Grant Thornton

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A majority budget: on the road to a surplus for 2015-2016

Federal budget March 29, 2012

Today, Canadian Finance Minister, the Honourable James M. Flaherty, presented the first budget of the Conservative majority government; his objective is to generate a $3.4 billion surplus as of 2015-2016.

Spending cuts will achieve savings of about $5.2 billion, representing less than 2% of program spending in 2016–17 or 0.2% of Canada's GDP that same year.

Compared with other G7 members, Canada has fared well, despite the debt crisis and European banking crisis that continue to undermine the world economy. While Canada expects modest growth in the short term, the government has chosen to support business and entrepreneurs directly by encouraging innovation and prosperity.

To support research, innovation and entrepreneurship, the 2012 economic action plan will provide $1.1 billion over five years in direct research and development support and $500 million in venture capital. However, the significant Scientific Research and Experimental Development (SR&ED) Tax Incentive Program will unfortunately see a $1.33 billion reduction in business credits over five years. The SR&ED measures are summarized in this document.

Other measures include $165 million over two years for natural resource development, and a streamlined review process for major economic projects in order to reduce red tape, encourage investors and contribute to the economic viability of major projects.

Lastly, one measure that affects all Canadians is the gradual increase of the Old Age Security age of eligibility from 65 to 67 for anyone born after March 31, 1958.

Please contact us for more information on the tax measures in this bulletin.

Unless otherwise indicated these measures apply to fiscal years ending after March 29, 2012, for businesses and as of the 2012 calendar year for individuals.

Businesses

	Current measures	Proposed measures	+/-
Clean energy generation equipment			
Expansion of Class 43.2 eligible for accelerated capital cost allowance			
Waste-fuelled thermal energy equipment	• Eligible if energy generated is used in an industrial process or a greenhouse	• Requirement on use of energy withdrawn	+
Equipment of a district energy system	• Eligible if energy generated by a cogeneration system, a ground source heat pump, active solar heating equipment or heat recovery equipment	• Addition of equipment that uses thermal energy provided primarily by eligible waste-fuelled thermal energy equipment	+
Energy generation from residue of plants	• Generally eligible if used to produce biogas or bio-oil	• The residue of plants added to the list of eligible waste fuels that can be used in waste-fuelled thermal energy equipment	+
Environmental compliance of equipment using fuels from waste	• None	• Equipment eligible for accelerated capital cost allowance treatment only if it complies with environmental regulations at the time the equipment becomes available for use • Applicable to new equipment acquired on or after March 29, 2012	+
Mineral exploration and development			
Phase out of the tax credit for pre-production mining expenditures and pre-production development expenses	• Tax credit: 10%	• Tax credit for pre-production mining expenditures – 2012: 10% – 2013: 5% – 2014 and after: 0% • Tax credit for pre-production development expenses – 2012 and 2013:10% – 2014: 7% – 2015: 4% – 2016 and after: 0% • Transitional relief for pre-production development expenses: – Credit of 10 % from 2012 until 2015 – Under a written agreement entered into before March 29, 2012	-

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Atlantic Investment Tax Credit (AITC)			
Phasing out of the AITC for oil & gas and mining activities	• 10% tax credit	• Tax credit: – 2012 and 2013: 10% – 2014 and 2015: 5% – 2016 and after: 0% • Transitional relief for certain projects: – Credit of 10% from 2012 to 2016 – If there is a written agreement or if construction, design or engineering work started before March 29, 2012	-
Expansion of base eligible for AITC for farming, fishing, logging, manufacturing and processing	• Eligible property: new prescribed building, machinery and equipment	• List of "qualified property" expanded to include: – Equipment used to produce electricity described in Class 17 or 48 – Clean energy generation and conservation equipment described in Class 43.1 or 43.2 • Applicable to new property acquired on or after March 29, 2012	+

Scientific Research and Experimental Development (SR&ED)			
Reduction of investment tax credit (ITC) general rate	• General rate is 20% • Enhanced rate is 35% for Canadian-controlled private corporations	• General rate reduced to 15 % • Enhanced rate unchanged • Applicable to taxation years ending after 2013 (pro-rated for years straddling January 1, 2014)	-
SR&ED capital expenditures (including payment for the right to use property that would be capital property)	• SR&ED capital expenditures: – Fully deductible; and – eligible for tax credit	• Capital expenditures now excluded from expenditures giving entitlement to deductions and SR&ED tax credits • Contract payments also excluded to extent payment is for a capital expenditure • Applicable to expenditures incurred after 2013	-
Reduction of rate used for proxy amount for overhead expenditures	• Proxy amount equal to 65% of eligible salaries	• Proxy amount reduced to: – 60% of salaries in 2013 – 55% of salaries for subsequent years	-
Reduction in SR&ED expenditures for contract payments to an arm's-length person	• Total amount paid to non-arm's-length performer eligible for tax credit	• 80% of amount paid to eligible performer (applicable to expenditures incurred as of 2013) • Capital expenditures incurred by performer excluded from performer's eligible expenditures as of 2014	-

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Partnerships			
Introduction of specific anti-avoidance measures	• No specific anti-avoidance measures: – against the possibility of circumventing the bump denial rule for income producing assets when the property owned by the subsidiary at the time of its winding-up or merger into the parent company is an interest in a partnership that holds income assets; – on the sale of a partnership by a taxpayer to a non-resident person or on indirect sales of partnership interests to a tax-exempt person	• Specific anti-avoidance measures are introduced to apply to these transactions • Applicable to amalgamations/wind-ups or dispositions on or after March 29, 2012, with some exceptions.	-
Partnership waivers	• Waiver period cannot be extended to determine new amount of income, loss or other deductions in respect of a partnership unless there is a waiver from all partners	• Designated partner of a partnership will be empowered to waive the time limit on behalf of all partners. • Applicable on Royal Assent to the enacting legislation	+
Eligible dividend			
Split-dividend designation and late designation	• Split-dividend designation and late designation not possible	• Split-dividend designation and late designation possible • Applicable to taxable dividends paid on or after the budget date.	+

International

	Current measures	Proposed measures	+/-
Transfer pricing			
Secondary adjustments	• No specific provision regarding secondary adjustments to account for the benefit conferred on the non-resident parent company after a primary adjustment has been made in respect of a Canadian corporation	• Secondary adjustments considered as dividends for Part XIII tax purposes • No deemed dividend if the non-resident is a controlled foreign affiliate or if an amount is repatriated to the Canadian corporation subject to the primary adjustment	+

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Thin capitalization rules			
Reduction of debt-to-equity ratio	• Deductibility of interest expense of a Canadian-resident corporation limited where the amount of debt owing to certain non-residents exceed a 2-to-1 debt-to-equity ratio	• Reduction of the debt-to-equity ratio to 1.5-to-1 • Applicable to taxation years that begin after 2012	-
Extension of the rules to interest expense incurred by partnerships	• Thin capitalization rules do not apply to interest expense incurred by partnerships	• The thin capitalization rules will apply to debts owed by partnerships of which a Canadian-resident corporation is a member • Debt obligations of the partnership allocated to its members based on their proportionate interest in the partnership • Applicable in respect of debts of a partnership that are outstanding during corporate taxation years that begin after March 28, 2012	-
Reclassification of non-deductible interest expense for purposes of the non-resident withholding tax	• Non-deductible interest expense under the thin capitalization rules are treated as interest for withholding tax purposes	• Non deductible interest expense to be treated as dividend for withholding tax purposes.	-
Elimination of double taxation of certain controlled foreign affiliate loans	• Possibility of double taxation on loans under the thin capitalization rules and foreign accrual property income (FAPI)	• Interest taxable as FAPI of a controlled foreign affiliate to be excluded from the application of the thin capitalization rules	+
Foreign affiliates			
Introduction of a deemed dividend	• None	• Dividend deemed to be paid by a Canadian subsidiary to its foreign parent to the extent of any non-share consideration given by the Canadian subsidiary for the acquisition of the shares of a foreign affiliate • Applicable to transactions that occur on or after March 29, 2012 subject to certain transitional rules	-
Overseas employment tax credit			
Phasing out of credit	• Tax credit on 80% of qualifying foreign employment income, up to a maximum foreign employment income of $100,000	• Eligible portion of qualifying employment income reduced to: – 60% for 2013 – 40% for 2014 – 20% for 2015 • Credit eliminated as of 2016 • Some transitional rules apply	-

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Individuals

	Current measures	Proposed measures	+/-
Medical expense tax credit			
Addition to the list of eligible expenses	• None	• Prescribed blood coagulation monitors for use by individuals who require anti-coagulation therapy, including pricking devices, lancets and test strips	+
Registered Disability Savings Plans			
RDSP plan holder	• Where RDSP is established for beneficiary who has attained the age of majority, plan holder must be either the beneficiary or the beneficiary's guardian or other legal representative	• On a temporary basis, a spouse, common-law partner or parent can become the plan holder for the RDSP beneficiary • Applicable on Royal Assent of enacting legislation until the end of 2016	+
Repayment of Canada Disability Savings Grants (CDSGs) and Canada Disability Savings Bonds (CDSBs)	• 10-year replacement rule if an amount is withdrawn from the RDSP, the RDSP is terminated or the beneficiary ceases to be eligible for the disability tax credit (DTC) or dies	• A proportional repayment rule is introduced for RDSP withdrawals • Repayment will equal $3 for each $1 withdrawn (up to a maximum) • Applicable to withdrawals after 2013	+
Maximum and minimum withdrawals	• Rules limit the minimum and maximum amount that may be withdrawn annually	• The maximum annual limit for withdrawals from primarily government assisted plans (PGAPs) will increase • Minimum annual withdrawal requirements for PGAPs will be extended to all RDSPs • Applicable after 2013	+
Rollover of RESP investment income	• None	• Investment income earned in an RESP can be transferred on a tax-free basis to an RDSP if the plans share a common beneficiary • Applicable to rollovers after 2013	+
Termination of RDSP	• RDSP must be terminated once beneficiary ceases to qualify for DTC	• Extension of time period during which an RDSP can remain open when a beneficiary becomes DTC-ineligible. • Applicable to elections made after 2013	+
Administrative changes	• None	• Certain administrative changes announced to extend or eliminate deadlines	+
Mineral exploration tax credit			
Extension of tax credit	• Tax credit of 15% of mineral exploration expenses renounced to flow-through share investors • Introduced in 2000, ending at the end of March 2012	• Eligibility period extended by one year to flow-through share agreements entered into before April 1, 2013 and in respect of eligible expenses which may be incurred until the end of 2014	+

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Group sickness or accident insurance plans			
Employer contributes to group sickness or accident insurance plan	• Benefits included in employee's income when received except where benefits are not payable on a periodic basis or there is no loss of employment income	• Employer contributions included in employee's income for year contributions are made to extent contributions are not in respect of a wage-loss replacement benefits payable on a periodic basis • Applicable to employer contributions made after March 28, 2012 where contributions relate to post 2012	-
Retirement compensation arrangements			
Prohibited investments	• None	• Rules will parallel existing rules for Tax-Free Savings Accounts, RRSPs and RRIFs • Applicable to RCAs that have a "specified beneficiary" • 50% tax on FMV of prohibited investment; refundable in certain situations • Applicable to investments that become prohibited investments on or after March 29, 2012	-
Advantage rules	• None	• Rules will parallel existing rules for Tax-Free Savings Accounts, RRSPs and RRIFs • 100% tax equal to FMV of advantage • Applicable to advantages received on or after March 29, 2012; subject to special transitional rules where the advantage relates to property acquired before March 29, 2012	-
RCA refunds	• Refundable portion equal to 50% of contributions plus income earned and capital gains realized	• Restrictions on refundable portion where property held in RCA has declined in value	-
Employees Profit Sharing Plans (EPSPs)			
Introduction of a special tax	• None	• New special tax payable by a "specified employee" on an excess EPSP amount • Special tax on excess amount equal to 29% plus the top marginal rate of tax for the province of residence of the specified employee • Excess EPSP amount is calculated as the portion of an employer's EPSP contribution for a specified employee that exceeds 20% of the employee's salary received in the year • Applicable to EPSP contributions made on or after March 29, 2012, with an exception for certain contributions made before 2013	-

Salary of the Governor General of Canada			
Taxation of salary	• Exempt	• Taxable as of 2013	+
Life insurance policy exemption			
Exemption criteria	• Tax exemption for life insurance policies when savings accrued in the policy do not exceed those of a benchmark policy using various criteria.	• Exemption criteria amended to simplify exemption test	-

Sales tax

	Current measures	Proposed measures	+/-
Health measures			
GST exemption or zero-rating of certain health care services or medical devices	• None	• Exemption: – Certain services provided by pharmacists in their pharmacist-patient relationship, as well as diagnostic services ordered by pharmacists (where authorized to do so) • Zero-rated: – Corrective eyewear prescribed by a person authorized under provincial law; – Blood coagulation monitoring or metering devices, associated test strips and reagents – Devices supplied on the written order of registered nurses, occupational therapists and physiotherapists – Non-prescription Isosorbide-5-mononitrate	+
GST rebate for books			
Expansion of GST rebate for books acquired to promote literacy	• GST rebate for printed books purchased by certain organizations to promote literacy • Books purchased to be sold or given away are not included in measure	• Printed books by certain literacy organizations purchased to be given away for free will be eligible for the rebate • Applicable to GST payable after March 29, 2012	+
GST/HST streamlined accounting thresholds			
Thresholds increased	• Taxable sales threshold for electing to use streamlined method for GST/HST remittances: $200,000 • Threshold for electing to use the streamlined method for ITC calculations: – $500,000 of taxable sales; and – $2M of taxable purchases	• Taxable sales threshold increased to $400,000 for GST/HST remittances • Taxable sales and purchase thresholds increased to $1M and $4M respectively for ITC calculation • Applicable to reporting periods starting after 2012	+

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Foreign-based rental vehicles temporarily imported			
Tax relief	• GST, green levy and tax on automobile air conditioners currently applies on foreign-based rental vehicles temporarily imported to Canada by Canadian residents	• Various exemptions applicable to temporary imports after May 31, 2012	+

Other measures

	Current measures	Proposed measures	+/-
Charities			
Rules for registering certain foreign charitable organizations as qualified donees	• Foreign charities may issue an official donation receipt it has received a gift from the Government of Canada	• Foreign charitable organization may apply for qualified donee status if they pursue activities: – Related to disaster relief or urgent humanitarian aid; or – In the national interest of Canada • Status granted for a 24-month period • Effective to applications on or after the later of – January 1, 2013; and – Royal Assent to the enacting legislation	+
Enhancing transparency and accountability of registered charities	• A charity is allowed to engage in political activity as long as the activities represent a limited portion of its resources, are non-partisan and are ancillary and incidental to its charitable purposes and activities • No requirement to disclose the extent to which it receives funding from foreign sources for political activities • The CRA may not apply intermediate sanctions in the context of political activities • A gift by a charity to another qualified donee considered to have been devoted to its charitable purposes even if the gift is earmarked for political activities	• Additional enforcement tools to be provided to the CRA to enhance compliance and increase disclosure by charities regarding political activities • The CRA will have the authority to suspend the tax-receipting privileges of the charity – If it exceeds the limitations on political activities, or – If it provides inaccurate or incomplete information • The gift will be considered to be an expenditure made by the charity on political activities • Applicable on Royal Assent to the enacting legislation	+

Tax shelter administrative changes			
Modification of the penalty applicable to a promoter when the person participates in an unregistered charitable donation tax shelter	• Penalty: – The greater of: • $500; and • 25% of the consideration received	• Penalty: – The greater of: • $500; • 25 % of the consideration received; and • 25 % of the amount asserted by the promoter to be the value of property that participants in the tax shelter can transfer to a donee • Applicable on Royal Assent to the enacting legislation	+
New penalty for a promoter of tax shelter	• Penalty for late filing of annual information return: – The greater of: • $100; and • $25 multiplied by the number of days that the return is outstanding to a maximum of $2 500	• Additional penalty if a promoter fails to file an annual information return or fails to report in the return an amount paid by a participant in respect of the tax shelter: – 25% of the consideration received or receivable by the promoter; – In the case of a charitable donation tax shelter, the greater of • 25% of the consideration received or receivable by the promoter; and • The amount asserted by the promoter to be the value of the property that those participants can transfer to a donee • Applicable on Royal Assent to the enacting legislation	+
Limit to the validity of the tax shelter identification number	• No expiration date	• The tax shelter identification number will be valid only for the calendar year identified in the application for the number – Effective to applications made on or after March 29, 2012 – Tax shelter identification numbers issued as a result of applications made before March 29, 2012 will be valid until the end of 2013	+

Customs tariff			
Energy	• 5% Most-favoured-nation (MFN) rate of duty on certain imported oils used as production inputs in gas and oil refining as well as electricity production	• Elimination of rate of duty in respect of goods imported on or after March 30, 2012	+
Travellers' exemption	• Exemption of customs duty and GST/HST applicable to returning Canadian residents – $50 for returning residents who are out of the country for 24 hours or more – $400 for returning residents who are out of the country for 48 hours or more – $750 for returning residents who are out of the country for seven days or more	• Exemption of customs duty and GST/HST applicable to returning Canadian residents – $200 for returning residents who are out of the country for 24 hours or more – $800 for returning residents who are out of the country for 48 hours or more	+