on or after March 21, 2013. It will also apply to agreements entered into before that date if the term is extended on or after March 21, 2013.
- Transactions that are considered to be "character conversion transactions", under which a derivative investment is linked with an unrelated capital property to form a derivative forward agreement, will be subject to income treatment rather than capital gains treatment if the derivative forward agreement has a duration of more than 180 days. The adjusted cost base of the capital property will be adjusted for the income or loss in order to prevent double taxation. This measure will apply to derivative forward agreements entered into on or after March 21, 2013, as well as those entered into before March 21, 2013 if the term is extended on or after March 21, 2013.
- The budget proposes to extend to trusts the loss-streaming rules that currently apply to corporations on an acquisition of control. The new rules will apply when a trust has been subject to a "loss restriction event". Rules will be introduced that deem certain transactions to be considered (or not considered) a loss restriction event, which will prevent many typical transactions, such as changes in the beneficiaries of a personal trust, from being caught by these proposed changes. This measure will apply to transactions that occur on or after March 21, 2013.
- For taxation years that end on or after March 21, 2013, the deemed residence rules applicable to certain non-resident trusts are proposed to be extended to include circumstances where property that is held by a non-resident trust under conditions whereby effective ownership of the property is maintained by a Canadian-resident taxpayer. The budget also proposes to restrict the application of the trust attribution rules so that they apply only in respect of property held by a trust that is resident in Canada (determined without application of the deemed residence rules).
- The budget announces the government's intention to consult on the potential introduction of measures that would eliminate the tax benefits associated with the graduated tax rates enjoyed by certain testamentary and certain inter vivos trusts. A consultation paper inviting comments from the public will be released.

Sales and excise tax measures

- Budget 2013 proposes to exempt the supply of publicly subsidized or funded personal care services from goods and services tax/harmonized sales tax (GST/HST), effective for supplies made after budget day. The exemption applies to such services as bathing, feeding, assistance with dressing or taking medication rendered to persons who, due to age, infirmity or disability, require assistance in their home.
- The budget proposes to clarify that supplies of reports, examinations and other services that are not performed for the purpose of the protection, maintenance or restoration of the health of a person or for palliative care are taxable if made after budget day, and if not paid for by provincial/territorial health insurance programs. Supplies of property or services in respect of such taxable reports, examinations or other services would likewise be taxable.
- The budget proposes certain prospective measures intended to simplify compliance for employers participating in registered pension plans, including an election to prevent the simultaneous application of both the deemed taxable supply rules and tax on actual supplies made (after budget day) to a pension entity, as well as relief from accounting for tax (for fiscal years beginning after budget day) on the deemed taxable supplies where the amount of the deemed GST (and the federal portion of the HST) in a preceding year does not exceed certain de minimis thresholds.
- Budget 2013 proposes to authorize the Minister to withhold GST/HST refunds claimed by a business until such time as the business has provided all requisite business identification information that should

otherwise have been provided upon registration. This measure will be applicable on Royal Assent to the enacting legislation.

- The budget proposes to clarify that supplies of paid parking made on a regular basis in the course of a business carried on by a public sector body (PSB) are subject to GST/HST, even if all or substantially all of such supplies of parking are made for free. Occasional supplies of paid parking, not made in the course of the PSB's business, would continue to be exempt. This measure is effective as of the date the GST legislation was enacted.
- The budget also proposes to clarify that supplies of paid parking made after budget day in the course of a business carried on by a charity are taxable where the charity was set up or used by a municipality, university, public school, college, or a hospital to operate a parking facility.
- Budget 2013 proposes substantial administrative monetary penalties and criminal offenses (subject to reasonable due diligence efforts) in respect of the use, possession or acquisition, manufacture, development, and sale of Electronic Suppression of Sales software. These new sanctions apply on the later of January 1, 2014 and Royal Assent to the enacting legislation.
- The budget proposes to increase the rate of excise duty on manufactured tobacco effective after March 21, 2013.
- For goods imported into Canada on or after April 1, 2013, the budget proposes to permanently eliminate all tariffs on baby clothes and sports and athletic equipment (excluding bicycles).
- The budget includes certain proposed modifications to the list of countries eligible for Canada's General Preferential Tariff regime for developing countries. The changes are effective for goods imported into Canada on or after January 1, 2015, and will remain in effect for 10 years.

Other measures

- The temporary hiring credit for small business has been expanded and extended for one year. This credit will provide up to $1,000 to offset increased Employment Insurance (EI) premium costs for a small business that had total EI premiums of less than $15,000 in 2012.
- The budget proposes to introduce the Canada Job Grant for businesses who plan to train Canadians for an existing job or a better job. The Grant includes a maximum federal contribution of $5,000 and could provide $15,000 or more per person as federal contributions are required to be matched by both provinces/territories and employers.
- To support economic growth in southern Ontario, the budget proposes to provide $920 million over five years through the Federal Economic Development Agency for Southern Ontario, starting on April 1, 2014. As part of this funding for manufacturers in southern Ontario, the budget proposes to provide $200 million over five years for a new Advanced Manufacturing fund.
- The budget announces an investment of over $10 billion in federal infrastructure projects including a new bridge for the St. Lawrence River, the Windsor-Detroit International Crossing, and maintaining VIA Rail services for remote communities.
- Following the recommendations of the Aerospace Review, the budget proposes to provide additional funding of almost $1 billion over five years for the Strategic Aerospace and Defence Initiative and to create an Aerospace Technology Demonstration Program with funding of $110 million over four years, starting in 2014-2015, and $55 million per year thereafter.
- To further enhance Canada's venture capital industry, the budget proposes to invest funds in Canadian business accelerators and incubators and Canadian Youth Business and to create a new award for entrepreneurs.
- To enhance support for business innovation in Canada, the budget proposes to provide additional funds to transform the National Research Council, to implement a new pilot program to support the commercialization of research of small and medium-sized businesses, and to continue to support development of new, clean technologies through Sustainable Development Technology Canada.

For further details, we refer you to the **Ministry of Finance website**.

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