

## HIGHLIGHTS OF THE 2007 FEDERAL BUDGET

On March 19<sup>th</sup> Finance Minister Jim Flaherty delivered the second budget proposed by Stephen Harper's Conservative Government, projecting a surplus of \$9.2 billion for 2006-07, which will be applied to pay down the national debt. Of course, nothing is 'caste in concrete' until – and if – the budget fights its way through Parliament and receives Royal Assent sometime in the next 90 days.

The budget contained a variety of tax changes, business and personal. We have summarized some of the highlights in this document; should you need additional clarification or information, please get in touch with us at Sonogo, Boivin.

### PROPOSED BUSINESS TAX CHANGES

#### Temporary CCA Rate Increase for M&P Assets –

The budget proposes to temporarily increase the capital cost allowance (CCA) rate for manufacturing and processing (M&P) machinery and equipment currently included in Class 43 to a 50% straight-line rate (from 30%). The new rate will apply to eligible assets acquired on or after March 19, 2007 and before 2009.

#### Other CCA Rate Increases –

The budget also proposes the following CCA rate increases for assets acquired on or after March 19, 2007:

<b>INCREASES TO CCA RATES (PROPOSED)</b>		
	<b>CURRENT RATE</b>	<b>PROPOSED RATE</b>
Computer equipment	45%	55%
Buildings used for manufacturing or processing	4%	10%
Other non-residential buildings	4%	6%

To access the enhanced CCA rates for buildings used in M&P and for other non-residential buildings, the asset will be required to be placed in a separate class or the current treatment will apply. Further, at least 90% of the building (measured by square footage) must be used for the designated purpose by the end of the taxation year. Buildings used for M&P that do not meet the 90% M&P usage threshold at the end of the taxation year will at least be eligible for the new 6% proposed rate for other non-residential buildings if 90% of the building is used for non-residential purposes.

### **CCA Changes for Oil Sands Projects –**

While oil sands projects (both mining and *in situ*) will continue to be eligible for the regular 25% CCA rate for such projects, the government proposes to eliminate the additional allowance that allows taxpayers to deduct up to 100% of the remaining cost of eligible assets for a taxation year (up to the taxpayer's income for the year from the project after deducting regular CCA).

The accelerated CCA will continue to be available for assets acquired before March 19, 2007 and for assets acquired before 2012 that are part of a project phase on which major construction began before March 19, 2007. For other assets, the additional accelerated CCA will be phased out in stages over a period from 2011 - 2015.

### **Accelerated CCA for Clean Energy Generation –**

The budget proposes to extend eligibility for accelerated CCA under Class 43:1 (30%) or 43.2 (50%) to include the following assets acquired on or after March 19, 2007 and used to produce clean energy through emerging technologies:

- Wind and tidal energy equipment
- Active solar equipment
- Small photovoltaic and fixed-location fuel cell systems
- Biogas production equipment
- Pulp and paper waste fuel cogeneration systems
- Biomass drying and other fuel upgrading equipment
- Waste-fuelled thermal energy systems

### **Investment Tax Credit for Child Care Spaces –**

The budget introduces a nonrefundable investment tax credit for businesses for the creation of licensed child care spaces for the children of their employees and, potentially, for children in the surrounding community. The credit will equal up to 25% of eligible expenditures incurred on or after March 19, 2007, to a maximum credit of \$10,000 per child care space created.

## **PROPOSED PERSONAL TAX CHANGES**

### **Personal Tax Changes in General -**

Among other personal tax changes, the budget proposes to:

- **Enhance contribution amounts** and Canada Education Savings Grant limits under Registered Education Savings Plans and extend eligibility for payments out of RESPs for more part-time programs
- **Provide full tax exemption** for scholarships and bursaries provided to attend elementary and secondary schools (currently, only \$500 of such income is tax-exempt)
- **Introduce Registered Disability Savings Plans**, broadly modeled after the existing Registered Education Savings Plan, to help parents save for long-term financial security of children with severe disabilities.
- **Extend eligibility for the public transit tax** credit to include the costs of certain electronic payment cards and certain weekly public transit passes.

**A brief description of some of the highlights of other proposed changes are as follows:**

**Revised Child Tax Credit -**

The budget introduces a new non-refundable child tax credit for parents based on an amount of \$2,000 for each child under age 18 at the end of the year, starting in 2007. The credit is worth about \$310 per child for 2007 and will be indexed for inflation. Unused credit amounts may be transferred between spouses.

**Age Limit for RRSPs & RPPs –**

The budget proposes to increase the age at which you must convert your Registered Retirement Savings Plans (RRSP) and Registered Pension Plans (RPP) to the end of the year you turn age 71 (from 69), starting in 2007. If you turn 70 in 2007, you may make contributions to your RRSP in 2007 and 2008, provided you have contribution room. If you turn 71 in 2007, you may make contributions to your RRSP in 2007. Minimum withdrawals required under Registered Retirement Income Funds will be adjusted accordingly. An RRIF annuitant who is age 71 or younger at the end of 2007 may convert the RRIF back to an RRSP, so long as the plan is converted back to a RRIF before the end of the year he or she turns 71.

**Other Amounts –**

Starting in 2007, the budget proposes to increase the amounts used for calculating the spousal and wholly dependent relative credits (currently \$7,581 for purposes of both credits) so that the amounts match the basic personal amount, which is \$8,929 for 2007. The credit amounts will increase to match previously announced increases for the basic personal amounts. The increase in the spousal amount for 2007 is worth up to about \$209.

**Phased Retirement -** The budget proposes to amend the tax rules to allow an employee to receive pension benefits from a defined benefit RPP and simultaneously accrue further benefits, subject to certain constraints.

**Donations of Securities to Private Foundations –**

The budget proposes to eliminate capital gains tax arising from donations of publicly-listed securities to private foundations. Similarly, the effective inclusion rate for publicly listed securities acquired through an employee stock option and eligible for the employee stock option deduction is also reduced to zero where such securities are donated to private foundations. These changes apply to such gifts made on or after March 19, 2007.

**Capital Gains Exemption –**

The budget proposes to increase the lifetime capital gains exemption for qualified small business corporation shares and qualified farming and fishing property to \$750,000 (from \$500,000) for dispositions of property occurring on or after March 19, 2007. Transitional measures are proposed for 2007.

**Qualified Investments –**

Eligible qualified investments for RRSPs and other registered plans are extended after March 18, 2007 to include most investment-grade debt and securities (other

than futures contracts) listed on any prescribed stock exchange. This change will allow these plans to invest in, for example, certain foreign-listed trusts and partnership units and foreign-issued Canadian dollar bonds.

#### **Mineral Exploration Credit –**

The budget extends the mineral exploration tax credit for flow-through share investors, which was set to expire at the end of March 31, 2007. The credit will continue to be available for flow-through share agreements entered into on or before March 31, 2008.

## **INTERNATIONAL TAXATION**

#### **Elimination of Withholding Tax on Interest –**

Canada and the US negotiators have agreed in principle to amend the Canada-US tax treaty to eliminate the current 10% tax withholding on cross-border interest payments set out in the existing treaty. Under these negotiations, which are expected to conclude in the near future, withholding tax on interest payments between non-related (arm's length) parties would be eliminated in the first calendar year following the treaty's entry-into-force. Withholding tax on interest payments between related (non-arm's length) parties will be reduced to:

- 7% in the first year following entry into force
- 4% in the second year
- 0% in the third year following entry into force and later years.

Once these exemptions are implemented in the Canada-US tax treaty, the government proposes to eliminate Canadian withholding tax on interest paid to *all* arm's length non-residents, regardless of their country of residence.

#### **Restrictions on Interest Deductibility for Foreign Affiliate Financing –**

The budget proposes to eliminate the deductibility of interest on debt incurred by corporations to finance foreign affiliates. Instead, generally, the interest expense will be pooled for deduction if and as the foreign affiliate's shares generate non-exempt income of the corporation. The restriction applies to interest arising after 2007 to debt incurred on or after March 19, 2007 (except where an agreement in writing was in place before that date). The restriction also applies to interest on existing non-arm's length debt payable after 2008 or expiry of its current term, whichever is sooner, and to arm's length debt for interest payable after 2009 or expiry of its current term, whichever is sooner.

**Deemed Active Business Income Changes** - The budget also proposes to change the current rules that deem certain passive income of a foreign affiliate to be active business income. For taxation years of foreign affiliates starting after 2008, a Canadian taxpayer will be required to have a qualifying interest (generally, a direct or indirect economic interest of at least 10%) in the paying entity in order to have these payments treated as active business income.

### **Foreign Affiliates & Reporting Information with Other Countries –**

The budget proposes the following measures to encourage more exchange of tax information with tax administrations in other countries:

- **The existing exemption for dividends** received out of active business income earned by foreign affiliates in treaty countries will be extended to include such income earned by foreign affiliates residing in a country that has entered into a tax information exchange agreement with Canada.
- **Income earned by foreign** affiliates in countries that have no treaty or tax information exchange agreement with Canada will be taxed in Canada on an accrual basis (i.e., as it is earned).
- **It is proposed that** all new tax treaties and revisions to existing treaties will be required to include the new OECD standards relating to exchange of tax information among tax administrators of both treaty partners.

### **Foreign Affiliate Technical Amendments (Draft) –**

Previously announced technical tax changes regarding the taxation of foreign affiliates will be reviewed and evaluated in light of the above measures.

### **Stock Exchanges –**

The budget proposes to replace the two lists of currently prescribed stock exchanges with a new three-tier system, consisting of:

- **Recognized stock exchanges . . .** which will apply for purposes of the Section 116 withholding tax exemption and will include stock exchanges located in Canada and in OECD member countries that have a tax treaty with Canada.
- **Stock exchanges . . .** which will include all stock exchanges, wherever located, that meet the general legal and commercial meaning of the term and will be used for purposes of the securities lending rules.
- **Designated stock exchanges . . .** which will include all current prescribed stock exchanges and will apply for all other tax purposes other than section 116 withholding procedures and the securities lending rules.

## **SALES & EXCISE TAX CHANGES**

### **Exports of Intangible Personal Property –**

The GST rules will be amended to ensure that all supplies of intangible personal property made to non-residents who are not registered for GST/HST purposes for use outside of Canada are zero-rated. This change applies to supplies made after March 19, 2007. The change also applies to supplies made on or before that date provided no GST was charged or collected on the supply.

### **Foreign Convention & Tour Incentive –**

The existing GST Visitor Rebate Program will be replaced by a new incentive that will provide GST relief for certain property and services used in the course of conventions in Canada and the accommodation portion of tour packages for non-residents.

#### **48-Hour Travellers' Exemption -**

The customs and tax exemptions for returning Canadian residents who have been out of Canada for more than 48 hours is increased to \$400 (from \$200), for travellers returning on or after March 19, 2007. (The other exemption amounts are not changed.)

#### **Green Levy on Fuel- Inefficient Vehicles –**

The budget proposes a new "green levy" to promote the purchase of fuel-efficient vehicles. The tax will apply to new automobiles designed primarily to carry passengers, including station wagons, vans and sport utility vehicles, but not pick-up trucks, in accordance with the vehicle's fuel efficiency rating. The tax applies to new vehicles delivered or imported after March 20, 2007; it will not apply to vehicles held in inventory by dealers or vehicles sold under agreements in writing before that date.

#### **Excise Tax on Renewable Fuels –**

The budget repeals the current excise tax exemption for renewable fuels, including biodiesel and alcohol-based fuels such that these fuels will be subject to the excise tax on gasoline and diesel fuel. The measure applies to fuel delivered on or after April 1, 2008.

### **ADMINISTRATIVE CHANGES**

#### **CCPC's Installment Frequency –**

The budget proposes to allow small Canadian controlled private corporations with taxable income at or below \$400,000 in the current or preceding year to pay tax installments quarterly (instead of monthly), provided certain conditions are met. Quarterly installments will be determined under one of three alternative methods, for taxation years starting after 2007.

#### **Corporate Tax Installment Threshold –**

Currently, corporations are required to pay corporate tax installments if their income tax payable for the year or the preceding year exceeds \$1,000. The budget also proposes to increase the threshold to \$3,000 (from \$1,000) for taxation years that begin after 2007.

#### **Personal Tax Installments -**

Currently, you are required to pay personal tax installments if your estimated income tax payable for the year or your actual income tax payable for either of the two preceding years exceeds \$2,000 (\$1,200 for Quebec residents). The budget increases this threshold to \$3,000 (\$1,800 for Quebec residents), starting with the 2008 taxation year.

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**SONEGO, BOIVIN & ASSOCIATES can help you assess the tax change effects on your personal finances or business affairs . . . and point out ways to take advantage of the benefits or to ease their impact**