

INVESTMENT PLANNING COUNSEL'S
Special Report



Live *your* dream.

PERSONAL TAX CHANGES

Highlights from the 2014 Federal Budget

The 2014 Federal Budget tabled a number of proposals that will impact the financial, tax and estate plans of Canadians. We've pulled together some of the key budget proposals that may affect the financial planning strategy for you and your family.

1. Federal Tax Rates

There are no changes to personal federal income tax rates or income brackets.

2. Adoption Expense Tax Credit

The Adoption Expense Tax Credit is a 15% non-refundable tax credit that allows adoptive parents to claim eligible adoption expenses related to the completed adoption of a child under the age of 18 (up to a maximum of \$11,774 in expenses per child for 2014). Expenses which are eligible include fees such as those paid to a licensed adoption agency as well as mandatory immigration expenses in respect of the child. The Adoption Expense Tax Credit is claimed in the taxation year in which an adoption is completed.

Budget 2014 proposes to increase the maximum amount of eligible expenses to \$15,000 per child for 2014. This maximum amount will be indexed to inflation for taxation years after 2014.

3. Medical Expense Tax Credit (METC)

The list of expenses eligible for the METC is regularly reviewed and updated in light of disability-specific or medically-related developments and new technologies. Currently, the METC provides tax relief for costs incurred for therapy provided to an individual who claims the Disability Tax Credit. However, effective therapy requires that a plan be designed to meet the specific needs of an individual (e.g., applied behaviour analysis therapy for children with autism). The design of a plan normally includes both its initial development and subsequent adjustment if necessary.

Budget 2014 proposes that amounts paid for the design of an individualized therapy plan be eligible for the METC as long as the cost of the therapy itself would be eligible for the METC as well as meeting some other conditions. In addition, Budget 2014 also proposes to add to the list of eligible medical expenses the costs for service animals specially trained to assist an individual in managing severe diabetes.

These expenses will be eligible for the METC if they were incurred after 2013.

4. Extended Eligibility for Mineral Exploration Tax Credit

Flow-through shares allow companies to renounce or "flow through" Canadian exploration expenses to investors who can deduct the expenses in calculating their own taxable incomes. This facilitates the raising

of equity to fund exploration. The mineral exploration tax credit is an additional benefit, equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow through share investors.

Budget 2014 proposes to extend eligibility of this credit for one year, to flow-through agreements entered into on or before March 31, 2015.

5. Registered Disability Savings Plans (RDSPs) – Legal Representation

Last year, a temporary measure was introduced to allow “qualified family members” to establish an RDSP for an adult beneficiary who lacks the mental capacity to enter into a contract. While this allowed more adult persons with disabilities to access RDSPs, it failed to solve the problem for beneficiaries who do not have a parent or spouse. Some provinces streamlined processes to allow for the appointment of a trusted person to manage the resources of an adult who lacks contractual capacity, or have processes in place to address this concern. This includes British Columbia, Alberta, Saskatchewan, Manitoba, Newfoundland and Labrador, and Yukon. Ontario has recommended a streamlined procedure and Northwest Territories has indicated that it will address it on a case-by-case basis. The government is encouraging the remaining provinces/ territories (which include Quebec, Nova Scotia, New Brunswick, PEI and Nunavut) to take prompt action. These are positive developments that will allow a greater number of individuals with disabilities to take advantage of the many benefits that RDSPs offer.

6. Pension Transfer Limits

The Income Tax Act defines the limit as to how much an individual is able to transfer from a defined benefit pension plan (RPP) to an RRSP, RRIF, or other pension plan, on a tax-deferred basis. In 2011, the Government introduced a special rule that allows the maximum transferable amount for a plan member who is leaving an underfunded RPP to be the same as if the RPP were fully funded. This can reduce the taxable amount of the commuted value to the individual.

Budget 2014 proposes to allow this rule to apply in additional situations. In particular, the rule will be available in respect of a commutation payment to a plan member who is leaving an RPP if that payment has been reduced due to plan underfunding and either:

- where the plan is an RPP other than an individual pension plan (IPP), the reduction in the estimated pension benefit that results in the reduced commutation payment is approved pursuant to the applicable pension benefits standards legislation; or
- where the plan is an individual pension plan, the commutation payment to the plan member is the last payment made from the plan (i.e., the plan is being wound up).

This measure will apply in respect of commutation payments made after 2012.

7. Tax on Split Income (Extension of the “Kiddie Tax”)

Tax on Split Income (also known as the “kiddie tax”) limits income splitting techniques that attempt to shift certain types of income from a higher income individual to a lower income minor. The highest marginal tax rate, currently 29% (Federal) applies to ‘split income’ paid or payable to a minor. Traditionally, this has applied to taxable dividends (and shareholder benefits) received directly or indirectly through a partnership or trust, in respect of unlisted shares of Canadian and foreign corporations by a minor. Recent rules have also included capital gains from dispositions of these same types of shares to persons who do not deal at arm’s length with the minor, as well as other types of income.

Budget 2014 proposes to extend the definition “split income” to also include income that is, directly or indirectly, paid or allocated to a minor from a trust or partnership, if:

- the income is derived from a source that is a business or a rental property; and
- a person related to the minor

- o is actively engaged on a regular basis in the activities of the trust or partnership to earn income from any business or rental property, or
- o has, in the case of a partnership, an interest in the partnership (whether held directly or through another partnership).

This measure will apply to the 2014 and subsequent taxation years.

8. Elimination of the Graduated Rate Taxation of Trusts and Estates

Budget 2014 proposes to generally proceed with the measures the Federal Government introduced in a consultation paper released on June 3, 2013 relating to taxation of testamentary trusts and grandfathered inter vivos trusts. Specifically, **Budget 2014 proposes** to apply flat top-rate taxation to grandfathered inter vivos trusts, trusts created by will and certain estates. Two exceptions to this treatment are proposed.

First, graduated rates will continue to apply for the first 36 months of an estate that arises on and as a consequence of an individual's death and that is a testamentary trust. For estates which remain in existence beyond 36 months after death, flat top-rate taxation will apply at the end of that 36-month period. Second, graduated rates will continue to be made available with respect of such trusts having as their beneficiaries individuals who are eligible for the Federal Disability Tax Credit. More detail regarding the parameters of this exception will be released in the coming months.

In addition, testamentary trusts (other than estates for their first 36 months) and grandfathered inter vivos trusts will not benefit from special treatment under a number of related tax rules such as an exemption from income tax installments, or exemption from having a calendar year end, to name a couple.

The measure will apply to the 2016 and subsequent tax years.

9. Change to Tax Treatment of Estate Donations

Where an individual makes a charitable donation that is specified under the terms of a will (by way of a formula or dollar amount), the donation is treated for income tax purposes as having been made by the individual immediately before the individual's death. Similar rules apply where an individual designates a registered charity as a beneficiary under an RRSP, RRIF, TFSA or life insurance policy. In these cases, a charitable donation tax credit is available on the deceased's final tax return. Alternatively, donations considered to be made by the estate may only be applied against the estate's income tax payable.

Budget 2014 proposes to provide more flexibility in the tax treatment of charitable donations made in the context of a death that occurs after 2015. Donations made by will and designation donations will no longer be deemed to be made by an individual immediately before death. Instead, these donations will be deemed to have been made by the estate. In addition, the trustee of the individual's estate will have the flexibility to allocate the available donation (and thus the charitable donation tax credit) among any of:

- i) the taxation year of the estate in which the donation is made
- ii) an earlier taxation year of the estate or;
- iii) the last two taxation years of the deceased individual.

This measure will apply to the 2016 and subsequent taxation years. In light of the changes to the taxation of testamentary trusts, this proposal is good news for estate trustees, as this will allow some flexibility to apply the charitable donation tax credits to where they may be most needed, either on the deceased's personal returns, or on the estate tax return.

10. The Automatic Exchange of Information for Tax Purposes (and FATCA)

The exchange of tax information between countries is a tool to combat tax evasion. Canada's exchange of information relationships with other countries were made more effective in 2007 when the Canadian Government announced that all future tax treaties (and updates to existing treaties) would include a new standard for information exchange. This was an important step towards a new global standard that would

allow for an automatic exchange of tax information across countries. A current example of this information exchange is FATCA.

In 2010, the U.S. enacted provisions known as the Foreign Account Tax Compliance Act (FATCA). FATCA would require non-U.S. financial institutions to identify accounts held by U.S. persons (including U.S. citizens living abroad), and report to the U.S. Internal Revenue Service (IRS) information in respect of these accounts. FATCA has raised a number of concerns in Canada among both U.S. citizens living in Canada and Canadian financial institutions. Without an intergovernmental agreement between Canada and the U.S., under FATCA legislation, Canadian financial institutions and U.S. persons holding financial accounts in Canada would be required to report the existence of accounts directly to the IRS starting July 1, 2014.

In response to concerns, the Government of Canada successfully negotiated an intergovernmental agreement with the U.S. which contains significant exemptions and other relief. Under the agreement, Canadian financial institutions will report to the Canada Revenue Agency (CRA) information in respect of U.S. persons that will be transmitted by the CRA to the IRS (this relieves Canadian financial institutions from having to report directly to the IRS). The agreement also clarified that a variety of registered accounts (including Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Education Savings Plans, Registered Disability Savings Plans, and Tax-Free Savings Accounts) will be exempt from the reporting. Note though, Canada will not be collecting and remitting U.S. tax liabilities of Canadian citizens on behalf of the United States (whether or not the individual is also a U.S. citizen).

Meanwhile, the CRA will receive information from the U.S. in respect of Canadian resident taxpayers that hold accounts at U.S. financial institutions, which will assist with the enforcement of Canadian taxation.

The new reporting regime will come into effect starting in July 2014, with Canada and the U.S. beginning to receive enhanced tax information from each other in 2015.

*Should you wish to discuss how some of these tax proposals may affect you,
please contact our office or speak to your tax advisor.*



Trademarks owned by Investment Planning Counsel Inc. and licensed to its subsidiary corporations. Investment Planning Counsel, is a fully integrated Wealth Management Company. Mutual Funds available through IPC Investment Corporation and IPC Securities Corporation. Securities available through IPC Securities Corporation, a member of the Canadian Investor Protection Fund. Insurance products available through IPC Estate Services Inc.

Mortgage Broker Services provided by Invis Inc. (Lic# ON 10801 / SK 315928) or Mortgage Intelligence Inc. (Lic# ON 10428 / SK 315857).

Source: Mackenzie Tax & Estate Planning