



2007 Federal Budget Commentary

“Aspire to a Stronger, Safer, Better Canada”

Introduction

The second budget of the Conservative Minority Government lead by Prime Minister Stephen Harper was tabled today in the House of Commons by Finance Minister James Flaherty.

The budget projects a surplus of approximately \$9 billion for the 2006-2007 fiscal year and budget surpluses of approximately \$3 billion per year over the subsequent fiscal years.

The key initiatives for budget 2007 are as follows:

- ***Building a Better Canada*** will receive funding of approximately \$1.6 billion. These initiatives include spending on the environment, investing in Canadians, investing in the health care system and celebrating Canadian Culture.
- ***Restoring Fiscal Balance for a Stronger Federation*** increases equalization payments by \$833 million and Canada Social Transfer by \$1.7 billion.
- ***A Stronger Canada through a Stronger Economy*** allocates \$342 million to infrastructure, entrepreneurial incentives, science and technology leadership and post-secondary education.
- ***Tax Advantage*** provides \$2.9 billion in income tax relief for individuals and businesses.
- ***A Safer Canada*** increases net funding of \$187 million on the Canada First Defence Plan and other security measures.

These initiatives along with other spending initiatives proposed before 2007 are projected to increase Federal Government spending by approximately \$9 billion per year over the next two years.

Personal Tax Measures

Lifetime Capital Gains Exemption

There has been a great deal of speculation over the years on whether the government would increase the lifetime capital gains exemption. Budget 2007 proposes to increase the lifetime capital gains exemption to \$750,000 from \$500,000 applicable to the disposition of qualified small business corporation shares, qualified farm property and qualified fishing property for dispositions on or after March 19, 2007.

Transitional measures are proposed for 2007.

Registered Retirement Savings Plans (RRSP) and Registered Pension Plans (RPP)

Age of conversion into a Registered Retirement Income Fund (RRIF)

Recognizing the reality of an aging population and that taxpayers are working past the historical age of retirement, the budget proposes to increase the RRSP and RPP conversion age from 69 to 71 years of age for individuals who turn 69 years of age in 2007 or later years.

Transitional measures will allow persons who turn 70 or 71 years of age in 2007 to make contributions to their RRSPs in 2007 and 2008 to the extent they have contribution room available. In addition, the specified minimum amount that must be withdrawn from their existing RRIF will be waived for 2007 and 2008.

Qualified Investments for RRSPs and RRIFs

The budget proposes to immediately extend the definition of qualified investment to include:

- investment grade debt obligations that are part of a minimum \$25 million issuance;
- any security (other than futures contracts) listed on a designated stock exchange.

Child Tax Credit

The budget proposes the introduction of a non-refundable child tax credit. The credit, effective for 2007 and subsequent taxation years, will be based on an amount of \$2,000 per child and will provide tax relief for up to \$310 per child.

Increase in the Spousal and Related Credits

Under current legislation, the spousal and wholly dependant exemption amount on which a non-refundable tax credit is based is \$7,581 (for 2007) which is less than the \$8,929 (for 2007) basic personal exemption amount. These amounts will be increased in 2007 to match the annual basic exemption amount of \$8,929. For 2008 and subsequent years, these amounts will be increased to match currently legislated increases for the basic personal exemption amount.

Education Initiatives

Registered Education Savings Plan (RESP)

To increase the flexibility for families to invest for their children's education, the budget proposes to eliminate the \$4,000 annual RESP contribution limit and increase the lifetime contribution limit to \$50,000 from \$42,000.

The maximum annual RESP contribution qualifying for a Canada Education Savings Grant (CESG) will be increased to \$2,500 from \$2,000, increasing the maximum CESG to \$500 from \$400.

These measures are applicable beginning in 2007.

Elementary and Secondary School Scholarships

The budget proposes to eliminate taxation of elementary and secondary school scholarships beginning in 2007.

Registered Disability Savings Plan (RDSP)

The budget introduces the RDSP to help parents and others save for the financial security of a disabled child. The plan may be established by any person eligible for disability tax credit or their parent/legal representative. Payments into the plan will not be deductible and investment income will accrue tax free.

There is a lifetime maximum of \$200,000 for contributions into the plan and no contributions will be permitted after the beneficiary reaches 59 years of age.

Canada Disability Savings Grant (CDSG)

To further assist persons with disabilities, the budget introduces the CDSG which will provide government assistance based upon contributions to the RDSP.

Canada Disability Savings Bonds (CDSB)

The budget also introduces CDSBs for low income persons with disabilities. A person with disabilities may receive up to \$1,000 in CDSBs which are paid annually to their RDSP. The payments are not contingent on contributions to the RDSP.

Investment income in a RDSP as well as CDSGs and CDSBs are taxable in the hands of the beneficiary when paid out.

The government will work with financial institutions to put the administrative mechanisms in place to start offering RDSPs in 2008. Individuals establishing an RDSP in 2008 will be eligible for CDSGs and CDSBs.

Working Income Tax Benefit (WITB)

The budget proposes the creation of the WITB, a new refundable credit for low income Canadians. The maximum credit, effective 2007, for individuals and families are proposed to be \$500 and \$1,000 respectively.

For individuals and families, the credit will be equal to 20% of each dollar earned in excess of \$3,000. For individuals, the credit will be phased out at a rate of 15% of income in excess of \$9,500, eliminating the credit when the individual's income exceeds \$12,833. For families, the credit is phased out on net family income between \$14,500 and \$21,167.

Individuals are eligible for the credit if they are at least 19 years of age or in the year they become the primary caregiver of dependent child. Full time post secondary students with no dependents and who are enrolled in full-time studies for more than three months are not eligible for the credit.

There is an additional \$250 credit for persons eligible for the Disability Tax Credit. The additional credit is calculated at a rate of 20% for each dollar of income in excess of \$1,750 to a maximum of \$250. For individuals, the disability portion of the credit is phased out on income between \$12,833 and \$14,500. The credit is phased out for families with net family income between \$21,167 and \$22,834.

Starting in 2008, taxpayers can apply for a prepayment of one-half of the 2008 WITB credit.

Other Personal Tax Measures

The budget proposes to eliminate the taxation of capital gains arising from donations of publicly listed securities to private foundations. As well, the budget eliminates the taxation of the employment benefit on publicly listed securities acquired by employees through a stock option plan where the securities are donated to a public charity within 30 days. These measures apply to donations made after March 18, 2007.

The budget proposes to extend existing public transit tax measures to include electronic payment cards for single trip fares and weekly passes subject to trip and purchase thresholds.

The deductibility of meal expenses for long-haul truckers will increase from 50% to 80% over a five-year phase in.

The eligibility for the mineral exploration tax credit which was scheduled to expire March 31, 2007 will be extended to flow through share agreements entered into on or before March 31, 2008.

For the 2008 and subsequent taxation years, the budget proposes to increase the income tax threshold for personal income tax instalments to \$3,000 (\$1,800 for Quebec residents) from \$2,000 (\$1,200 for Quebec residents).

Business Income Tax Measures

Corporate Taxes

The budget confirmed previously announced corporate rate changes as follows:

General corporate income tax rate

The rate will be reduced to

20.5%	January 1, 2008
20%	January 1, 2009
19%	January 1, 2010
18.5%	January 1, 2011

Corporate Surtax

4 % corporate surtax eliminated January 1, 2008

The above tax changes will be prorated for taxation years that do not coincide with the calendar year.

Corporate Tax Instalment Frequency and Threshold

- For Canadian Controlled Private Corporations with taxable income not exceeding \$400,000, the frequency of instalment remittances will be reduced to quarterly from monthly.
- The requirement to make corporate tax instalments will be eliminated when income tax payable in a preceding year did not exceed \$3,000 (up from \$1,000).

These measures are effective for tax years beginning after 2007.

Significant Changes to Capital Cost Allowance (CCA) Rates

The budget proposes to change the rate of capital cost allowance for certain depreciable asset classes to better align with their useful life.

Proposed Increases to CCA Rates

<i>Asset</i>	<i>Current Rate</i>	<i>New Rate</i>
Buildings used for manufacturing or processing	4%	10%
Other non-residential buildings	4%	6%
Computer equipment	45%	55%
Natural gas distribution lines	4%	6%
Liquefied natural gas facilities	4%	8%

These new rates apply to assets acquired after March 19, 2007.

Temporary CCA Rate Increase for M&P Equipment

There will be an increase from 30% to 50% on a straight-line basis of capital cost allowance for manufacturing and processing equipment acquired between March 19, 2007 to December 31, 2008.

Oil Sands Equipment

The budget proposes to phase out the accelerated capital cost allowance applicable to oil sands machinery and equipment. The CCA rate applicable after the phase out will be 25% declining balance. The accelerated CCA will continue to be available in full for:

- assets acquired before March 19, 2007;
- assets acquired before 2012 that are part of a project phase on which major construction began before March 19, 2007; and
- for other assets, the additional accelerated allowance will be gradually phased out between 2011 to 2015.

Accelerated CCA for Clean Energy Generation

There will be extended eligibility for a 50% accelerated CCA claim on equipment using wave and tidal energy to generate electricity and equipment used in a broad range of other applications including:

- active solar heating;
- photovoltaics;
- stationary fuel cells;
- biogas production from organic waste; and
- pulp and paper waste fuels.

Once again, these changes will apply to assets acquired after March 18, 2007.

Investment Tax Credit for Child Care Space

To encourage businesses to create licensed child care spaces, the budget proposes the implementation of a non-refundable tax credit. This credit will be up to 25% of eligible expenditures incurred after March 18, 2007 to a maximum credit of \$10,000 per child care space created.

International Taxation

Elimination of Withholding Tax on Interest

The government is currently negotiating an amendment to the Canada-U.S. Tax Treaty to eliminate the current 10% tax withholding on current cross-border interest payments. The withholding tax will be eliminated in the first calendar year following the new treaty in force date for interest payments between non-related parties. The rate will be gradually eliminated for other payments of interest to related parties as follows:

- 7% in the first year after treaty in force;
- 4% in the second year; and
- 0% thereafter.

As a follow-up to these measures, the government also proposes to eliminate Canadian withholding tax on all interest paid to arm's length non-residents. The implementation is intended to coincide with the effective date of the amended Canada-U.S. Tax Treaty.

Restricted Interest Deductibility on Foreign Affiliate Financing

The Minister proposes to eliminate the deductibility of interest on debt used to make investments in foreign affiliates if there is insufficient taxable income being generated by the affiliate. These changes

may have a significant impact for many Canadian multi-nationals and may change the method of investing in their related foreign companies.

Tax Information Exchange Agreements (TIEAs)

The government has announced that no new treaty will be signed without comprehensive TIEAs. The budget proposes to broaden the exempt surplus rules to include active business income earned in non-treaty countries that have signed TIEAs.

In addition, the policing of transfer pricing and international tax avoidance cases will increase as the Minister has announced additional resources to the Canada Revenue Agency.

GST and Excise Tax Measures

Foreign Convention and Tour Incentive Program

The budget proposes to replace the Visitor Rebate Program which was eliminated effective April 1, 2007 with the Foreign Convention and Tour Incentive Program designed to provide GST relief in respect of certain property and services used in the course of conventions held in Canada and the accommodation portion of tour packages for non-residents.

48-Hour Travellers' Exemption

The Excise Tax Act currently allows Canadian Travellers who have been travelling outside of Canada an exemption allowing them to bring back goods up to a specified dollar limit without having to pay duties or taxes. The budget proposes to raise the 48-Hour Travellers' Exemption from \$200 to \$400.

Exports of Intangible Personal Property

To ensure that exports of Intellectual Personal Property (IPP) are not subject to GST, the budget proposes that supplies of all IPP to non-residents who are not registered for the GST for use outside of Canada be zero rated.

Excise Tax on Renewable Fuels

The budget proposes the repeal of the excise tax exemptions for renewable fuels such as biodiesel and alcohol based fuels effective April 1, 2008. These fuels will now be included within the excise tax structures that apply to gasoline and diesel fuel.

Green Levy on Fuel-Inefficient Vehicles

The budget introduces a Vehicle Efficiency Incentive designed to promote the purchase of fuel-efficient vehicles. The program includes an incentive rebate up to \$2,000 on fuel efficient vehicles and a new Green Levy of up to \$4,000 on fuel inefficient vehicles. The Levy will apply to automobiles designed to carry passengers including station wagons, vans and sport utility vehicles. Pick-up trucks are excluded from the Levy which will apply to new vehicles delivered or imported after March 19, 2007.

Administrative Changes

Trust T3 Information Returns

The government is expected to release draft regulations related to streamlining the T3 filing process. The new regulations are intended to provide taxpayers their T3 supplementaries allowing sufficient time to file their tax returns while allowing trust filers, including income trusts, sufficient time to compute their income and prepare the slips.

Disclaimer

The information contained herein is for information purposes only and is not intended to be complete in all respects. It is a summary of budget materials released by the Department of Finance Canada. We recommend that you consult with a tax professional before acting on the basis of material contained herein.