Federal Budget 2014:
Individual Tax Changes

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The 2014-15 federal Budget announced on February 11, 2014, by Minister of Finance Jim Flaherty did not contain any new personal taxes or changes to existing personal tax rates.

Many of the Budget measures affecting individuals were relieving measures targeted at specific taxpayer groups, including adoptive parents, volunteers, and amateur athletes. However, other rules, including those governing testamentary trusts, certain charitable donations, and some kinds of income splitting techniques have been tightened to address perceived or potential abuses of those rules.

Adoption tax credit increased

Canadians who seek to adopt a child typically incur significant expenses during the adoption process. Those who do are entitled, once the adoption is complete, to claim a 15% non-refundable federal tax credit on up to $11,774 on such expenses incurred.

The federal government has determined that an increase in the amount of expenses eligible for the credit is warranted. Consequently, for 2014 and subsequent years, parents who have completed an adoption will be able to claim a 15% credit on up to $15,000 in related expenses per child. Those who claim the maximum amount will have their federal taxes for the year reduced by $2,250.

Medical expense tax credit expanded

Individuals who incur medical expenses which are not covered through either public or private health care plans can claim a non-refundable credit for those expenses on their tax return. Expenses claimable are those which exceed a threshold of $2,171 or 3% of the taxpayer's income for the year, whichever is less, and which constitute "eligible medical expenses".

As medical technology and practices advance, the list of expenses which qualify for the medical expense tax credit (METC) likewise expands. In this year's Budget, two new items were added to that list.

Effective for 2014 and subsequent years, expenses incurred to acquire and care for a service animal trained to assist an individual with severe diabetes will be eligible for the METC. Travel expenses incurred by the individual to attend a facility to be trained in the handling of that service animal will also qualify as expenses eligible for the METC.

Under current rules, the METC is provided for the cost of therapy provided to individuals who qualify for the disability tax credit–that is, individuals who have a severe and prolonged mental or physical impairment where such therapy is prescribed by a medical professional. Beginning in 2014, where an individual obtains therapy that would qualify for the METC, the cost of obtaining an individualized therapy plan would also constitute an eligible medical expense, if the following conditions are met:

- such an individualized therapy plan is required to access public funding for specialized therapy, or the individualized therapy plan is prescribed by a medical professional;
- the plan is designed for an individual who is eligible for the disability tax credit; and
- the amounts claimed are paid to persons who ordinarily provide such services to unrelated individuals.

New tax credit for search and rescue volunteers

The federal government and some of the provinces provide tax assistance to volunteer first responders, such as volunteer firefighters, through tax exemptions or credits. A new non-refundable federal tax credit will, beginning in 2014, be made available to search and rescue volunteers.

The credit will be equal to 15% of $3,000, which will mean that those who claim the credit will see their federal tax payable for the year reduced by $450. In order to claim the credit, an individual must perform at least 200 hours of volunteer search and rescue services during the year for a qualifying search and rescue organization. Such search and rescue organizations include those that are members of the Search and Rescue Volunteer Association of Canada, the Civil Air Search and Rescue Association, and the Canadian Coast Guard Auxiliary. Search and rescue organizations recognized by provinces, municipalities, or other public authorities will also qualify.

Individuals who provide both volunteer firefighting and volunteer search and rescue services will be able to claim either the Volunteer Firefighters or Volunteer Search and Rescue credit. Where either credit is claimed, the individual will not be eligible for the existing tax exemption on up to $1,000 in honoraria paid by a government or other public authority.

Mineral exploration tax credit extended

Investors who hold "flow-through" shares in a company are entitled to deduct qualifying mineral exploration expenses renounced to them by that company when calculating their own taxable income. Such investors can also claim the federal mineral exploration tax credit, which is equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to shareholders.

The mineral exploration tax credit program was scheduled to expire in 2014, but it was announced in the Budget that it had been extended for a further year, to flow-through share agreements entered into on or before March 31, 2015.

Measures affecting amateur athletes

Any Canadian who is a member of a registered Canadian amateur athletic association and is eligible to compete in international sporting events as a Canadian national team member can become the beneficiary of an amateur athlete trust. Income received by the athlete from activities related to his or her participation in international sports (e.g., prize money, endorsement income, income from public appearances, etc.) can be contributed to the trust. Any amounts so contributed are excluded from the athlete's income for the year and can compound inside the trust free of tax. All amounts in the trust must be distributed to the athlete beneficiary and taxed as income, within eight years after he or she ceases to compete as a national team member.

The tax-exempt nature of income contributed to an amateur athlete trust means that such income does not, under current rules, qualify as earned income in determining the athlete's registered retirement savings plan (RRSP) contribution limit. The Budget proposes a change which would allow any income amounts contributed to the trust in a year to qualify as earned income for the purpose of determining the athlete's RRSP contribution limit for the following year.

The change will take effect for 2014 and subsequent taxation years. An election is, however, available to have the new rule apply to income amounts contributed to an amateur athletic trust for the 2011, 2012, and 2013 taxation years. Where an election is made, the athlete's RRSP contribution limit for the affected years will be re-calculated. Any such election must be made, in writing, by March 2, 2015.

Measures affecting farming and fishing businesses

Intergenerational transfers and the lifetime capital gains exemption

Canadian farming and fishing businesses benefit from a number of tax provisions which are intended to facilitate the intergenerational transfer of such businesses. Those provisions include the ability to defer any capital gains arising on such intergenerational transfers (known as a "rollover") and an $800,000 lifetime capital gains exemption (LCGE) on the sale of certain farming or fishing property, shares, or partnerships interests.

The beneficial tax treatment is intended to be made available to those who are engaged in the business of farming or fishing on a full-time or nearly full-time basis and not, for instance, to hobby farmers. To that end, the rules require that, where an individual carries on a farming or fishing business as a sole proprietor or through a partnership, the qualifying property is required to be used principally (50% or more) in a farming business or a fishing business. Similarly, in order for an individual's shares in a family corporation or interest in a family partnership to qualify for the intergenerational rollover and the LCGE, all or substantially all (90% or more) of the fair market value of the property of that corporation or partnership must be property used principally in a farming business or a fishing business.

Under the current rules, difficulties can arise where the property is used in a combination of farming, fishing, and other uses, and where neither farming nor fishing activities alone meet the 50% or 90% test. The Budget proposes the following measures to alleviate those difficulties:

- eligibility for the intergenerational rollover and the LCGE is extended to property of an individual used principally (50% or more) in a combination of farming and fishing; and
- eligibility for the intergenerational rollover and the LCGE is extended to situations in which an individual holds shares in a corporation or an interest in a partnership, and the property of the corporation or partnership is used principally for either farming or fishing or for any combination of the two. Such property will now qualify as eligible property for purposes of the all or substantially all (90%) test.

The new rules will apply to dispositions and intergenerational transfers that take place in 2014 and subsequent years.

Tax deferral for weather-affected farmers expanded

Farmers who dispose of breeding livestock because of drought, flood, or excess moisture conditions prevailing in regions identified by the federal government in a particular year are allowed to defer up to 90% of the sale proceeds of such forced dispositions. The deferral is available until the following taxation year or until conditions improve (whichever is later). The deferral permits farmers to use sale proceeds to replenish their breeding stock.

Current rules provide that a deferral is available with respect to breeding livestock, including cattle, goats, and sheep that are over the age of one and kept for breeding, and horses that are over the age of one and kept for breeding in the commercial production of pregnant mare's urine.

The Budget proposes a change to these rules such that the tax deferral will be extended to bees and to all types of horses over the age of one kept for breeding.

Measures affecting the taxation of trusts

Changes to taxation of testamentary trusts

A testamentary trust is one that is created following the death of an individual. Under Canadian tax law, testamentary trusts (as well as non-testamentary trusts that were created before June 18, 1971) are taxed at graduated tax rates, meaning that the tax rate imposed on trust income rises as the amount of trust income in a year increases. Non-testamentary trusts that were created after June 18, 1971, do not benefit from a graduated tax rate, as all income of such trusts is taxed at the top personal tax rate.

In the 2013 Budget, the federal government announced that it would be examining and thereafter releasing a consultation paper on whether the eligibility of certain trusts for graduated tax rates should be continued.

That public consultation process ended in December 2013 and the federal government has decided to proceed with the measures outlined in the consultation paper. Consequently, beginning in 2016, all testamentary and non-testamentary trusts will be taxed at the top personal marginal rate, with two exceptions, as follows.

- Testamentary trusts will continue to benefit from graduated rates during the first 36 months after they are created. This exception recognizes that estates require a period of administration and that such administration can be carried out, in most cases, within a 36-month period. Once the period of administration goes beyond 36 months, however, the testamentary trust will become subject to taxation at the top marginal rate.
- Where the beneficiary of a testamentary trust is a disabled person who qualifies for the federal disability tax credit, the testamentary trust will continue to be eligible for graduated rates throughout its life. The Budget papers indicate that more details of this exception will be released in the near future.

Under pre-Budget rules, testamentary trusts and non-testamentary trusts created before June 17, 1971, benefitted from special treatment under a number of other tax rules, including an exemption from the income tax instalment rules. Many of those preferences and exemptions are being withdrawn. A full listing of the changes is provided in the Budget papers.

Changes to taxation of immigrant trusts

Canadian residents are taxed on their worldwide income, and where a Canadian resident makes a contribution to a non-resident trust, tax rules apply to treat that trust as a "deemed" resident of Canada, subject to Canadian tax. However, an exemption from that rule applies if the person contributing to a non-resident trust is someone who is resident in Canada for less than 60 months. In that case, there is no "deemed" residence provision, and the trust (known as an immigrant trust) is not subject to Canadian tax on foreign source income.

The federal government has concluded that the use of immigrant trusts raises issues of tax fairness and integrity and the Budget contains a proposal to eliminate the 60-month exemption rule. The change will apply for trust taxation years ending after February 11, 2014, with some transitional relief available.

Measures affecting charitable donations

Donations of certified cultural property

Individuals who donate property to charity can generally claim a charitable donations tax credit, with the amount of such credit based on the value of the property donated. That rule does not apply, however, where the property donated was acquired by the donor as part of a tax shelter gifting arrangement, or was held by a donor for a short period of time. In such cases, the value of the donated property, for tax purposes, is limited to the cost of that property to the donor.

One type of charitable donation which was not subject to that limitation was a gift of certified cultural property. In order to encourage Canadians to donate culturally significant property to institutions capable of ensuring adequate preservation, such donations must have received preferential tax treatment.

However, the federal government is concerned that such favourable tax treatment makes donations of certified cultural property an attractive target for those promoting abusive charitable donation tax shelter transactions. Consequently, and effective for donations made on or after February 11, 2014, donations of certified cultural property acquired by the donor as part of a tax shelter gifting arrangement will no longer be eligible for the exemption. In other words, the value of that property, for purposes of claiming a charitable donation tax credit or deduction, will be limited to the cost of the property to the donor.

The Budget papers specify that this change will affect only donations of certified cultural property acquired as part of a tax shelter gifting arrangement and that all other donations of certified cultural property will continue to be eligible for the exemption.

Estate donations

Many Canadians leave money or property to charity in their wills, or designate such donations to be made from the funds in their registered retirement savings plans, registered retirement income funds, or tax-free savings accounts ("designated donations"). All such donations are treated, for tax purposes, as though they were made during the last year of the donor's life, and a charitable donations tax credit can be claimed on the tax return filed for that year or the previous taxation year.

The Budget proposes a change which will increase the flexibility available to the estate of a donor in claiming a charitable donations tax credit in respect of such donations. Beginning with the 2016 tax year, donations made in a will, or designated donations, will be treated, for tax purposes, as though they were made by the donor's estate, at the time the money or property is actually transferred to the donee. In addition, the estate will have much greater flexibility in determining the tax year for which a charitable donations tax credit is claimed in respect of any such donation.

Under the new rules, any qualifying charitable donation made in a will or any designated donation can be allocated, and a charitable donations tax credit claimed, for the taxation year of the estate in which the donation is made, an earlier tax year of the estate, or the last two taxation years of the individual. For purposes of the new rule, a qualifying donation will be one which is carried out within 36 months after the death of the donor.

Donations of ecologically sensitive land

Individual Canadians who donate property which qualifies as ecologically sensitive land can claim a charitable donations tax credit, while corporations which make such donations are eligible for a charitable donations tax deduction. In addition, any capital gains which would normally be earned on the disposition of such land are exempt from tax.

As is the case for all charitable donations, amounts which are not claimed in the year the donation is made can be carried forward and claimed in any of the five subsequent taxation years.

In order to encourage donations of ecologically sensitive land, the Budget proposes to extend the carryforward period for such donations from 5 years to 10 years, effective for such donations made on or after February 11, 2014.

Measures affecting income splitting

Because Canada has a progressive tax system, in which higher tax rates apply at higher income levels, a tax advantage can be gained within a family by transferring income from high income adults to lower-income minor children. The tax legislation contains a set of rules known at the "attribution rules" to prevent such transfers, except in prescribed circumstances. Part of those attribution rules is a special tax known as the "kiddie tax", which applies the highest tax rate to income transferred from a high income adult to a lower-income minor, thereby negating any tax advantage.

The federal government has determined that certain partnership and trust structures are being used to circumvent the kiddie tax rules, and a proposal in the Budget will extend the application of the kiddie tax to such structures. Specifically, where an adult individual is actively involved in the activities of a trust or partnership to earn income from a business or from rental property, or has an interest in such partnership, and a minor related to that adult is allocated income from that trust or partnership which arises from a business or a rental property, any such income will be taxed in the hands of the adult individual.

This change to the income splitting rules will apply for 2014 and subsequent taxation years.

GST/HST tax credit application

On the first page of every individual income tax return form is an application box which allows the taxpayer, by ticking the box, to apply for the Federal Goods and Services/Harmonized Sales Tax (GST/HST) credit. That credit is paid to low-income and moderate-income Canadians four times a year.

Once the page 1 box is ticked, the Minister of National Revenue is obligated to issue and send to the individual a notice of determination informing him or her of their eligibility or ineligibility for the GST/HST tax credit.

Beginning with the 2014 individual income tax return form, individuals will no longer need to apply for the GST/HST tax credit. Instead, the Minister will determine, based on the information provided in the return, whether an individual is eligible to receive the credit. Those who are will receive a notice of determination notifying them of their eligibility, but no notice will be sent to ineligible individuals.

Those who are found to be ineligible but wish to contest that finding will be able to request a notice of determination, which will preserve their right to object to the finding of their ineligibility.