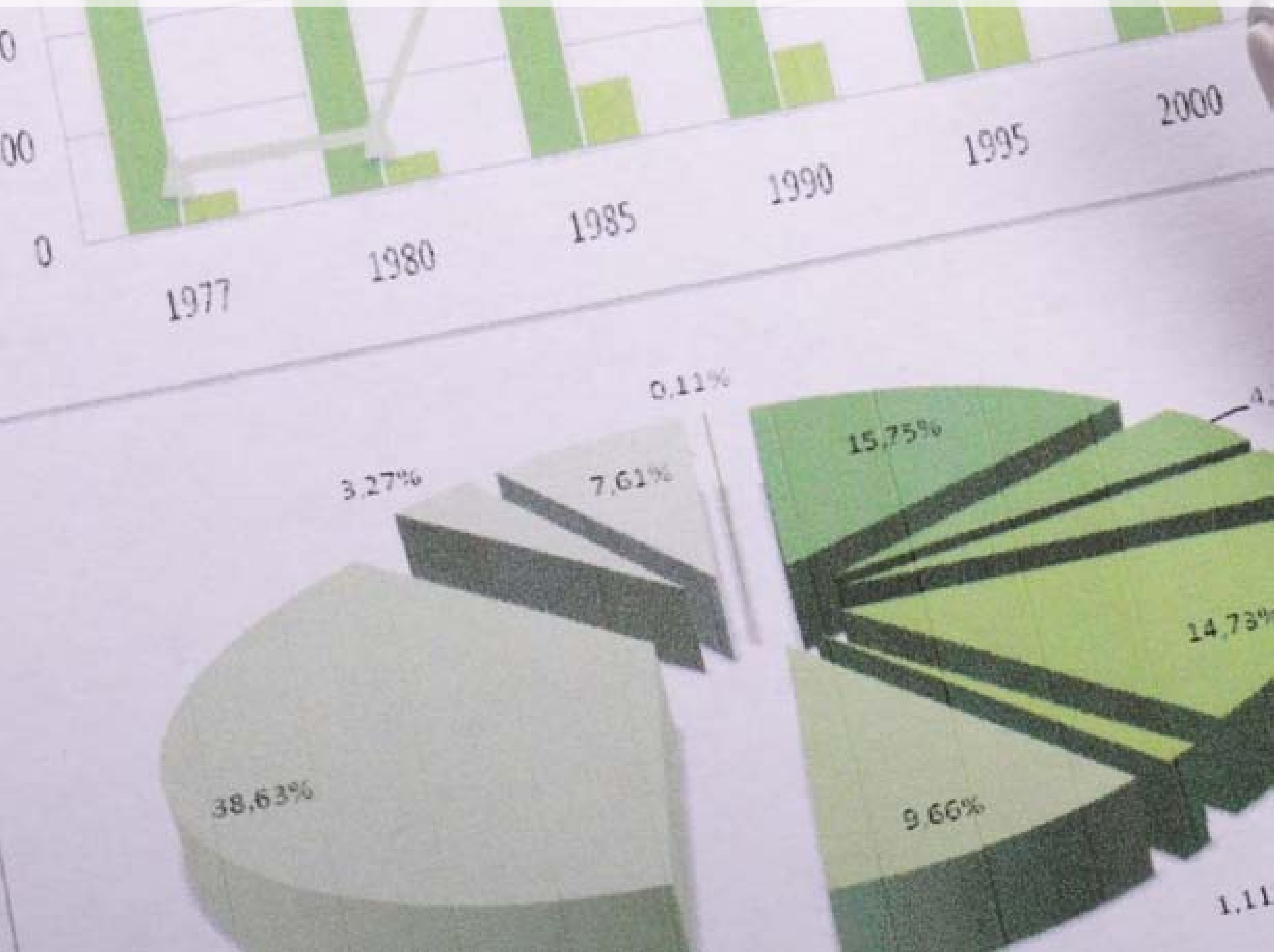
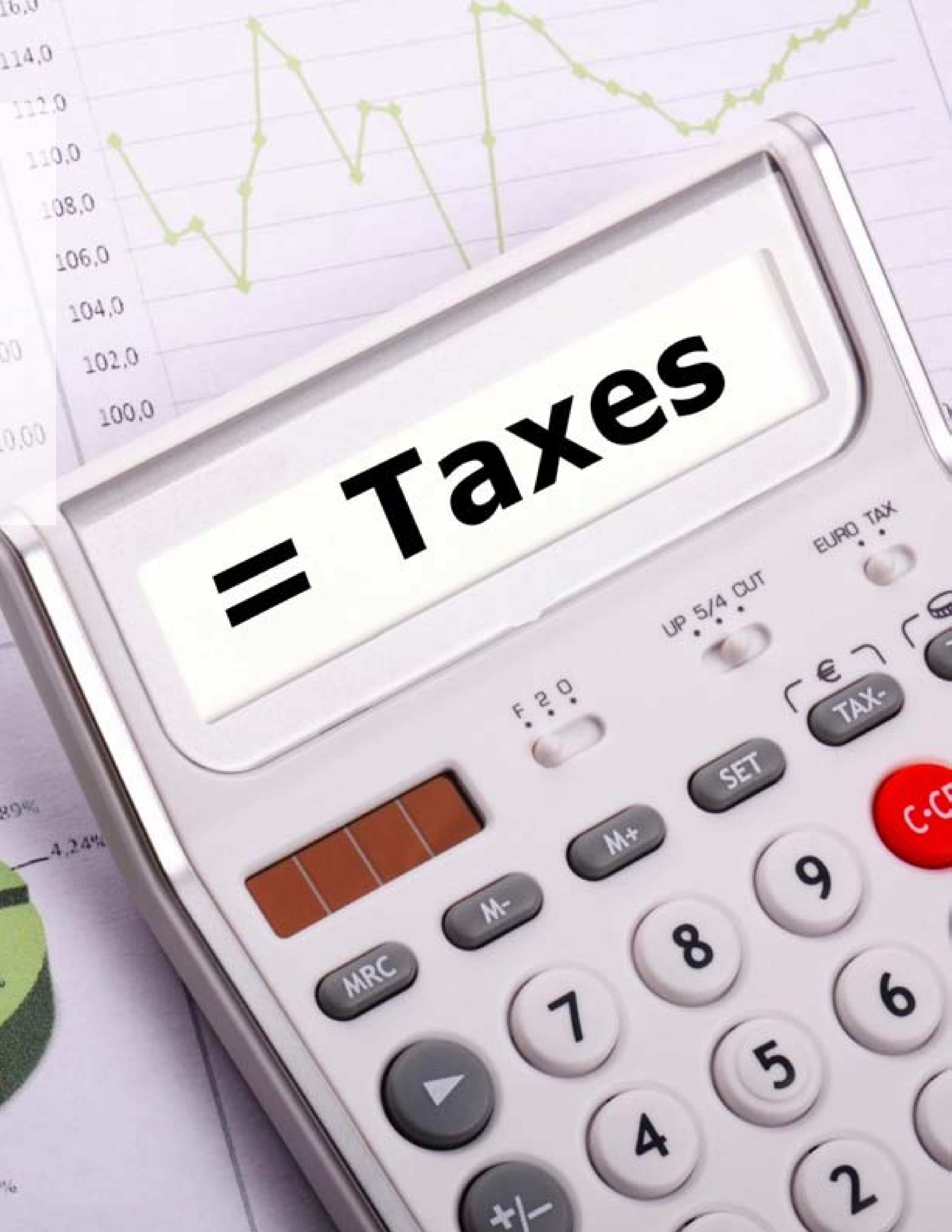
THE 2013 FEDERAL BUDGET

Business Tax Measures

BY TINA TEHRANCHIAN

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The main goals of the 2013 Federal Budget consisted of creating jobs, simplifying taxes and closing perceived tax loopholes.

THE FOLLOWING ELEMENTS in the budget have the biggest impact on corporations and on financial planning for business owners.

Lifetime Capital Gains Exemption

The budget proposed to increase the $750,000 lifetime capital gains exemption by $50,000 to $800,000 in 2014 and to index it to inflation for 2015 and subsequent years. The new limit will be available for dispositions of qualified small business corporation shares, qualified farm property and qualified fishing property. The new higher lifetime limit will be available to all individuals, including those who had previously claimed the maximum exemption at the time.

Dividend Tax Credit

In order to address over-compensation concerns, improve tax integration, and to more accurately reflect the corporate income taxes that are paid on active business income, the budget proposed to make changes to the non-eligible dividend regime and reduce the 25% gross-up on non-eligible dividends to 18% as well as reduce the dividend tax credit rate of 13.33% of the grossed-up dividend to 11%. This will effectively increase the highest marginal federal tax rate on non-eligible dividends from 19.58% to 21.22%. These changes are applicable to non-eligible dividends paid after 2013.

Non-eligible dividends are dividends issued by public or private Canadian corporations that are not eligible for the enhanced dividend tax credit. The non-eligible dividend tax credit rate is used for dividends received from Canadian controlled private corporations (CCPCs) to the extent that their income is subject to tax at the small business rate. These dividends are usually reported in boxes 10, 11 and 12 of your T5 slip.

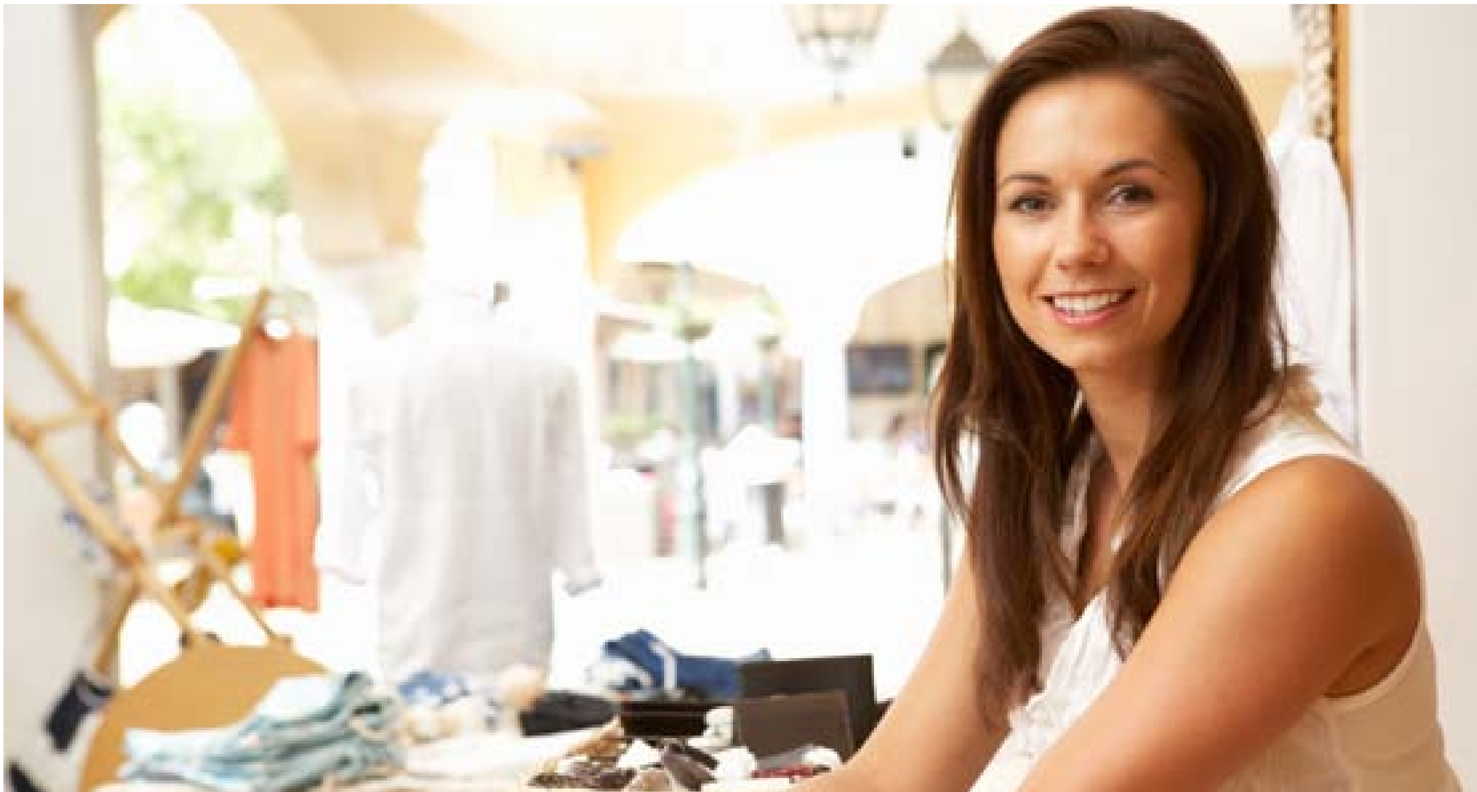
Corporate Income Tax Rates

The budget proposed no changes to the corporate income tax rates. The table below shows federal tax rates and the small business limit for 2013.

Category	2013 tax rates
General rate	15%
Manufacturing & processing rate	15%
Small business rate	11%
Small business limit	$500,000

Hiring Credit for Small Business

In order to help create jobs and help small



The hiring credit for small business will be available to employers whose EI premiums were $15,000 or less in 2012.

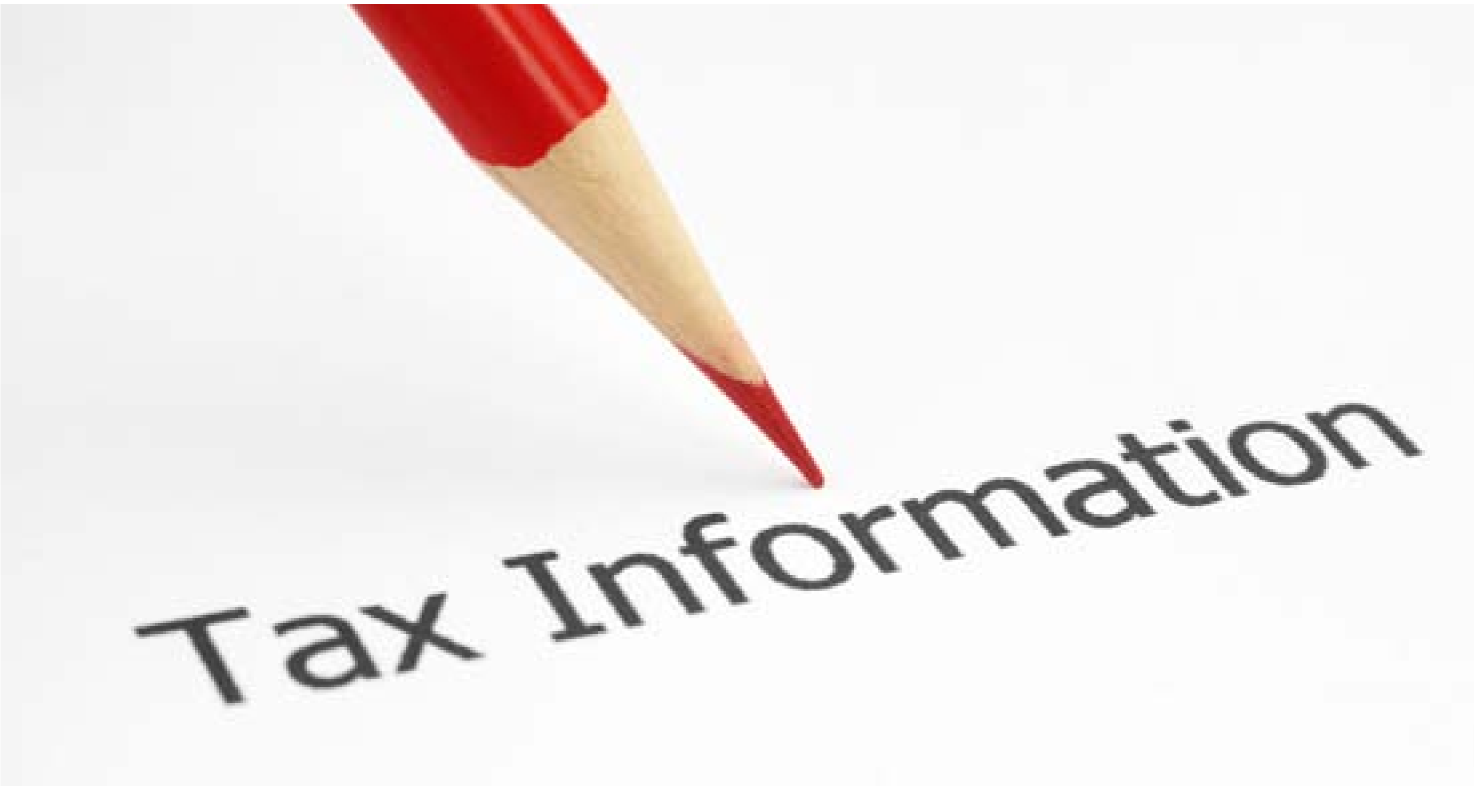
businesses hire the talent they need, the budget proposed a further one-year extension of the temporary hiring credit for small business that was originally introduced in the 2011 budget. This credit will be available to employers whose EI premiums were $15,000 or less in 2012 and offers up to $1,000 to offset the increase that a small business experienced in Employment Insurance (EI) premiums paid in 2013 over those paid in 2012.

Canada Job Grant

In order to stimulate employee training and to improve the workforce, the budget proposed a new grant that could provide $15,000 or more per person, including a maximum federal contribution of $5,000 with matching contributions by the provinces or territories and employers. Detailed design of the program will be negotiated with the provinces and territories over the next year in consultation with stakeholder groups, including employer associations, educational institutions and labour organizations.

Temporary incentives

Before the 2013 budget was announced, manufacturing and processing (M&P) machinery and equipment acquired after March 18, 2007 and before 2014 were eligible for temporarily



Going forward, more detailed information will be required when taxpayers use third parties to prepare a claim for SRED tax credits.

accelerated capital cost allowance (CCA). This temporary increase, from 30% to 50% straight-line (subject to the half-year rule), resulted in a full write-off of qualifying new M&P equipment costs over three years.

In order to provide further stimulus to the manufacturing sector, the 2013 federal budget proposed to extend applicability of the 50% straight-line method to acquisitions in 2015 and 2016. The half-year rule will continue to apply and will result in a full write-off of the cost of qualifying M&P equipment over three years. Acquisitions after 2016 will be included in Class 43, subject to a 30% declining balance rate of CCA.

SRED Tax Credit

In order to give CRA new resources and administrative tools to better respond to claims where the risks of non-compliance are high and eligibility for scientific research and experimental development (SRED) credits is unlikely, the budget proposed several changes to the SRED tax program.

Going forward, more detailed information will be required when taxpayers use third parties to prepare a claim. In particular, business numbers for each third party along with details about the billing arrangements, including the existence of contingency fees and the amount of fees payable, will be required. The claimant will also have to certify if there was no third-party involvement in preparing the claim.

The budget proposed a new $1,000 penalty for all claims where the abovementioned information is missing, incomplete or inaccurate. Where a third-party tax preparer is involved, the SRED claimant and the tax preparer will be jointly and severally liable for the penalty. This measure will apply to SRED claims filed on or after the later of January 1, 2014 and the date of royal assent.

Corporate Loss Trading

The budget proposed to introduce a new anti-avoidance rule that will apply where a person or group of persons acquires shares of a loss corporation that have a value equal to more than 75% of the total value of the corporation, but they do not acquire voting control of the corporation. This provision will be effective for shares acquired on or after March 21, 2013, unless the acquisition was pursuant to a written agreement entered into before that date.

This measure was taken to support the existing legislative provision that restricts the deductibility of losses in cases where there has been an acquisition of control of a corporation. If one of the main reasons that they do not acquire voting control is to avoid the loss restriction use rules, this provision will apply.

Taxation of Corporate Groups

The budget indicated that while the government has concluded its review of the taxation of corporate groups, introducing provisions dealing with corporate groups, such as inter-corporate loss transfers and consolidated reporting, are not priorities at this time.

Leveraged Insured Annuities

Leveraged insured annuities are a financial planning strategy that uses a combination of borrowed funds, life annuities and life insurance policies to create a current interest expense deduction, reduced capital gains tax payable on death, tax-free growth within the policy and an increase to the capital dividend account of the corporation. The budget eliminated the tax effectiveness of using this strategy by proposing that:

- The income earned in the life insurance policy would be subject to annual accrual taxation;
- The life insurance premiums would not be tax deductible;
- The life insurance proceeds received on death would not add to the capital dividend account of the corporation; and
- The amount of premiums paid for the annuity contract would constitute the fair market value of the annuity for the purposes of the

Leveraged insured annuities are a financial planning strategy that uses a combination of borrowed funds

deemed disposition on death.

These measures will generally apply to taxation years that end on or after March 21, 2013, but will not apply to arrangements where all borrowings were entered into before budget day.

10/8 Arrangements

10/8 arrangements were used by many business owners and used a combination of life insurance policies and borrowed funds to create an ongoing interest expense deduction, a tax deduction for a portion of the life insurance premiums paid and an increase to the capital dividend account of the corporation. The budget proposed to deny all tax advantages offered by these arrangements by deeming:

- The interest paid or payable on the borrowing relating to a period after 2013 not to be deductible;
- The life insurance premiums relating to a period after 2013 not to be deductible; and
- The capital dividend account not to increase by the amount of the death benefit

s, life annuities and life insurance policies.

that becomes payable to the corporation after 2013 under the policy that is associated with the borrowing.

To facilitate the windup of existing arrangements before 2014, the budget offered to alleviate the tax consequences of withdrawing from a policy under this arrangement to repay the borrowing, provided the withdrawal is made on or after March 21, 2013 and before January 1, 2014.

To be able to take the best advantage of all the new tax measures introduced in the 2013 budget, consult your tax professional and Financial Advisor. **CBJ**

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