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2013 federal budget - impact on credit unions

March 25, 2013

Tax rates to rise due to elimination of additional deduction for credit unions

The March 21, 2013 federal budget included a surprise for the credit union system.

Since the 1970s, credit unions in Canada have been eligible for the preferential income tax rate available to small business corporations that are Canadian-controlled private corporations. An additional deduction, available only to credit unions, provides for a preferential income tax rate for income that is not eligible for the small business corporation tax rate. The result is that most credit unions are only subject to federal tax at the rate of 11%.

The amount of taxable income eligible for the additional deduction is subject to a limit, based on a credit union's cumulative taxable income that was taxed at the preferential rate (including as a result of the additional deduction) and the amount of its deposits and member shares.

The budget proposes to phase out the additional deduction for credit unions over five calendar years. A credit union will be entitled to deduct only 80% of the amount of the additional deduction otherwise calculated for 2013, 60% for 2014, 40% for 2015 and 20% for 2016. The additional deduction will be eliminated as of 2017.

This provision is proposed to apply to taxation years that end on or after March 21, 2013, with proration for taxation years that include March 21, 2013 to ensure that only those days in the taxation year that are on or after March 21, 2013 are subject to the reduced deduction. Proration will also apply where a credit union's taxation year does not coincide with the calendar year.

Provincial impact

Federal tax rate decisions are generally independent of provincial tax policy. Most provinces, including British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island mirror the federal treatment. However, Quebec eliminated the unique tax rate for credit unions in 2003. The provincial impact is currently unknown as it will be up to each province to decide whether to end its tax support of credit unions in similar fashion.

The gap between general and small business federal tax rates is only 4%. However, it is greater at the provincial level. In British Columbia, it is 7.5%; Saskatchewan, 10%; Manitoba, 12%; Ontario, 7%; and Prince Edward Island, 15%. The cost to credit unions will significantly increase if the provinces incorporate the federal tax change.

Financial reporting under IFRS - change in future rates

With the adoption of IFRS by Canadian credit unions, this proposal may have an impact on their financial statements in 2013. Under IFRS, deferred tax balances are calculated using the future tax rates that are expected to apply, based on tax rates and tax laws enacted or substantively enacted at the end of the reporting period.

In some jurisdictions, the announcement of new tax rates and tax laws by the government may have the substantive effect of enactment, even if formal enactment takes place some months later. In these circumstances, deferred tax balances are measured using the announced rates.

The federal government generally enacts changes in tax laws and rates by first introducing them in Parliament in a budget or a tax bill; however, governments, both federal and provincial, also introduce proposed changes in income tax laws or rates by way of draft legislation for consideration or press release.

Substantive enactment of proposed changes in income tax laws and income tax rates are generally not satisfied until detailed draft legislation has been tabled as a bill and has received first reading in Parliament. If there is a minority government, proposed amendments to the Income Tax Act would not be considered to be substantively enacted until the proposals have passed third reading in the House of Commons.

With the current majority Conservative government, the proposed changes will be considered substantively enacted after a budget implementation bill receives first reading in the House of Commons. We anticipate that the budget implementation bill will be introduced in the House of Commons during the second quarter of 2013.

What does this mean?

Credit unions have been adversely impacted by the change in policy announced in the budget. Federal income tax rates will rise over the next five years, from an effective rate of 11% to an effective rate of 15% for most credit unions. This increased tax burden could more than double if the provinces decide to follow the federal lead and eliminate the low rate of tax for credit unions.

The budget documents state this change will increase government revenues (i.e., increase credit union federal income taxes) by $10 million in the 2013-14 fiscal year; $25 million in 2014-15; $40 million in 2015-16; $55 million in 2016-17; and $75 million in 2017-18. However, the credit union system will bear much of the brunt of this impact in 2013 as credit unions adjust their deferred income tax balances for the change in rates and pay a higher rate of tax on current income.

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