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Tax Highlights of the Federal budget – March 19, 2007

Today the Conservative government tabled their second balanced budget. The budget estimates a surplus of \$9.5 billion for the first 10 months of 2006 – 2007 and provides for federal debt reduction of \$3 billion in each of the next two years. This budget provides \$9.7 billion in tax relief for Canadian individuals and businesses. The tax relief for individuals is primarily targeted to working families, while the majority of the tax relief for businesses will benefit the manufacturing sector.

The following is a summary of the tax measures as proposed in the budget. Please note that these measures are not yet law and may undergo revisions prior to receiving Royal Assent.

Business Measures

CCA changes for the manufacturing sector:

The budget proposes a new investment incentive for businesses engaged in manufacturing or processing (M&P) in Canada of goods for sale or lease. It is proposed that M&P machinery and equipment that would otherwise qualify for a 30% CCA rate under Class 43, will, for a limited time, qualify for an accelerated straight-line rate of 50%. This temporary increase in the rate will apply to eligible machinery and equipment acquired on or after March 17, 2007, and before 2009.

Businesses will also benefit from an increase in the CCA rate for buildings used in M&P in Canada. It is proposed that the rate for eligible buildings acquired on or after March 19, 2007 will increase from 4% to 10% to better reflect the useful life of buildings used in the M&P sector.

CCA rate adjustments for other assets:

In addition to the increase set out above for buildings and machinery and equipment used in M&P, the following changes to CCA rates are proposed:

- For other non-residential buildings, the rate is increased from 4% to 6%;
- For computers, the rate is increased from 45% to 55%
- For natural gas distribution pipelines, the rate is increased from 4% to 6%;
- For liquefied natural gas facilities, the rate is increased from 4% to 8%.

The new rates will apply to assets acquired on or after March 19, 2007. The half-year rule will continue to apply, such that timing of acquisitions just before a year end would provide for a faster write-off.

Other changes to the CCA system:

- Phase-out of the accelerated CCA for oil sands projects over the period from 2011 to 2015

Accelerated CCA for clean energy generation equipment – proposed to extend the 50% CCA rate provided for Class 43.2 equipment

Investment tax credit for child care spaces:

It is proposed that a non-refundable investment tax credit be available to eligible businesses that create new child care spaces for the children of their employees and, potentially, for children in the surrounding community. The credit will equal 25% of eligible expenditures incurred on or after March 19, 2007, to a maximum credit of \$10,000 per space created

Remittance and filing thresholds:

It is proposed that the threshold for determining whether a corporation is subject to income tax instalments be increased from \$1,000 to \$3,000. Further, for Canadian-controlled private corporations required to pay income tax instalments, the frequency of instalments will be reduced from monthly to quarterly where the following conditions are met:

- The taxable income of the corporation for either the current or previous year does not exceed \$400,000;
 - The corporation qualified for the small business deduction for either the current or previous year;
 - The corporation's taxable capital employed in Canada does not exceed \$10,000,000 in either the current or previous year;
- AND
- The corporation has no compliance irregularities under the Income Tax Act and Part IX of the Excise Tax Act during the preceding 12 months.

It is also proposed that the threshold for determining a monthly remittance filer for source deductions be increased from \$1,000 to \$3,000.

INTERNATIONAL TAX MEASURES

The budget proposes fundamental changes to the taxation of Canadian companies doing business abroad.

Canada-U.S. tax treaty

The budget confirms that Canada and the U.S. have agreed in principle on the major elements of an updated Canada – U.S. tax treaty, with formal negotiations expected to conclude in the near future. Under the updated treaty, Canadian individuals and businesses can expect to benefit from the following:

- The elimination of withholding tax on interest paid on both arm's length

and non-arm's length debt between Canada and the U.S. The withholding tax on arm's length interest payments will be eliminated in the first calendar year following the treaty's entry-into-force and will be phased in over a three year period on non-arm's length interest.

- Extension of treaty benefits to limited liability companies which are commonly used by U.S. venture capital firms and others to access U.S. capital.
- Increased harmonization of the tax treatment of pension contributions in Canada and the U.S. and new rules to clarify the treatment of stock options.

Withholding tax on interest payments:

The budget also proposes to eliminate withholding tax on interest paid to all arm's length non-residents regardless of their country of residence, once the above-noted withholding tax exemption is implemented in the Canada – U.S. tax treaty.

Personal Measures

New child tax credit:

A new non-refundable child tax credit is proposed equal to \$2,000 per child under the age of 18 at the end of the taxation year who resided with their parents throughout the year. Where the child resided with both parents throughout the year, either parent may claim the tax credit and any unused portion may be transferred to the claiming parent's spouse or common-law partner. Given the current minimum federal tax rate of 15.5%, this new tax credit would equate to a \$310 federal income tax savings per child.

Spousal and dependent tax credit amounts increased:

Increases to the spouse or common-law partner tax credit amount and the equivalent amount for wholly dependant relatives are proposed to bring them equal to the basic personal amount of \$8,929. This would be an increase of \$1,348 which, given the current minimum federal tax rate of 15.5%, would equate to a \$209 federal income tax savings for 2007. It is also proposed that these same credits be further increased in 2008 and 2009 such that they reach an amount of \$10,000 for the 2009 taxation year with annual indexing for the 2010 and subsequent taxation years.

Working Income Tax Benefit (WITB):

In order to improve incentives for low and modest-income Canadians to enter or remain in the workforce, a new working income tax benefit (WITB) is proposed. The WITB would be comprised of a refundable tax credit of up to 20% for each dollar earned

in excess of \$3,000 to a maximum credit of \$500 for single individuals and \$1,000 for couples and single parents. To ensure that the benefit is received by low and modest-income Canadians, the credit is reduced by 15% of net family income in excess of \$9,500 for single individuals and \$14,500 for families.

Registered Education Savings Plan (RESP):

For contributions made to a Registered Education Savings Plan (RESP) after 2006, it is proposed that the \$4,000 limit on annual contributions be eliminated and the lifetime contribution be increased from \$42,000 to \$50,000. Furthermore, it is proposed that the maximum Canada Education Savings Grant be increased from \$400 to \$500 annually. In order to allow part-time students to benefit from their RESP savings, it is proposed that the requirements that 10 hours per week be spent on courses be changed to 12 hours per month.

Registered Disability Savings Plan (RDSP):

A new Registered Disability Savings Plan (RDSP) intended to improve the financial security and well-being of children with severe disabilities is proposed. The RDSP program, to commence in 2008, would work in concert with a Canada Disability Savings Grant program and a Canada Disability Savings Bond program. The RDSP will be based generally on the existing RESP design and would be available to any Canadian resident person eligible for the disability tax credit.

RPP and RRSP age limit:

It is proposed that for years after 2006, RRSP annuitants may retain their RRSP and continue to make contributions to it until they turn 71, as opposed to the current maximum age of 69. Furthermore, it is proposed that for individuals turning 70 or 71 in 2007 and for those turning 71 in 2008, the minimum withdrawal from a RRIF for those years be nil.

RRSP qualified investments:

In order to provide registered plan investors with greater investment choice, it is proposed that the following become qualified investments for RRSPs and other registered plans:

- Any debt obligation that has an investment grade rating and that is part of a minimum \$25 million issuance; and
- Any security (other than futures) that is listed on a designated stock exchange which currently includes prescribed stock exchanges.

Lifetime capital gains exemption:

It is proposed that the lifetime capital gains exemption for dispositions of qualifying property be increased from \$500,000 to \$750,000 effective March 19, 2007. Therefore for qualifying dispositions by farmers, fishers and small business owners on

or after March 19, 2007, the first \$750,000 of capital gains may be received tax free.

Donations of publicly-listed shares to private foundations:

For gifts made on or after March 19, 2007, it is proposed that there be an elimination of income tax on any capital gains arising on donations of publicly-listed shares to private foundations. This will result in a similar relief as donations to public foundations. This measure would include an exemption of any resulting employment income deemed earned by an individual who makes a qualifying charitable donation of publicly-listed shares within 30 days of acquiring them through an employee stock option plan.

Other personal tax measures:

The following personal tax measures were also proposed:

- The instalment threshold for 2008 and subsequent years will be increased from \$2,000 to \$3,000;
- The Public Transit tax Credit which was introduced in 2006 will be extended to include innovative fare products such as electronic fare cards and weekly passes when used on an on-going basis;
- Elementary and secondary school scholarships received in 2007 and subsequent years may be excluded from the person's taxable income;
- Phased retirement will allow an employer to simultaneously pay a partial pension from a defined benefit RPP and continue to provide further pension accruals to the employee;
- Meal expense deductions for long haul truck drivers will be increased from 50% to 80% over 5 years beginning with meal costs incurred after March 18, 2007.

Sales and Excise Tax Measures:

- Foreign Convention and Tour Incentive Program: The budget proposes to reintroduce the GST incentives for conventions and the accommodation portion of non-resident tour packages. These incentives replace the former Visitors' Rebate Program. Foreign conventions (where more than 75% of the attendees are non-resident) will be eligible for a rebate of the GST in respect of the facilities and supplies for the conventions. Admissions for non-residents to Canadian conventions will also have exemptions. Rebates will be available for non-resident exhibitors as well as GST rebates on the accommodation portion of tour

packages for non-resident individuals.

- 48 Hour Travelers' Exemption: Effective March 20, 2007, the value of goods that may be imported duty and/or tax free by returning Canadian residents after a 48 hour absence will be increased from \$200 to \$400;
- GST/HST Paid on Meal Expenses for Long-Haul Truck Drivers: The amount by which the input tax credit for GST/HST is allowed for food and beverage expenses will increase from 50% to 80%;
- Annual Filer Threshold: The taxable supplies threshold which enables a registrant to elect to file GST/HST returns annually will increase from \$500,000 to \$1,500,000. The net tax threshold below which an annual filer does not need to make instalments and may make one annual tax remittance will double up to \$3,000. These changes are applicable to fiscal periods beginning after 2007;
- Green Levy on Fuel-Inefficient Vehicles: Effective March 20, 2007 and subject to certain transitional rules, Canadian manufacturers and importers of new automobiles other than pick-up trucks, will be subject to an excise tax. Vehicles that have a weighted fuel consumption rating of 13 litres or more litres per 100 kilometers will be subject to the tax. The tax will increase in \$1,000 increments up to a maximum tax of \$4,000 for each additional litre per 100 km. Inventory on car dealers' lots as of March 19, 2007 will not be subject to the tax;
- New Rebate for Fuel-Efficient Vehicles: After March 19, 2007, purchasers and lessees of fuel-efficient vehicles will be eligible for a maximum rebate of \$2,000. The rebate will be based on Transport Canada's fuel consumption ratings.

Disclaimer

The information provided is of a general nature and is not intended to construe an opinion. As each taxpayer's situation is unique, no one should act upon any of the above without first obtaining professional advice, from a Chartered Accountant, concerning the particular facts of their situation.