

Federal Budget 2011 summary

A leader in the timely and thorough preparation of tax information on a range of issues, Invesco Trimark has been providing a customized summary of the Federal Budget for over a decade.

This summary has been prepared from within the Budget lockup in Ottawa by Doug Carroll, Invesco Trimark's Vice President of Tax & Estate Planning.

As is our practice, this Invesco Trimark summary selectively focuses on specific Budget elements that may have the biggest impact on personal finances and investments.

While there are quite a number of measures proposed in Budget 2011, it would be difficult to characterize any of them as major developments.

Still, there is welcome income support for low-income seniors in the form of improvements to the Guaranteed Income Supplement.

As well, families will get some tax relief for the costs of cultural activities for young children, and both Registered Education Savings Plan (RESP) and Registered Disability Savings Plan (RDSP) administration will be made more flexible.

For financial advisors it will be important to become familiar with proposed changes targeted at "closing tax loopholes," including new anti-avoidance rules for Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs) that follow from recent Tax-Free Savings Accounts (TFSA) changes. On the positive side, the costs of professional licensing and certification exams may now be eligible for the tuition credit.

Personal income tax measures

Rates and brackets

Federal tax brackets and tax credits are indexed each year by an indexation factor defined in the Income Tax Act, which this year is 1.4%.

For federal tax calculation, that brings the basic personal amount up to \$10,527, with the top bracket rate applicable at \$128,800.

The rates at each bracket level remain unchanged.

Applicable rate	2010	2011
15%	10,382	10,527
22%	40,970	41,544
26%	81,941	83,088
29%	127,021	128,800

Seniors

Enhancing the Guaranteed Income Supplement for low-income seniors

The Budget announces a new Guaranteed Income Supplement top-up benefit targeted to the most vulnerable seniors.

Effective July 1, 2011, seniors with little or no income other than Old Age Security and the Guaranteed Income Supplement will receive additional annual benefits of up to \$600 for single seniors and \$840 for couples.

Single recipients with an annual income (other than Old Age Security and the Guaranteed Income Supplement) of \$2,000 or less, and couples with an annual income of \$4,000 or less, will receive the full amount of the benefit. Above these income thresholds, the amount of the top-up will be gradually reduced and will be completely phased out at an income level of \$4,400 for singles and \$7,360 for couples.

Ongoing consideration of the retirement income system

The Budget confirms existing efforts to review the retirement income system, with one financial commitment following through on the financial literacy initiative.

- Federal, provincial and territorial officials are working together to implement Pooled Registered Pension Plans (PRPPs) to provide Canadians with a new, low-cost, accessible vehicle to meet their retirement objectives
- The Government has received the recommendations of the Task Force on Financial Literacy, and a Financial Literacy Leader will soon be appointed to promote national efforts. The Budget proposes to provide \$3 million per year to undertake financial literacy initiatives
- Federal, provincial and territorial governments are continuing work on options for a modest enhancement to the Canada Pension Plan (CPP)

Families

Children's Arts Tax Credit

The Budget proposes to introduce a Children's Arts Tax Credit.

This will allow parents to claim a 15% non-refundable tax credit based on an amount of up to \$500 in eligible expenses per child paid in a year. The credit will be available for the enrolment of a child who is under 16 years of age at the beginning of the year, in an eligible program of artistic, cultural, recreational or developmental activities.

For a child who is under 18 years of age at the beginning of the year and is eligible for the Disability Tax Credit, the 15% non-refundable tax credit may be claimed on an additional \$500 disability supplement amount when a minimum of \$100 is paid in eligible expenses.

An eligible program must include a significant amount of eligible activities and must be ongoing in nature. In this regard, an eligible program will be either:

- a weekly program lasting a minimum of eight consecutive weeks; or
- in the case of children's camps, a program lasting a minimum of five consecutive days.

This measure will apply to eligible expenses paid in the 2011 and subsequent taxation years.

Child Tax Credit eligibility

The Child Tax Credit (CTC) is a 15% non-refundable credit based on an indexed amount (\$2,131 in 2011) that can be claimed by parents for each child who is under 18 years of age at the end of a taxation year.

Current rules provide that not more than one individual can claim the CTC in respect of the same domestic establishment, which means that when two or more families share a home, only one individual in one family may claim the CTC in respect of his or her children. For example, if two adult sisters live together and each has a child under 18 years of age, under current rules, only one sister can claim the CTC for her child.

To ensure that sharing a home does not prevent otherwise-eligible parents from claiming the CTC in respect of their children, the Budget proposes to repeal the rule that limits the number of CTC claimants to one per domestic establishment.

This measure will apply to the 2011 and subsequent taxation years.

Family Caregiver Tax Credit

To provide new support to caregivers of dependants with a mental or physical infirmity, including spouses, common-law partners and minor children, the Budget proposes to introduce a Family Caregiver Tax Credit.

Caregivers will benefit from the Family Caregiver Tax Credit by claiming an enhanced amount for an infirm dependant under one of the following existing dependency-related credits:

- Spousal or Common-Law Partner Credit
- Child Tax Credit
- Eligible Dependant Credit
- Caregiver Credit
- Infirm Dependant Credit

This 15% non-refundable credit will be based on an amount of \$2,000 and will apply beginning in 2012.

Medical Expense Tax Credit for other dependants

A taxpayer may claim a credit regarding eligible expenses incurred in respect of himself or herself, his or her spouse or common-law partner, or his or her child who is under 18 years of age.

Caregivers may also claim the Medical Expense Tax Credit regarding eligible expenses incurred in respect of a "dependent" relative if the caregiver pays medical or disability-related expenses of the dependent relative, subject to a \$10,000 annual limit. For this purpose, a "dependent" relative is defined as a child 18 years of age or older, grandchild, parent, grandparent, brother, sister, uncle, aunt, niece or nephew who is dependent on the taxpayer for support.

To better recognize the impact that extraordinary medical expenses can have on a caregiver's ability to pay tax, the Budget proposes to remove the \$10,000 limit on eligible expenses that can be claimed under the Medical Expense Tax Credit in respect of a dependent relative.

This measure will apply to the 2011 and subsequent taxation years.

Education

Tuition tax credit - Examination fees

The Budget proposes to amend the Tuition Tax Credit to recognize fees paid to an educational institution, professional association, provincial ministry or other similar institution to take an examination that is required to obtain a professional status recognized by federal or provincial statute, or to be licensed or certified in order to practice a profession or trade in Canada.

Ancillary fees and charges paid in respect of occupational, trade or professional examinations will also be eligible for the credit.

This measure will apply to eligible amounts paid in respect of examinations taken in 2011 and subsequent taxation years.

Education tax measures - Study abroad

To improve the tax recognition of education costs and access to Educational Assistance Payments (EAPs) for Canadian post-secondary students who study outside Canada, the Budget proposes to reduce the minimum course-duration requirement that a Canadian student at a foreign university must meet in order to claim the Tuition, Education and Textbook Tax Credits to three consecutive weeks from 13 consecutive weeks.

It is also proposed that the 13-consecutive-week requirement for EAP purposes be reduced to three consecutive weeks when the student is enrolled at a university in a full-time course.

This measure will apply with respect to tuition fees paid for courses taken in the 2011 and subsequent taxation years and to EAPs made after 2010.

Registered Plans

RESPs - Asset sharing among siblings

RESPs are tax-assisted savings vehicles designed to help families accumulate savings for a child's post-secondary education. An RESP may take the form of an individual plan or a family plan.

Family plans allow parents who have named multiple children as beneficiaries to direct plan assets from those among their children who do not pursue post-secondary education to those who do pursue post-secondary education.

To provide subscribers of separate individual plans with the same flexibility to allocate assets among siblings as exists for subscribers of family plans, 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. The Budget also proposes related amendments to the *Canada Education Savings Regulations* to give effect to this measure in relation to CESGs.

These measures will apply to asset transfers that occur after 2010.

RDSPs - Shortened life expectancy

The Budget proposes to allow RDSP beneficiaries who have shortened life expectancies of five years or less to withdraw more of their RDSP savings by permitting annual withdrawals without triggering the 10-year repayment rule, subject to specified limits and certain conditions.

Under the proposal, withdrawals made at any time following an election will not trigger the repayment of Canada Disability Savings Grants (CDSGs) and Canada Disability Savings Bonds (CDSBs) provided that the total of the taxable portions of the withdrawals does not exceed \$10,000 annually. Accordingly, total annual withdrawals may exceed \$10,000 due to non-taxable portions.

An election must be made using a prescribed form and submitted with the medical certification to the RDSP issuer.

Once an election has been made:

- No further contributions to the plan will be allowed, except that a rollover of a deceased individual's RRSP or a RRIF proceeds to the RDSP of a financially dependent infirm child or grandchild will still be permitted
- No new CDSGs or CDSBs will be paid into the plan. Upon the passing of the beneficiary, any CDSGs and CDSBs remaining in the plan and that were received by the plan within the preceding 10 years must be repaid
- No CDSG or CDSB entitlements will be carried forward in respect of years under election, other than for the year in which the election is made
- The minimum withdrawal requirements that ordinarily apply in the year in which a beneficiary attains 60 years of age will apply to the plan starting in the year following the election, regardless of the age of the beneficiary

Using a prescribed form, a plan holder will be permitted to reverse an election prescribed form on a prospective basis at any time. In this case, the regular RDSP rules will generally apply, except that no new CDSGs and CDSBs will be paid into the plan until the year after that in which the election is reversed.

This measure will apply after 2010 to withdrawals made after Royal Assent to the enacting legislation. However, as a transitional rule, beneficiaries making an election under this measure will be permitted to utilize their 2011 withdrawal limit in 2012 provided that the required medical certification was obtained before 2012.

RDSP three-year review

A review of the RDSP program will be conducted in 2011, coinciding with the three-year anniversary of its introduction 2008. Key items to be reviewed include:

- The general requirement that grants and bonds paid into an RDSP in the previous 10 years be repaid if an RDSP withdrawal is made
- The requirement that an RDSP be closed if an individual is no longer eligible for the Disability Tax Credit, which is of particular concern for those with periodic disabilities
- Difficulties in establishing a plan when the nature of an individual's disability precludes him or her from entering into a contract

RRSPs - Anti-avoidance rules

The Budget proposes to enhance the existing RRSP anti-avoidance rules by introducing rules similar to the following anti-avoidance rules that currently apply to TFSAs.

Generally these new provisions will apply to transactions occurring, and investments acquired, after Budget Day.

The advantage rules

The Budget proposes to expand the existing RRSP advantage rules by adopting the "advantage" concept from the TFSA rules, with certain modifications.

Under the TFSA rules, an "advantage" may generally be described as a benefit obtained from a transaction that is intended to exploit the tax attributes of a TFSA. Among the portions of the TFSA advantage concept that will be included as RRSP advantages:

- Benefits derived from transactions that would not have occurred in a regular, open market between arm's length parties, if it is reasonable to conclude that the transactions were undertaken to benefit from the tax attributes of RRSPs
- Certain payments related to services rendered, special classes of shares or investment income tied to the existence of another investment
- Asset purchase and sale transactions ("swap transactions") between RRSPs and other accounts controlled by the RRSP annuitant, particularly performed on a frequent basis with a view to exploiting small changes in asset value, potentially be used to shift value to or from an RRSP without paying tax

The prohibited investment rules

The Budget proposes to introduce a “prohibited investment” concept for RRSPs, based closely on the TFSA prohibited investment rules.

In the TFSA context, a “prohibited investment” includes debt of the TFSA holder and investments in entities in which the TFSA holder or a non-arm’s length person has a “significant interest” (generally 10% or more) or with which the TFSA holder does not deal at arm’s length. This definition will be adopted for RRSP purposes.

A special tax equal to 50% of the fair market value of the investment will apply to an RRSP annuitant on acquisition of a prohibited investment by his or her RRSP.

The non-qualified investment rules

The holding of a non-qualified investment (i.e., an investment that is not a “qualified investment” under the *Income Tax Act*) by an RRSP results in certain tax consequences. Examples of non-qualified investments include shares in private investment holding companies or foreign private companies, and real estate. Income earned on non-qualified investments of an RRSP is taxable to the RRSP. In addition, when an RRSP acquires a non-qualified investment, the fair market value of the investment is included in the RRSP annuitant’s income.

The Budget proposes to replace the income inclusion and deduction components of the non-qualified investment rules, as well as the 1% per month tax. Under this proposal, an RRSP annuitant will be subject to a special tax of 50% of the fair market value of a non-qualified investment.

Individual Pension Plans

The Budget proposes two new tax measures that will apply to certain “individual pension plans” or “IPPs” with three or fewer members, if at least one member is “related” for tax purposes to an employer that participates under the pension plan.

Contributions made to an IPP that relate to past years of employment will, in effect, be required to be funded first out of a plan member’s existing RRSP assets.

This measure will apply to IPP past service contributions made after Budget Day, except that it will not apply to IPP past service contributions made in respect of past service that was credited to an IPP member before Budget Day under terms of the IPP submitted for registration on or before Budget Day.

In some cases, taxpayers have established IPPs as a transfer vehicle for the commuted value of their pension under a defined benefit RPP. The result is that it is not subject to any withdrawal requirements under the existing tax rules applicable to Registered Pension Plans (RPPs).

The Budget proposes that an IPP be required to pay out to a member, each

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year after the year in which he or she attains 71 years of age, an amount equal to the greater of:

- the regular pension amount payable to the member in the year pursuant to the plan terms, or
- the minimum amount that would be required to be paid from the IPP to the member if the member's share of the IPP assets were held in a RRIF of which the member was the annuitant.

It is proposed that the requirement for these RRIF-like withdrawals apply to the 2012 and subsequent taxation years. For those IPP members who reached 72 years of age in 2011 or earlier, the required withdrawals will start in 2012. For those IPP members who attain 72 years of age after 2011, the required withdrawals will start in the year in which they attain 72 years of age.

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