Federal Budget 2012 summary

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

This summary has been prepared from within the budget lock-up in Ottawa by Doug Carroll, Invesco's Vice President of Tax and Estate Planning.

As is our practice, this Invesco summary selectively focuses on specific budget elements that could substantially impact Canadians' personal finances and investments.

1. Retirement system

a. Old Age Security (OAS)

i. OAS Age of Eligibility

The eligibility age for OAS and Guaranteed Income Supplement (GIS) will gradually rise from age 65 to 67, starting in April 2023. This will be fully implemented by January 2029.

This will not affect anyone who is 54 or older as of March 31, 2012. Those who were born on or after February 1, 1962 will be eligible for OAS at age 67. Those who were born between April 1, 1958 and January 31, 1962 will be eligible between ages 65 and 67. The accompanying table provides the full schedule based on birth month.

OAS/GIS age of eligibility by date of birth					
	Year of birth				
	1958	1959	1960	1961	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

In line with the increase in the OAS/GIS eligibility age, the ages at which the Allowance and the Allowance for the Survivor are provided will also gradually increase from 60-64 (under current rules) to 62-66 starting in April 2023. This change will not affect anyone who is 49 years of age or older as of March 31, 2012.

Adjustments will also be necessary for certain federal programs that currently provide income support benefits until age 65, including programs provided by Veterans Affairs Canada and Aboriginal Affairs and Northern Development Canada. The alignment with OAS/GIS age-eligibility changes will ensure that these individuals do not face a gap in income at ages 65 and 66.

ii. Option to defer the OAS pension

Individuals will now have the option to defer take-up of their OAS pension to a later time and subsequently receive an actuarially adjusted higher pension. Starting on July 1, 2013, the Government will allow for the voluntary deferral of the OAS pension for up to five years. The adjusted pension will be calculated on an actuarially neutral basis, as is done with the Canada Pension Plan (CPP).

GIS benefits, which provide additional support to the lowest-income seniors, will not be eligible for actuarial adjustment.

iii. Proactive enrolment for OAS and GIS benefits

As part of the Government's Administrative Services Review, initiated in Budget 2010, the Government will continue to work toward a proactive enrolment regime for OAS and GIS. This is directed at eliminating the need for many seniors to apply for OAS and GIS. It will be implemented in a phased-in approach from 2013 to 2015.

b. Canada Pension Plan (CPP)

Following the 2010–2012 triennial review of the Canada Pension Plan, the Government has confirmed that the CPP is financially sustainable for at least the next 75 years at the current contribution rate of 9.9% of pensionable earnings. No changes to premiums are proposed at this time.

c. Pooled Retirement Pension Plans (PPRPs)

The Government introduced legislation in November 2011 to implement Pooled Registered Pension Plans (PPRPs). A consultation process followed, ending February 14, 2012. The Government will review the consultation submissions and proceed to implement the tax rules for PRPPs in 2012.

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2. Registered Disability Savings Plans (RDSPs)

a. Plan Holders

Under current rules, when an RDSP is established for a beneficiary who has attained the age of majority, the plan holder must be either the beneficiary or, if the beneficiary lacks the capacity to enter into a contract, the beneficiary's guardian or other legal representative. However, a number of adults with disabilities have experienced difficulties in establishing a plan because their capacity to enter into a contract is in doubt.

The Budget proposes to allow, on a temporary basis, certain family members to become the plan holder of the RDSP for an adult individual who might not be able to enter into a contract. Specifically, where, in the opinion of an RDSP issuer, an individual's ability to enter into a contract is in doubt, the spouse, common-law partner, or parent of the individual will be considered a "qualifying family member" and will be eligible to establish an RDSP for the individual.

This measure will apply from the date of Royal Assent to the enacting legislation until the end of 2016. A qualifying family member who becomes a plan holder under this measure will be able to remain the plan holder after 2016, though that person may be replaced by a later-named legal representative.

b. Proportional Repayment Rule

Under current rules, any Canada Disability Savings Grants (CDSGs) and Canada Disability Savings Bonds (CDSBs) paid into an RDSP in the preceding 10 years generally must be repaid to the Government on any of the following events:

- any amount is withdrawn from the RDSP;
- the RDSP is terminated or de-registered; or
- the RDSP beneficiary ceases to be eligible for the disability tax credit (DTC) or dies.

The Budget proposes to introduce a proportional repayment of $3 of CDSGs or CDSBs for each $1 withdrawal made from an RDSP. This rule will replace the 10-year repayment rule only in respect of RDSP withdrawals. The existing 10-year repayment rule will continue to apply where the RDSP is terminated or de-registered, or the RDSP beneficiary ceases to be eligible for the DTC or dies.

c. Maximum and Minimum Withdrawals

Current rules limit the maximum amount that may be withdrawn annually from RDSPs where CDSGs and CDSBs paid into the plan exceed private contributions made to the plan. Such RDSPs are known as Primarily Government-Assisted Plans (PGAPs).

The Budget proposes to increase the maximum annual limit for withdrawals from PGAPs, and to extend to all RDSPs the minimum annual withdrawal requirement that currently applies only to PGAPs.

These measures will apply after 2013.

d. 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 if the plans share a common beneficiary. The amount of RESP investment income rolled over to an RDSP may not exceed, and will reduce, the beneficiary's available RDSP contribution room.

The rollover amount will be included in the taxable portion of RDSP withdrawals. Subscriber contributions in the RESP will be returned to the RESP subscriber on a tax-free basis.

This measure will apply to rollovers of RESP investment income made after 2013.

e. Termination of an RDSP following Cessation of Eligibility for the DTC

If a beneficiary's condition factually improves such that the beneficiary does not qualify for the disability tax credit for a taxation year, the RDSP must be terminated by the end of the following year. Due to the nature of their condition, it is possible that a beneficiary again becomes eligible for the DTC for some later year and would be able to establish a new RDSP.

The Budget proposes to extend, in certain circumstances, the period for which an RDSP may remain open when a beneficiary becomes DTC-ineligible. An election will generally be valid until the end of the fourth calendar year following the first full calendar year for which a beneficiary is DTC-ineligible.

3. Life Insurance Policy Exemption Test

The exemption test that determines whether a life insurance policy is an exempt policy was implemented in the early 1980s and is intended to differentiate protection-oriented life insurance policies from investment-oriented life insurance policies.

The Government has determined that technical improvements are required to update and simplify the test, including the applicable interest rates, extending the endowment time of the benchmark policy from age 85 to age 90, and reducing the pay period of the benchmark policy to 8 years from 20 years.

4. Business matters

a. Retirement Compensation Arrangements (RCAs)

The Canada Revenue Agency has identified a number of arrangements that seek to take advantage of various features of the RCA rules in order to obtain unintended tax benefits. The Budget proposes 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 (TFSAs) and Registered Retirement Savings Plans (RRSPs).

For example, some arrangements involve the deduction of large contributions that are indirectly returned to the contributors through a series of steps ending with the purported RCA having little or no assets but still being able to claim refundable tax. Other arrangements use insurance products to allocate costs to the arrangement for benefits that arise outside the arrangement.

i. Prohibited investments

The Budget proposes that the new prohibited investment rules apply in respect of RCAs that have a "specified beneficiary," generally being an employee entitled to benefits under the RCA who has a significant interest in their employer.

This measure will apply in respect of investments acquired, or that become prohibited investments, on or after Budget Day.

ii. Advantages

The Budget also proposes that the definition of "advantage" be adapted to address the specific forms of tax planning that have been identified in relation to RCAs. An "RCA strip" will be a new definition similar to the existing definition of "RRSP strip" in the RRSP rules. It will include situations where an RCA holds a promissory note issued by a non-arm's-length debtor in respect of the RCA and the debtor fails to make commercially reasonable payments of principal and interest on the promissory note.

A special tax equal to the fair market value of the advantage will generally apply to advantages extended, received or receivable on or after Budget Day.

iii. RCA tax refunds

The Budget proposes that if RCA property has declined in value, the RCA tax be refunded only in circumstances where the decline in value of the property is not reasonably attributable to prohibited investments or advantages.

b. Eligible Dividends – Split-Dividend Designation and Late Designation

Under current rules, the enhanced dividend tax credit 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 to simplify the manner in which a corporation resident in Canada pays and designates eligible dividends by allowing the corporation to designate, at the time it pays a taxable dividend, any portion of the dividend to be an eligible dividend. As well, late designations will now be allowed within the three-year period following the day on which the designation was first required to be made.

c. Employee Profit Sharing Plans (EPSPs)

Employee Profit Sharing Plans (EPSPs) are trust arrangements that enable employers to share profits with employees.

Following a review announced in Budget 2011, the Government has determined that EPSPs have been used increasingly as a means for some business owners to direct profits to members of their families in order to reduce or defer the payment of income tax on these profits.

The Budget proposes a targeted measure to discourage excessive employer contributions for employees who have a significant equity interest in their employer or who do not deal at arm's length with their employer.

This measure will apply in respect of EPSP contributions made by an employer on or after Budget Day.

For more information about this topic, contact your advisor, call us at 1.800.874.6275 or visit our website at invesco.ca.

d. Group Sickness or Accident Insurance Plans

Budget 2012 proposes to include the amount of an employer's contributions to a group sickness or accident insurance plan in an employee's income for the year in which the contributions are made to the extent that the contributions are not in respect of a wage-loss replacement benefit payable on a periodic basis. This measure will not affect the tax treatment of private health services plans.

This measure will generally apply in respect of employer contributions made on or after Budget Day to the extent that the contributions relate to coverage after 2012.

5. The penny

The Royal Canadian Mint will cease distribution of pennies to financial institutions, effective fall 2012. After the Mint ceases distribution, businesses will be asked to return pennies through their financial institutions to the Mint for melting and recycling of the metal content.

The cent will, however, continue to be Canada's smallest unit of currency for pricing goods and services, and pennies may continue to be used in cash transactions to make exact payment or change after fall 2012.

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