

Federal Budget 2011 Tax highlights

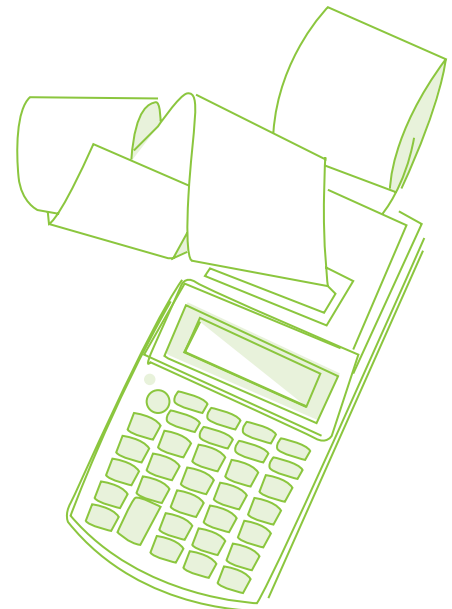
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INTRODUCTION

Dear Valued Clients and Colleagues:

On Tuesday, March 22, 2011, Finance Minister Jim Flaherty tabled the 2011 Federal Budget in the House of Commons, the 6th budget of the present government. The budget is part of the Conservative government’s “Next Phase of Canada’s Economic Action Plan” and promises new spending aimed at improving fiscal stability and security for Canadians. Entitled “A Low-Tax Plan for Jobs and Growth,” this year’s budget establishes some limited new personal tax credits, does not introduce any new taxes but does make efforts to close perceived “tax loopholes”. We have summarized below the major tax changes affecting businesses and individuals.



CORPORATE PARTNERSHIPS

Previously, partnerships with less than six partners were not required to file Partnership Information Returns (T5013 Returns). However, partnerships that exceed certain asset or revenue and expense thresholds, or have one partner that is either a corporation or a second partnership, must now file T5013 Returns. These previously-announced changes increase the visibility of partnerships.

Where even one partner of a partnership is an individual, the partnership's fiscal year-end must be December 31. This measure was established in 1995 and prevents individuals from deferring income earned by the partnership to the subsequent calendar year. A partner corporation that is a professional corporation is also required to have a December 31 year-end. Other corporate partnerships still had deferral opportunities.

New rules will now apply to each corporate partner that alone, or together with related persons, is entitled to more than 10% of the partnership's income (or assets in the case of a wind-up). The new rules will apply if a corporation has a March 23, 2011 or later year-end.

Where a partnership of corporations is established, it is common to set the year-end of the partnership on a date that follows the year-ends of the corporate partners. For example, if the corporate partners have March 31

year-ends, the partnership would generally be given an April 30 year-end, in order to defer 11 months of income. This deferral opportunity will no longer be available. Now, each corporate partner will be required to include stub period income in its current fiscal period rather than in the subsequent period.

The following provides a broad overview of the new rules based on the above example. The new rules apply to all corporate partners (other than professional corporations) even if other members of the partnership are individuals or professional corporations.

Before the Budget, each corporate partner would include in its March 31, 2011 income, only its share of the partnership's April 30, 2010 income. Subject to transitional rules, providing relief for the first five years (see below), the Budget will require an additional income inclusion equal to 11/12ths of that April 30, 2010 income. This approach is referred to as the formulaic approach. This stub period inclusion is then deducted from the partner's March 31, 2012 income and a new income inclusion equal to 11/12ths of the April 30, 2011 income is added to the March 31, 2012 income. This procedure continues in subsequent years.

A corporate partner can elect to include a lesser amount of stub period income if it estimates that the pro-rated portion of the actual April 30, 2011 income will be lower. If it is subsequently determined that the formulaic inclusion is greater

than the estimated inclusion, penalty and interest provisions can apply.

The requirement to suddenly include 23 months of income in a March 31, 2011 taxation year is onerous. Therefore, transitional rules allow the stub period income to be brought into income over five years. Thus, the stub period income is taxable at a rate of 0% in 2011, 15% in 2012, 20% annually for 2013 to 2015 and 25% in 2016.

Any partnership, where all of the members are corporations other than professional corporations, will be allowed a one-time election to change the partnership year-end. This may be done to align the year-end of the partnership with that of one or more of its partners. The transitional relief described above will also apply if this election is made.

There are other numerous rules to consider. These include provisions that deal with, for example, partnerships that have other partnerships as members, situations involving a first-year corporate partner, where no partnership year-end falls within the partner's fiscal period; partnerships with resource expenses, and situations where more than one partnership year-end falls within one corporate fiscal period.

OTHER BUSINESS MEASURES

STOP-LOSS RULES

There are stop-loss rules, which reduce the capital loss on the redemption of shares by the amount of dividends received. There are circumstances where a corporation can receive a tax-free intercorporate dividend and realize a capital loss on redemption of shares even though there is no economic loss on the redemption. The Budget limits situations in which this may apply.

The new rules will not apply to private corporations that receive redemption proceeds on other private corporation shares.

MANUFACTURING AND PROCESSING (M&P) EQUIPMENT

M&P equipment acquired before 2012 and included in Class 29, is eligible for a 50% straight-line CCA rate. This CCA class is subject to the half-year rule; thus, providing an opportunity for a full write-off over three years. The Budget has extended Class 29 treatment to eligible M&P equipment acquired before 2014. Eligible M&P equipment acquired after 2013 will be included in Class 43, which is subject to a 30% declining balance CCA rate.

CLEAN ENERGY GENERATION EQUIPMENT

Eligible clean energy generation and conservation equipment, included in Class 43.2, is subject to a 50% declining balance CCA rate. The Budget expands Class 43.2 to include equipment that generates or conserves energy by using a renewable energy source (e.g., wind or

solar), using fuels from waste, or making efficient use of fossil fuels.

EMPLOYEE PROFIT SHARING PLANS (EPSPS)

The government is undertaking a review of EPSPs and will have consultations to ensure that EPSPs are being used appropriately and that tax rules are also appropriate.

CHARITABLE SECTOR

In the past years, the government significantly expanded the opportunity for Canadians to make tax-deductible charitable contributions. Along with this enhanced opportunity, there have been a number of issues that the government feels have impacted the “regulatory regime” and “fairness” of the current system. The Budget proposes a number of changes to address these issues.

Qualified donees

A qualified donee is an organization eligible to issue a tax-deductible receipt and will include Registered Canadian Amateur Athletic Associations (RCAAAAs). Generally, the rules for these organizations have been extended to conform to other charitable entities, municipalities and certain municipal public bodies in Canada. Additionally, rules for RCAAAs will now also more closely align with housing corporations, which exclusively provide low-cost housing for the aged, universities outside Canada, the student bodies of which ordinarily include students of Canada, and certain charitable organizations outside Canada. Each

qualified donee is now required to be listed on a publicly available list maintained by the Canada Revenue Agency (CRA).

If a qualified donee does not comply with the following requirements, the CRA may suspend its receipting privileges, revoke its qualified donee status or assess it monetary penalties:

- **Official receipts**

A receipt must be in accordance with the rules set out in the Income Tax Act and its regulations.

- **Books and records**

A qualified donee must maintain proper books and records.

- **Good governance**

The Minister of National Revenue may review the status of any director, trustee, officer or any person who controls or manages the operations of a charity. If any such individual is determined to have been found guilty of a criminal offence or to have been involved in other specified inappropriate activities, whether involving the charity concerned or another organization, the Minister may require the organization to take remedial action or risk revocation of its registration, including its authority to issue donation receipts.

Returned gifts

Where a qualified donee returns a gift with a value greater than \$50 to a donor, the donee will be required to issue a revised receipt and the donor's original

tax return will be reassessed accordingly.

Other tax consequences may apply depending on whether or not the original "gift" is considered to have been a gift.

Gifts of non-qualifying securities (NQS)

A taxpayer is not able to claim a charitable donation of a NQS (e.g., shares of or debt obligations issued by the taxpayer or a person that is not at arm's length from the taxpayer) unless the donee disposes of the security within five years after the date of the gift. The amount of the donation is deemed to have been made in the year of the disposition, for an amount not exceeding the proceeds realized by the donee.

Granting of options to qualified donees

Prior to the Budget, a qualified donee could issue a receipt equal to the value of an option to acquire property of the donor that the donor granted to the donee. The donee must now acquire the property in order to issue a receipt.

Donations of publicly listed Flow-Through Shares

The current legislation provides that when a taxpayer makes a gift of publicly listed shares, the taxpayer will receive a donation receipt equal to the value of the shares and will not be required to include any resultant capital gain in the computation of income. In the case of a donation of publicly traded flow-through shares, the tax cost of the

shares is often reduced to nil by virtue of the flow-through of deductions and credits. Therefore, the resultant capital gain, which is equal to the value of the share, is not taxed under the existing rules. The combination of the flow-through deduction and the elimination of the capital gain significantly reduce the after-tax cost of the donation. The Budget proposes that only the capital gain in excess of the original cost of the flow-through share be exempt from tax. The rules will apply to flow-through shares issued pursuant to an agreement entered into after March 21, 2011.

PERSONAL TAX MATTERS

TAX CREDITS

Family Caregiver Tax Credit

For 2012 and subsequent taxation years, a Family Caregiver Tax Credit will be introduced to provide a 15% non-refundable credit, based on a flat amount of \$2,000. This credit will assist caregivers of dependants with a mental or physical infirmity, including spouses, common-law partners and minor children. Caregivers will be able to claim an enhanced amount for an infirm dependant under one of the existing dependency-related credits.

Consequently, this enhancement would apply to one of the following credits: Spousal or Common-Law Partner Credit, Child Tax Credit, Eligible Dependant Credit, Caregiver Credit or Infirm Dependant Credit.

A dependant who is a minor will be considered to be infirm only if he or she is likely to be dependent on others for significantly more assistance when compared generally to persons of the same age for a long continuous period of indefinite duration. This test will apply to dependants who are under age 18 at the end of the year and who are claimed for purposes of the Child Tax Credit or the Eligible Dependant Credit.

Medical Expense Tax Credit for Other Dependants

Individuals may generally claim a Medical Expense Tax Credit in respect of eligible expenses paid for themselves, their spouse or common-law partner or their children under age 18. Caregivers may also claim this credit for a dependant relative if the caregiver pays their medical or disability-related expenses. A dependant for this purpose includes a child age 18 or older, a grandchild, a parent, a grandparent, a brother, a sister, an uncle, an aunt, a niece or a nephew who is dependent on the individual for support. Currently, the maximum claim by a caregiver for such a dependant is limited to \$10,000 per year. The Budget proposes to remove this \$10,000 maximum for 2011 and subsequent taxation years.

Tuition Tax Credit — Examination Fees

For 2011 and subsequent taxation years, amounts eligible for the Tuition Tax Credit will include fees paid to an educational institution, professional association or provincial ministry to take an examination that is required to obtain a professional status or to be licensed or certified in order to practice a profession or trade in Canada. Ancillary fees and charges, such as examination material used during the examination and certain prerequisite study materials, will also be eligible for the credit. However, eligible ancillary fees and charges will not include the cost for travel, parking or equipment. Also, fees in respect of examinations taken in order to begin study in a profession or field, such as a medical college admission test, will not qualify. The total of tuition and examination fees paid to the institution or association must exceed \$100 to be eligible.

Education Tax Measures— Study Abroad

A Tuition Tax Credit is currently available to a Canadian student in full-time attendance at a university outside Canada to the extent that the tuition fees are paid for a course of at least 13 consecutive weeks. The Education Tax Credit and the Textbook Tax Credit are also subject to this rule. In addition, a Canadian student can currently receive educational assistance payments (EAPs) from an RESP for enrolment in such a program.

The Budget proposes to reduce the minimum course duration requirement to three consecutive weeks, from 13 consecutive weeks.

Children's Arts Tax Credit

For 2011 and subsequent taxation years, a Children's Arts Tax Credit was introduced to provide a 15% non-refundable credit, based on an amount of up to \$500 of eligible expenses per child paid in a year. An eligible expense includes artistic, cultural, recreational or development activities. Expenses which are eligible for purposes of the Child Care Expense Deduction, the Children's Fitness Tax Credit or the Medical Expense Tax Credit will not be eligible for this tax credit.

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. For a child who is eligible for the Disability Tax Credit and who is under 18 years of age at the beginning of the year an additional \$500 credit may be available. An eligible program is considered to 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. The credit can be claimed by either parent or can be shared between the parents.

Volunteer Firefighters Tax Credit

For 2011 and subsequent taxation years, a Volunteer Firefighters Tax Credit was introduced to provide a 15% non-refundable credit based on a flat amount of \$3,000. A volunteer firefighter will

qualify for this credit if he or she performs at least 200 hours of volunteer firefighting services in a taxation year for one or more fire departments.

INDIVIDUAL PENSION PLANS (IPPS)

The Budget has proposed two new measures with respect to IPPs. The first proposal will require annual minimum withdrawal amounts, similar to the current rules for RRIFs, once a plan member reaches age 72. In addition, contributions to an IPP which relate to past years of employment will have to be funded from a plan member's existing RRSP assets or by reducing the individual's accumulated RRSP contribution room, before new deductible contributions for past service may be made.

These new measures will apply to a defined benefit Registered Pension Plan (RPP) with three or fewer members if at least one member is related to an employer which participates under the plan. In addition, these new measures may apply to other RPPs whose members are "connected" to the employer or who are highly compensated employees. The minimum withdrawal rules will apply to the 2012 and subsequent taxation years. For those IPP members who reached age 72 in 2011 or earlier, the required withdrawals will commence in 2012. For those IPP members who reach age 72 after 2011, the required withdrawals will commence in the year they reach age 72.

The Budget proposal with respect to

past service contributions will apply to such contributions made after March 22, 2011, unless the past service was credited to an IPP member before March 22, 2011 under the terms of an IPP submitted for registration on or before March 22, 2011.

RRSPS — ANTI-AVOIDANCE RULES

The Budget proposes to enhance the current RRSP anti-avoidance rules to address concerns regarding the use of RRSPs in tax planning schemes, including “RRSP strips”, by introducing rules similar to the anti-avoidance rules which currently apply to Tax-Free Savings Accounts (TFSA). This proposal deals with the advantage rules, the prohibited investment rules and the non-qualified investment rules.

“KIDDIE TAX” ON CAPITAL GAINS

The tax on split income (the “kiddie tax”) applies to certain income received by a minor child with a parent resident in Canada. Split income currently includes taxable dividends received in respect of unlisted shares of Canadian and foreign corporations and partnership or trust income derived from providing property or services to a business carried on by a person related to the minor child. However, split income does not currently apply to capital gains realized by the minor child.

The Budget has proposed a measure to extend the kiddie tax to capital gains realized by a minor as a result of income-splitting techniques which have been developed to avoid kiddie tax. Such capital gains will be treated as

dividends, included in the minor’s split income and subject to the kiddie tax. In addition, because the gains are treated as dividends, they will not qualify for the capital gains exemption.

This proposal will apply to capital gains realized after March 22, 2011.

RESPS — ASSET SHARING AMONG SIBLINGS

For 2011 and subsequent taxation years, the Budget proposes to allow for transfers between individual RESPs for siblings, without tax penalties and without triggering the repayment of Canada Education Savings Grants, provided the beneficiary of the plan receiving the transfer of assets is not 21 years-old when the plan was opened.

This Budget proposal will provide subscribers of separate individual plans with the same flexibility to allocate assets among siblings as it currently exists for subscribers of family plans.

REGISTERED DISABILITY SAVINGS PLANS (RDSPS) — SHORTENED LIFE EXPECTANCY

Subject to specified limits and certain conditions, the Budget proposes to allow RDSP beneficiaries with a life expectancy of five years or less to withdraw more of their RDSP savings by permitting annual withdrawals without triggering the 10-year repayment rule.

In order to take advantage of this proposal, the holder of the RDSP must elect in prescribed form and submit the election with the medical certification completed by the medical doctor to the

RDSP issuer. A plan holder will also be permitted to reverse this election in the future.

This proposal will apply to withdrawals made after 2010, and after the enacting legislation receives Royal Assent.

OTHER PERSONAL MEASURES

The guaranteed income supplement will be enhanced. Effective for 2011, the top-up benefit for single seniors is \$600 and for couples \$840.

A Student Loan Forgiveness for up to \$40,000 for family physicians in rural or remote areas and up to a maximum of \$20,000 for nurses and nurse practitioners.

March 23, 2011
SOBERMAN LLP

The information contained in this Tax Letter is of a general nature and should not be acted upon without appropriate professional advice following a thorough examination of the particular situation.

NEED TO TALK TO SOMEONE?

Your Soberman LLP advisor is always available to answer your questions. Our group of tax experts are available to point you in the right direction and provide tangible planning and solutions.

Please contact one of the partners or senior managers of the Taxation Group at Soberman LLP:

Gary Kopstick	gkopstick@soberman.com	416 963 7113
Karyn Lipman	klipman@soberman.com	416 963 7159
Adam Rubinoff	arubinoff@soberman.com	416 963 7178
Adam Scherer	ascherer@soberman.com	416 963 7174
Karen Slezak	kslezak@soberman.com	416 963 7109
Hetal Kotecha	hkotecha@soberman.com	416 963 7236
Frederic Pansieri	fpansieri@soberman.com	416 963 7237
Ali Spinner	aspinner@soberman.com	416 963 7129

Contact us today and one of our tax advisors will be in touch with you to help you plan for your success!

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