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The March 2012 federal budget introduced various specific tax measures aimed at seniors, families, registered plans and small businesses. Rather than summarize the entire 498-page budget document, this report will focus on a number of key elements that are of most interest to individuals and small businesses.

OLD AGE SECURITY

The government points out that Canada's retirement system consists of three pillars: Old Age Security (OAS), Canada (Quebec) Pension Plan (CPP), and voluntary tax assisted savings, such as RRSPs, TFSAs and the recently proposed Pooled Registered Pension Plans (PRPPs).

The 2012 budget is proposing changes to the OAS system to ensure that it continues to be sustainable. The government stated that the CPP is sustainable at the current contribution rate of 9.9% of pensionable earnings, at least for the next 75 years, and that it is moving forward with the implementation of PRPPs.

The OAS program is financed from the government's general revenues and provides a monthly pension to nearly all Canadians age 65 years of age or over. For 2012, the maximum annual OAS pension is $6,481.

The 2012 federal budget proposes to change the age of eligibility for OAS benefits, to be phased in gradually, starting in 2023. As well, the budget introduced the option to defer the OAS pension and receive an actuarially adjusted pension, beginning July 1, 2013.

Background

OAS is the single largest government program. It was put into place when Canadians were not living as long. For example, in 1970, life expectancy was 69 years of age for men and 76 for women – today, it's 79 for men and 83 for women. The government therefore estimates that the cost of the OAS program will grow from $38 billion in 2011 to $108 billion by 2030.

In addition, in the 1970s, there were seven workers for each person over the age of 65. Today, there are four workers per senior, and in 20 years, based on estimates of Canada's declining birth rate the government projects that there will be only two workers for every 65-year old.[1]

OAS Age of Eligibility

It's proposed that the age of eligibility for OAS and the Guaranteed Income Supplement (GIS) will be gradually increased from 65 to 67, starting in April 2023, with full implementation by January 2029.

[1]Statistics quoted are from the Economic Action Plan 2012.

This 11-year notification period, followed by a six-year phase-in period, will provide individuals with significant advance notification to plan their retirement and make adjustments to their savings plans.

In other words, the proposed legislative change to the age of OAS/GIS eligibility won't affect anyone born on or before March 31, 1958.

If you were born on or after February 1, 1962, your OAS/GIS eligibility age will be 67. Canadians born between April 1, 1958 and January 31, 1962 will have an age of eligibility between 65 and 67, as indicated by Chart 1.

Chart 1 – Age of Eligibility by Date of Birth

	Year of Birth				
	1958	1959	1960	1961	1962
Month of Birth	**OAS/GIS Eligibility Age**				
January	65	65 + 5 mths	65 + 11 mths	66 + 5 mths	66 + 11 mths
February to March	65	65 + 6 mths	66	66 + 6 mths	67
April to May	65 + 1 mth	65 + 7 mths	66 + 1 mths	66 + 7 mths	↓
June to July	65 + 2 mths	65 + 8 mths	66 + 2 mths	66 + 8 mths	
August to September	65 + 3 mths	65 + 9 mths	66 + 3 mths	66 + 9 mths	
October to November	65 + 4 mths	65 + 10 mths	66 + 4 mths	66 + 10 mths	
December	65 + 5 mths	65 + 11 mths	66 + 5 mths	66 + 11 mths	

Source: Government of Canada, Economic Action Plan 2012

Option to Defer the OAS Pension

The budget papers state that Canadians are living longer and may prefer to work longer and as a result, the government believes that the OAS program should reflect this new reality and provide the option for individuals to work longer, defer OAS and receive higher retirement benefits.

As a result, beginning on July 1, 2013, the changes provide that you will be allowed to voluntarily defer taking your OAS pension, for up to five years, and receive a higher, actuarially adjusted, annual pension as a result. The adjusted pension will be calculated on an actuarially neutral basis, just like it is with CPP, which means that, on average, you could receive the same lifetime OAS pension whether you choose to take it at the earliest age of eligibility or defer it to a later year.

The government provided an example of how this would work. Consider Michael who turns 65 in September 2013. Instead of taking OAS at age 65, he plans to work a year longer and defer taking his OAS until age 66. As a result, his annual pension would be $6,948 instead of $6,481 (in 2012 dollars).

Proactive Enrolment for OAS and GIS Benefits

One of the problems with the OAS/GIS system is that you must actually apply to receive the benefits. Failure to apply means you could lose out on potential OAS payments since the government will only pay retroactive payments back to your 65th birthday up to a maximum of 11 months (plus the month of application).

This issue was highlighted in a recent Federal Court decision in which a taxpayer requested a formal review of Service Canada's decision to deny him retroactive OAS beyond the 11 months. He claimed he had received "erroneous advice" regarding his entitlement to OAS benefits. He lost his appeal.

In the 2012 budget, the government announced that it would be putting in place a "proactive enrolment regime" that would eliminate the need for many seniors to apply for OAS/GIS. This will be done in a phased-in approach from 2013 to 2015.

REGISTERED DISABILITY SAVINGS PLANS

In October 2011, Minister of Finance, Jim Flaherty, announced the launch of the government's review of the Registered Disability Savings Plan (RDSP) in which it invited stakeholders to comment on RDSPs to ensure that the plans are meeting the needs of Canadians with severe disabilities and their families.

The RDSP was introduced in the 2007 federal budget and became available in 2008 as way to help ensure the long-term financial security of children with severe disabilities. In 2008, the government announced that the RDSP program would be reviewed three years after plans became operational.

In the 2012 budget, the government has responded to various stakeholder comments it received during the course of its review and is proposing a number of changes.

Background

An RDSP can be set up for an individual, known as the RDSP "beneficiary," who is eligible for the Disability Tax Credit (DTC). The plan holder opens up the RDSP and makes decisions regarding contributions, investments, and withdrawals. This plan holder can be the beneficiary or a parent, if the plan is opened for a minor child. The plan holder can also be a legal representative of the beneficiary.

Contributions to an RDSP are limited to a lifetime maximum of $200,000 and can be made until the end of the year in which a beneficiary turns 59.

For beneficiaries age 49 and under, annual RDSP contributions attract Canada Disability Saving Grants (CDSGs) at matching rates of 100%, 200% or 300%, depending upon family income, up to a lifetime maximum of $70,000.

The government also provides up to $1,000 in Canada Disability Savings Bonds (CDSBs) annually to RDSPs established by low- and middle-income families, up to a lifetime maximum of $20,000. These are also available provided the beneficiary is 49 or under.

Contributions to an RDSP are not deductible and are not included in the beneficiary's income when withdrawn. Investment income earned in an RDSP grows tax-free and is only taxed, along with any accumulated CDSGs and CDSBs, in the hands of the beneficiary when withdrawn from the RDSP.

The budget proposed various changes to relax the RDSP rules, several of which are highlighted below.

Plan Holders

Under the current rules, when an RDSP is set up for a beneficiary who is over 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.

One of the issues raised in the consultation period is that a number of adults with disabilities have had trouble opening up an RDSP because their capacity to enter into a contract is in doubt.

In many provinces and territories, the only way that an RDSP can be opened for these individuals is for the individual to be declared legally incompetent and have someone named as their legal guardian. Some involved in the consultation asserted that this process involves a considerable amount of time and expense, and may have significant repercussions for the individual.

The 2012 budget is therefore proposing to allow, at least 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. This would allow individuals with disabilities who might not be contractually competent and who do not have a legal representative to benefit from by having an RDSP established for them.

Under the new rule, if, 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 permitted to open up an RDSP for the individual (i.e., become the plan holder.)

This measure would be effective from the date of Royal Assent of the budget legislation until the end of 2016; however, a qualifying family member who becomes a plan holder under this temporary rule will be permitted to remain the plan holder beyond 2016.

Proportional Repayment Rule

Under the "10-year repayment rule," any CDSGs and CDSBs paid into an RDSP in the preceding 10 years generally must be repaid to the government if any amount is withdrawn from an RDSP, the RDSP is terminated, or the RDSP beneficiary ceases to be eligible for the DTC or dies.

To ensure that RDSP funds are available to meet potential obligations under this rule, the RDSP issuer is required to set aside an "assistance holdback amount" equal to the total CDSGs and CDSBs paid into the RDSP in the preceding ten years. If one of the events described above occurs, assistance holdback amount must be repaid to the government.

The 2012 budget proposes to relax the rule to provide greater access to RDSP savings for small withdrawals by introducing a new "proportional repayment rule" that will apply when a withdrawal is made from an RDSP, replacing the 10-year repayment rule in respect of RDSP withdrawals. (The 10-year rule will continue to apply if the RDSP is terminated or the RDSP beneficiary ceases to be eligible for the DTC or dies.)

The new proportional repayment rule will require that, for each $1 withdrawn from an RDSP, $3 of any CDSGs or CDSBs paid into the plan in the 10 years preceding the withdrawal be repaid, up to a maximum of the assistance holdback amount. These repayments will be attributed to CDSGs or CDSBs that make up the assistance holdback amount based on the order in which they were paid into the RDSP, beginning with the oldest amounts.

This rule will apply to withdrawals made from an RDSP after 2013.

Example

Let's assume that Jeff opens an RDSP in 2009 and contributes $1,500 to his plan annually, which is eligible for the maximum CDSG each year of $3,500 (300% X $500 + 200% X $1,000). He does this annually until 2014 by which time he has received $21,000 (6 X $3,500) in CDSGs, which is equal to the assistance holdback amount.

In 2014, Jeff withdraws $600 from his RDSP. Under the old 10-year repayment rule, the entire assistance holdback amount of $21,000 would have to be repaid to the government. Under the proportional repayment rule, only $1,800 (3 X $600) of the assistance holdback amount will be repaid.

Rollover of RESP Investment Income

The budget will also permit parents, who save in a Registered Education Savings Plan (RESP) for a child with a severe disability, to transfer investment income earned in an RESP on a tax-free (or "rollover") basis to an RDSP, provided the plans share a common beneficiary.

To qualify, the beneficiary must have a severe and prolonged mental impairment that can reasonably be expected to prevent the beneficiary from pursuing post-secondary education, the RESP must have been in existence for at least 10 years and each of the RESP beneficiaries is at least 21 years of age and is not pursuing post-secondary education; or the RESP must have been in existence for more than 35 years.

The amount of RESP investment income rolled over to an RDSP cannot exceed, and will reduce, the beneficiary's available RDSP contribution room, but will not attract CDSGs. The rollover amount will be included in the taxable portion of RDSP withdrawals.

In addition, any Canada Education Savings Grants and Canada Learning Bonds in the RESP will be required to be repaid to the government and the RESP terminated by the end of February of the year after which the rollover to the RDSP is made.

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

RETIREMENT COMPENSATION ARRANGEMENTS

A retirement compensation arrangement (RCA) is a savings arrangement often used by private companies to fund the portion of an executive's pension benefit that exceeds the pension benefit permitted to be made under a defined benefit or defined contribution pension plan.

Contributions made by the corporation to an RCA are tax deductible but a 50% refundable RCA tax is charged on contributions to an RCA, as well as on income and gains earned or realized by the RCA. This RCA tax is refunded as taxable distributions are made from the RCA.

If the RCA has suffered investment losses, however, a special rule allows an RCA to obtain a refund of the RCA tax even if the property held in the RCA has lost some or all of its value.

Over the past number of years, the Canada Revenue Agency (CRA) noticed a significant increase both in the number of RCAs, as well as the amount of "refundable tax" it collected on RCAs.

As a result, in May 2010, the CRA sent out detailed questionnaires to a number of companies that established RCAs, as well as to certain RCA trustees, requesting more information about various RCAs established.

In the budget, the government acknowledged that it has become aware of a "number of arrangements that seek to take advantage of various features of the RCA rules in order to obtain unintended tax benefits." For example, some RCAs involve the deduction of large contributions that are indirectly returned to the contributors through a series of steps ending with the RCA having little or no assets, but still being able to claim the refundable tax using the special rule above. Others involve the use of life insurance products.

The budget indicated that the government will be challenging these tax-motivated arrangements, which in its view are "not consistent with the policy intent of the RCA rules." To this end, it is introducing new prohibited investment and advantage rules, similar to those introduced to stop abusive transactions in TFSAs and RRSPs, as well as a new rule to restrict RCA tax refunds in circumstances where RCA property has lost value.

EMPLOYEES PROFIT SHARING PLANS

Employees Profit Sharing Plans (EPSPs) are arrangements that allow employers to share profits with employees. Under an EPSP, an employer makes tax-deductible contributions to a trust and the trustee annually allocates to the beneficiaries (i.e. the employees) all employer contributions as well as any profits from the invested funds. These EPSP allocations are included in the income of the employee.

The government noted that between 2005 and 2009, the number of EPSPs has increased about fivefold, mostly among small, closely-held Canadian-controlled private corporations. EPSPs have been heavily marketed by various tax planning professionals as a way for business owners to reduce their tax liability by splitting their income with family members, to defer the payment of income taxes to a following year and to avoid paying Employment Insurance (EI) premiums or making Canada Pension Plan (CPP) contributions.

The 2012 federal budget proposes a specific measure to discourage excessive employer contributions. A special tax would be payable on an "excess EPSP amount" where EPSP payments are made to a "specified employee," which is an employee who has a significant equity interest in their employer or who does not deal at arm's length with their employer.

An “excess EPSP amount” is defined as the portion of an employer’s EPSP contribution allocated by the EPSP trustee to a specified employee that exceeds 20 per cent of the specified employee’s salary received in the year.

This new tax will generally apply to EPSP contributions made on or after March 29, 2012.

LIFE INSURANCE POLICY EXEMPTION TEST

The primary goal of life insurance is to help protect against the financial risk of premature death. Life insurance policies, however, can contain both an insurance protection component as well as a savings component. Under the favourable tax rules governing life insurance, the income earned on the savings component is generally exempt from annual taxation, provided it is an “exempt policy.”

The exemption test, which was introduced in 1982, measures the extent to which the savings portion in a policy does not exceed the savings in a “benchmark” policy. The purpose of the exempt test, which is highly complex, is to place limitations on the investment growth in a policy and thereby restrict the tax deferral to policies which have insurance protection as their main purpose.

As the exemption test was implemented almost 30 years ago, the government has reviewed the test and determined that various technical improvements are required to update and simplify the test. These include using updated mortality tables to measure policy savings due to increased longevity, lowering the assumed interest rate used in the exempt test from 4 per cent to 3.5 per cent to reflect present day investment returns, as well as various other technical changes.

While it’s too soon to tell exactly how the changes will impact the ability to save within a tax-exempt policy generally, it appears that the rules may specifically curb the use of "single premium" or "quick pay" universal life policies, although all policies will certainly be affected.

The new rules will apply to life insurance policies issued after 2013.

TRAVELLERS’ EXEMPTIONS

Canadians returning from a trip abroad currently qualify for an exemption that allows them to bring back goods valued up to a specified dollar limit without having to pay duties or taxes, including GST/HST or provincial sales and product taxes.

The 2012 federal budget proposes to increase the travellers’ exemption to $200 from $50 for returning Canadian residents who are out of the country for 24 hours or more. The budget also proposes to increase the exemption levels for travellers who are out of the country for 48 hours or more to $800, replacing both the current 48-hour exemption of $400 and the current 7-day exemption of $750.

There will continue to be no duty or tax exemptions for absences of under 24 hours. Note that the volume limits and quantity limits on the amount of alcohol and tobacco products you can bring back remain unchanged.

These measures will be effective for travellers returning to Canada on June 1, 2012 or thereafter.

ELIMINATION OF THE PENNY

Finally, the government announced that it will be eliminating the penny from Canada's coinage system. It will no longer distribute pennies as of Fall of 2012; however, the penny will retain its value indefinitely and can continue to be used in payments.

It currently costs the government 1.6 cents to produce it and other countries, such as New Zealand, Australia, the Netherlands, Norway, Finland and Sweden have similarly moved to a "penny-free economy."

The cent will remain Canada's smallest unit for pricing goods and services and pennies can be used in cash transactions indefinitely. When pennies are not available, the government has indicated that cash transactions should be rounded to the nearest five-cent increment in a "fair and transparent manner." Non-cash payments such as cheques, credit and debit cards will continue to be settled to the cent.