

On March 29, 2012, Finance Minister James Flaherty released the federal budget of the majority Conservative government which he labelled the 'Economic Action Plan 2012 – A Plan for Jobs, Growth and Long-term Prosperity'. The government described the budget as supporting jobs and opportunities and providing sustainable social programs and responsible expenditure management.

Although significant international tax changes and an overhaul of the Scientific Research and Experimental Development (SR&ED) tax incentives were proposed, only limited and targeted personal tax measures were introduced. No changes to personal (or corporate) tax rates were introduced. As anticipated, the eligibility for Old Age Security (OAS) is increasing from age 65 to 67, although this increase is not being phased in until 2023. Other notable personal tax proposals include enhancements to the Registered Disability Savings Plan (RDSP) and targeted measures which continue the theme of recent budgets of curtailing perceived abuses, in this case those involving Retirement Compensation Arrangements (RCAs) and Employee Profit Sharing Plans (EPSPs).

The most significant personal income tax measures are summarized below. Note that the measures introduced are only proposals at this stage and may not ultimately be enacted into law. Readers are cautioned to consult with their tax advisors for specific advice on how they may be affected by these proposals.

## Summary of personal income tax proposals

### Old Age Security – Age of Eligibility

The age of eligibility of Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) will gradually increase from 65 to 67 starting in April 2023, with full implementation by January 2029. The lengthy advanced notification and phase-in periods were provided to allow affected individuals to plan their retirement accordingly.

These proposed changes will not affect anyone who is 54 years or older as of March 31, 2012. Therefore, those who were born on March 31, 1958 or earlier will not be affected. Those who were born between April 1, 1958 and January 31, 1962 will have an age of eligibility between 65 and 67.

In order to provide for some flexibility, the budget also proposes to allow for the voluntary deferral of the OAS pension beginning July 1, 2013. This would provide individuals with the choice to defer the take-up of their OAS pension (for up to 5 years) and receive a higher, actuarially adjusted pension, similar to the election available with the Canada Pension Plan.

In addition, the government is making it easier for seniors to receive OAS and GIS by instituting a proactive enrolment regime that will eliminate the need for many seniors to complete the application process.

### Registered Disability Savings Plan – Enhancements

A Registered Disability Savings Plan (RDSP) is a savings plan to help parents and others save for the long term financial security of a person who is eligible for the Disability Tax Credit (DTC). The individual eligible for the DTC is the plan beneficiary. The plan holder is the individual who generally opens the RDSP and makes decisions regarding contributions, investments and withdrawals.

Contributions to an RDSP (limited to a lifetime maximum of \$200,000) are not deductible and are not included in the beneficiary's income when withdrawn. Investment income earned in an RDSP grows tax-free. Depending on the beneficiary's family income, Canada Disability Savings Grants (CDSGs) and Canada Disability Savings Bonds (CDSBs) may also be received by the RDSP from the government. In response to comments received during the recent review of the RDSP, the budget proposes a number of changes to the rules governing these plans.

## **Rollover of Registered Education Savings Plan (RESP) investment income**

To provide greater flexibility for parents who have an RESP for their child, the budget proposes to allow investment income earned in an RESP to be transferred on a tax-free basis (“rolled over”) to an RDSP if the plans share a common beneficiary. There are a number of conditions that must be met to qualify for this roll-over which are similar to the existing conditions to receive Accumulated Income Payments (AIPs) when the RESP beneficiary does not pursue post-secondary education. Under the new proposal, when RESP investment income is transferred to an RDSP, contributions in the RESP will be returned to the RESP subscriber (the individual who established the RESP) on a tax-free basis. The amount of RESP investment income transferred tax-free into the RDSP may not exceed, and will reduce, the beneficiary’s available RDSP contribution room. This proposal will apply to rollovers of RESP investment income made after 2013.

## **Plan holders**

Under current rules, when an RDSP is established for a beneficiary who has reached the age of majority, the plan holder must be either the beneficiary or, if the beneficiary does not have the capacity to enter into a contract, the beneficiary’s guardian or other legal representative. In order to facilitate the process of establishing a plan when an adult beneficiary’s capacity to enter into a contract is in question or lacking, the budget proposes to allow, on a temporary basis, certain family members to become the plan holder of the RDSP for that adult individual. This change will ensure that an RDSP may still be established for individuals who may not be contractually competent and who do not have a legal representative.

## **Proportional Repayment Rule**

Under current rules, any CDSGs and CDSBs paid into an RDSP in the preceding 10 years may be required to be repaid if amounts are withdrawn or the RDSP is terminated. To provide greater access to RDSP savings for small withdrawals, the budget introduces a “proportional repayment rule”. This rule generally requires that for each \$1 withdrawn from an RDSP, \$3 of any CDSGs or

CDSBs paid into the plan in the preceding 10 years must be repaid to the government.

## **Maximum and Minimum Withdrawals**

The budget proposals include measures that would change the maximum and minimum withdrawal rules to provide for greater flexibility in making withdrawals from an RDSP and ensure that RDSP assets are used to support the beneficiary during their lifetime.

## **Termination of an RDSP following Cessation of Eligibility for the DTC**

In order to reduce the administrative burden on beneficiaries who become ineligible for the DTC and to provide for greater continuity to their long-term saving, the budget proposes to extend, under certain circumstances, the period for which an RDSP may remain open when a beneficiary becomes ineligible for the DTC. An election must be submitted by the RDSP plan holder in order to take advantage of this new provision.

## **RCA and EPSP Measures**

The Retirement Compensation Arrangement (RCA) is an employer-sponsored, funded vehicle for retirement savings, which is typically established to provide a supplemental pension for executives. The government has become increasingly concerned with arrangements involving RCAs which have been structured to provide unintended tax benefits. As a result, new prohibited investment and advantage rules have been introduced to specifically prevent RCA’s from engaging in non-arm’s length transactions – similar to the anti-avoidance rules for RRSPs and Tax-Free Savings Accounts which were introduced recently. These measures may also restrict the ability of the RCA to obtain a refund of the upfront tax paid where the RCA assets have declined in value.

An Employee Profit Sharing Plan (EPSP) is a trust arrangement enabling employers to share profits with their employees. As with RCAs, the government has become increasingly concerned with unintended uses of EPSPs, particularly involving non-arm’s length employees. As a result, measures have been introduced to impose a special tax payable to certain non-arm’s

length employees who receive excess allocations, ie. generally amounts that exceed 20% of the employee's salary received in the year.

## Overseas Employment Tax Credit (OETC)

The OETC is a tax credit that is available to employees working outside of Canada (who remain a tax resident of Canada) for a period greater than six months if their employment overseas was in connection with certain activities such as the exploration for or exploitation of certain natural resources. The budget proposes to phase out the OETC over four taxation years beginning with the 2013 taxation year. The OETC will be eliminated for the 2016 and subsequent taxation years.

## Other tax measures

### Scientific Research and Experimental Development (SR&ED) Overhaul

Under current rules, qualified SR&ED expenditures incurred in Canada are fully deductible, and an Investment Tax Credit (ITC) may also be claimed. In order to simplify and provide for a more focused approach to the government's support for business research and development, the budget proposes several changes to the existing tax incentives, including measures that would effectively reduce the SR&ED ITC as well as restrict the expenditures eligible for SR&ED deductions.

### Exempt Life Insurance

Life insurance policies may provide both a protection and savings component. In general, the income earned on the savings component is not subject to accrual taxation to the policyholder, provided it meets the criteria

of an 'exempt policy'. However, since the exempt policy test was implemented almost 30 years ago, the government has reviewed this test and proposed changes to the test to reflect more current mortality rates, increased life expectancy and investment returns. The government intends to consult with key stakeholders on these proposed technical improvements and plans to implement these changes for life insurance policies issued after 2013.

### Gifts to Foreign Charities

In general, a donation to a foreign charity does not entitle the donor to a charitable tax credit or deduction. However, certain foreign charities that receive a gift from the government of Canada may register as qualified donees to enable tax receipting privileges. The budget proposes to modify these rules to ensure that qualifying foreign charities that receive a gift from the government must also pursue activities related to disaster relief or humanitarian aid or activities that are in the national interest of Canada.

### Administrative Changes

Continuing the theme of recent budgets, the government is seeking additional transparency and accountability from taxpayers, including charities and promoters of tax shelters.

In particular, the budget proposals will require additional disclosure for charities engaging in political activities and impose higher penalties for incomplete or lack of required disclosure for promoters of tax shelters.

**If you have any questions regarding these budget proposals, please consult with your tax advisor for further details.**

The comments included in the publication are not intended to be a definitive analysis of tax law. The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be attained in respect of any person's specific circumstances.

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