2007 FEDERAL BUDGET

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Tax highlights from the 2007 federal budget

Finance Minister James Flaherty tabled the 2007 federal budget on March 19, 2007. As expected, this budget once again projected a surplus, $3 billion for the coming fiscal year. While in opposition the Conservatives expressed a genuine interest in reducing program spending; however, projected spending in this budget increases by 7.8% to $233 billion, and is considerably higher than the record level set by the previous government. Returning some portion of the projected surpluses to taxpayers through tax relief was a prominent theme in the Minister's economic statement last fall. However, the Minister's promised "Tax Back Guarantee" that would see interest savings from reducing the national debt funneled back to taxpayers in the form of lower taxes, seems to ignore broad based income tax reductions in favour of targeted measures that apply only to certain constituencies.

On the tax relief side, there were some changes to personal and corporate tax measures. However, there were also some highly anticipated tax measures that have yet to see the light of day, including the Conservative's proposal during the last election campaign to allow for the deferral of capital gains when assets are reinvested. There was also no mention of the second 1% GST rate reduction that could happen before 2011. While this may seem like an election budget for the minority Conservatives, it is likely that at least one of the opposition parties will support the government to ensure that the budget passes, and thus defer the inevitable election call until sometime in the future.

The following pages are a summary of the changes announced in the budget. Please note that these changes are still proposals until passed into law by the federal government.

PERSONAL TAX CHANGES

Personal income tax rates

There were no changes announced with respect to personal income tax rates in the budget. The effective rates for 2007 and corresponding tax bracket thresholds are shown in the following table:

Taxable Income range	Tax rate
$8,929 - $37,177	15.5%
$37,178 - $74,356	22%
$74,357 - $120,886	26%
$120,887 or more	29%

Spousal and other amounts

Personal amounts with respect to spouses or common-law partners and wholly dependant relatives will be increased to equal the basic personal amount. This means that the current spousal and dependant credits of $7,581 will increase to $8,929 for 2007. There will also be a corresponding elimination of the dependant's net income threshold (currently $759) from the calculation. This results in additional tax savings of up to $209 in 2007. These credits will gradually increase to $10,000 by the year 2009 to match previously announced increases to the basic personal amount.

Canada employment credit

The 2006 budget introduced a new credit in respect of work-related expenses incurred by employees. This credit provides up to $155 of tax relief on the lesser of $1,000 and the individual's employment income for 2007, and will be indexed in subsequent years.

Child tax credit

The budget proposes a new non-refundable child tax credit for 2007. The $2,000 credit would be in respect of children under the age of 18 at the end of the year, would be calculated at the 15.5% non-refundable credit rate, and would be indexed in subsequent years. This provision results in a tax benefit of $310 per child in 2007.

When the child lives with both parents throughout the year, either parent may claim the credit. In other cases, the credit will be claimable by the parent who is eligible to claim the wholly dependant person credit in respect of the child. Any unused portion of the credit may be transferred by a parent to the parent's spouse or common-law partner.

Tax credit for public transit passes

The 2006 budget proposed that individuals be allowed to claim a non-refundable tax credit with respect to costs incurred for monthly or annual public transit passes. Public transit will include local bus; streetcar; subway; commuter train or bus; and local ferry.

This budget proposes to extend application of this credit to electronic payment cards issued by transit authorities if:

- the cost relates to the use of public transit for at least 32 one-way trips during an uninterrupted period not exceeding 31 days, and
- that transit usage, and cost of those trips, are recorded and receipted in sufficient detail to allow CRA to verify eligibility for the credit.

The budget further proposes to extend eligibility to accommodate weekly passes where an individual purchases at least four consecutive weekly passes.

Working income tax benefit

The budget proposes a new Working Income Tax Benefit (WITB), which is a refundable tax credit for low-income working Canadians, effective for the 2007 tax year. The WITB will be available to individuals over the age of 18, and will be equal to 20% of income from employment or business in excess of $3,000, to a maximum credit of $500 for single individuals and $1,000 for families.

The credit will be phased out at a rate of 15% of net family income in excess of $9,500 for single individuals, and $14,500 for families. Students without dependants who are enrolled in full time studies for more than three months during the year are not eligible for the credit.

The proposal also includes an additional disability supplement for each eligible individual who is eligible for the disability tax credit.

Registered disability savings plan

The budget proposes this new plan to allow parents and others to save for the long-term financial security of a child with a severe disability. The Registered Disability Savings Plan (RDSP) will have a Canada Disability Savings Grant (CDSG) and a Canada Disability Savings Bond (CDSB). This is very similar in structure to the RESP.

Generally, any individual eligible for the disability tax credit who is resident in Canada, or their parent or other legal representative will be able to establish an RDSP. Contributions to the plan will not be tax deductible, but the investment income earned within the plan will accrue tax-free. Similar to an RESP, earnings and grants will be taxable when withdrawn, but contributions will be returned free of tax.

Contributions will be limited to a lifetime maximum of $200,000 per beneficiary, with no annual maximum. There will be no restriction on who can contribute to the plan, and contributions will be permitted until the end of the year in which the beneficiary reaches 50 years of age.

RDSP contributions made in a year will qualify for a matching CDSG at rates of 100%, 200%, or 300%, depending on family income. The table below illustrates the proposed matching grant levels:

Matching grant	Family net income
300% on first $500, and 200% on next $1,000	Up to $74,357
100% on first $1,000	Over $74,357

The family net income threshold shown above is for 2007. This amount will be indexed in subsequent years. Family net income will generally be determined in the same manner as for RESPs, except that, for years after the beneficiary attains the age of 18, the relevant income will be that of the beneficiary and his or her spouse or common-law partner.

There will be a lifetime limit of $70,000 on CDSGs paid in respect of a beneficiary. An RDSP will be eligible to receive CDSGs until the end of the year in which the beneficiary attains 49 years of age.

Payments from the plan must start by the end of the year in which the beneficiary turns 60 years old. Payments will be subject to a maximum annual limit that is yet to be determined; however, the beneficiary, or his or her legal representative, will be allowed to encroach of the capital and income of the plan, in such amounts and for such purposes as the plan may allow.

Registered Education Savings Plans

The budget proposes a number of measures to increase the flexibility of RESPs, including:

- eliminating the $4,000 maximum annual contribution limit;
- increasing the lifetime contribution limit from $42,000 to $50,000;
- increasing the maximum annual contribution qualifying for the Canada Education Savings Grant (CESG) from $2,000 to $2,500, thus increasing the maximum annual grant from $400 to $500 (the lifetime CESG limit of $7,200 remains unchanged); and
- extending RESP eligibility to more part-time students by reducing the 10 hour per week course work requirement to 12 hours per month.

Scholarship and bursary income

Currently scholarships to attend elementary and secondary schools are included in computing the income of the student to the extent that they exceed $500. The budget proposes to fully exempt these scholarships and bursaries for 2007 and subsequent years. This is similar to the treatment accorded scholarships and bursaries at the post-secondary level.

Conversion age for RPPs and RRSPs

The budget proposes to increase the age at which an individual must convert a Registered Retirement Savings Plan (RRSP) or Registered Pension Plan (RPP), from age 69 to age 71. Transitional rules apply to taxpayers who turn 70 or 71 in 2007.

Individuals who turn 70 in 2007 may make contributions in 2007 and 2008, to the extent of their available contribution room. Similarly, 71 year olds may make a contribution in 2007 to the extent that they have contribution room. Minimum withdrawal schedules will be adjusted accordingly and can be waived for the 2007 and 2008 years.

A RRIF annuitant who is under 71 years of age at the end of 2007 may convert his or her RRIF back to an RRSP, as long as it is converted back to a RRIF before the end of the year in which the annuitant reaches age 71.

RRSP qualifying investments

The budget proposes to extend the definition of "qualifying investment" for registered plans after March 18, 2007. The new definition includes:

- any debt obligation that has an investment grade rating and is part of a minimum $25 million issuance; and
- any security (other than a futures contract) that is listed on a designated stock exchange.

These changes will broaden investment choices and diversification opportunities by allowing for investment in foreign listed trust and partnership units, and Canadian dollar bonds issued by foreign entities.

Pension income splitting

The Minister confirmed that the government intends to follow through on the pension income splitting proposal that was first introduced in the Tax Fairness Plan announced on October 31, 2006. This proposal allows a higher income spouse to allocate up to 50% of his or her eligible pension income to a lower income spouse.

For individuals aged 65 or older, eligible pension income includes lifetime annuity payments from a registered pension plan (RPP), a registered retirement savings plan (RRSP) or a deferred profit sharing plan (DPSP); or payments from a registered retirement income fund (RRIF). For individuals under the age of 65, eligible pension income includes lifetime annuity payments from a registered pension plan (RPP) and certain other payments received as a consequence of the death of the individual's spouse or common-law partner.

Phased retirement

The budget proposes to amend the Income Tax Regulations to allow an employee to continue to accrue pension benefits from a defined benefit pension plan, while receiving benefits from the plan, subject to various constraints.

In order to provide for appropriate consultation on the technical aspects of this measure, it is proposed that 2008 be the first year in which an employee be permitted to accrue benefits while receiving partial benefits.

Capital gains exemption

The budget proposes to increase the lifetime capital gains exemption in respect of qualified small business corporation shares and qualified farming and fishing property, from $500,000 to $750,000. The new limit applies to dispositions of property that occur on or after March 19, 2007. Transitional rules will apply for the 2007 year. This proposal could result in additional tax savings of up to $58,000 for a taxpayer in the highest marginal tax bracket.

Donations of publicly-listed securities to private foundations

Since 1997, the charitable donation of publicly listed securities to public charities has enjoyed a tax advantage over selling the securities and donating the cash. The current capital gains inclusion rate of 50% was reduced to 25% under this provision. In order to continue to encourage donation of appreciated securities to charitable organizations, the 2006 budget reduced the capital gains inclusion rate for such donations to zero.

The 2007 budget proposes to extend this favourable tax treatment to private foundations, for gifts made on or after March 19, 2007. This change will result in private foundations being treated equitably with public charities with respect to these types of donations. However, to protect against potentially abusive non-arm's length transactions, there will be regulations that require monitoring and reporting to CRA if the foundation owns more than 2% of the outstanding shares of a corporation. Ownership of more than 20% of the outstanding shares of a corporation, in aggregate by the foundation and non-arm's length parties, will lead to divestiture requirements and potential penalties.

Meal expenses of truck drivers

The budget proposes to gradually increase the deductible percentage of meal costs for long haul truck drivers, from 50% to 80%. The deductible portion will increase as follows:

Effective date	Deductible portion
On or after March 19, 2007	60%
January 1, 2008	65%
January 1, 2009	70%
January 1, 2010	75%
January 1, 2011	80%

Personal income tax installments

Currently, individuals are required to make quarterly installment payments in respect of income taxes, if the estimated tax payable for the current or preceding years exceeds $2,000 ($1,200 of federal tax for Quebec residents). The budget proposes to increase the threshold to $3,000 ($1,800 of federal tax for Quebec residents), starting in 2008.

Mineral exploration tax-credit for flow-through share investors

The budget extends this credit for flow-through share arrangements that was scheduled to expire on March 31, 2007. The credit will continue to be available for flow-through share arrangements entered into on or before March 31, 2008.

CORPORATE TAX CHANGES

General corporate income tax rate

The 2006 budget proposed to reduce the general corporate income tax rate by 2% by the year 2010. The Tax Fairness Plan announced on October 31, 2006 proposed to further reduce the rate to 18.5% in 2011. The transitional rates and their effective dates are shown in the following table:

Effective date	Income tax rate
Current	21%
January 1, 2008	20.5%
January 1, 2009	20%
January 1, 2010	19%
January 1, 2011	18.5%

Corporate fiscal years that span any of these effective dates will result in pro-ration of the applicable income tax rates based on the number of days in each calendar year.

Corporate surtax

The Minister confirmed the previous proposal that the 4% corporate surtax would be eliminated for all corporations effective January 1, 2008. Its elimination is equivalent to a 1.12% reduction in corporate income taxes.

Capital cost allowance rates

Capital cost allowance (CCA) is a deduction for tax purposes that recognizes the depreciation of capital property. CCA rates are generally intended to reflect the useful life of the property. Many factors affect the useful life of an asset, including changes to technology and other market related factors. The 2007 budget proposes several adjustments to CCA rates to better match these rates with the particular asset's useful life. The proposed CCA rate increases are as follows:

Asset	Current rate	Proposed rate
Buildings used for manufacturing & 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%

The new rates will apply to assets acquired on or after March 19, 2007, and the half-year rule will continue to apply.

The budget proposes to increase the CCA rate for new manufacturing and processing machinery and equipment acquired after March 19, 2007, and before 2009. This temporary increase from 30% to 50% straight-line (subject to the half-year rule) should result in a full write-off of qualifying new M&P equipment costs over three years.

The budget proposes to extend accelerated class 43.1 (30%) and class 43.2 (50%) CCA rates to include assets used to produce clean energy through new technologies.The following types of assets acquired after March 19, 2007 will now qualify:

- Wind and tidal energy equipment;
- Active solar equipment;
- Photovoltaic and stationary fuel cell systems;
- Biogas production equipment;
- Pulp and paper waste fuel cogeneration systems;
- Biomass drying and other fuel upgrading equipment; and
- Waste-fuelled thermal energy systems.

The budget also proposes to phase out the additional CCA allowance for certain oil sands projects over the period 2011 to 2015.

Corporate income tax installments

The budget proposes to triple the threshold amount above which corporations are required to remit corporate tax, from $1,000 to $3,000, effective for tax years that begin in 2008. In addition, installments for Canadian controlled private corporations will decrease in frequency from monthly to quarterly if the following conditions are met:

- 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 in either the current or previous year;

- the taxable capital, employed in Canada, of the corporation does not exceed $10 million in either the current or previous year; and
- the corporation has met all compliance requirements under the Income Tax Act and the Excise Tax Act.

Investment tax credits for child care spaces

In recognition of the fact that child care spaces are urgently needed in Canada, the budget proposes a non-refundable investment tax credit for businesses that create licensed child care spaces. The credit is equal to 25% of eligible expenditures, to a maximum credit of $10,000 per child care space created.

Donation of medicines for the developing world

The budget proposes to allow corporations that make donations of medicine from their inventory to claim a special deduction equal to the lesser of its cost and 50% of the amount by which the fair market value exceeds its cost. This additional deduction will only be available when the donee is a registered charity that has received a disbursement under a CIDA program, and the gift is made in respect of activities of the charity outside of Canada. This measure will apply to gifts made on or after March 19, 2007.

International tax changes

The budget proposes to restrict the deduction of interest expense on money borrowed by corporations to invest in debt or equity of a foreign affiliate. Interest expense will be pooled and may be deductible to the extent that the corporation earns non-exempt income from the foreign affiliate.

The budget proposes that the Canada – US Tax treaty be amended to eliminate the current 10% withholding tax on interest payments. Interest paid on arm's length debt will not be subject to withholding beginning in the first calendar year after the treaty changes come into force. Interest paid on non-arm's length debt will be subject to a maximum withholding rate of 7% in the first year following the change, 4% in the second following year, and full elimination in the third and subsequent years.

There are several other international measures discussed in this budget that are beyond the scope of this review.

OTHER PROPOSALS

48 hour travellers' duty-free exemption

The budget proposes to increase the travellers' duty-free exemption from $200 to $400 for returning Canadians who have been out of the country for 48 hours or more. The dollar limits that apply to the 24 hour and seven day duty-free exemptions will remain at $50 and $750 respectively. This new exemption will be effective for travelers returning to Canada on or after March 20, 2007.

Vehicle efficiency incentive

The budget proposes a vehicle efficiency incentive (VEI) designed to promote the purchase of fuel efficient and hybrid vehicles in Canada. The proposed program includes a rebate of up to $2,000 for highly fuel efficient vehicles, neutral treatment for vehicles of average fuel efficiency, and a new Green Levy on fuel inefficient vehicles.

The list of vehicles eligible for the rebate will be established by Transport Canada. Initially the rebate will apply to automobiles with an average fuel consumption rating of 6.5 litres or less per 100 kilometers, and minivans and sport utility vehicles with a consumption rating of 8.3 litres or less per 100 kilometers

The Green Levy will apply to new automobiles designed primarily to carry passengers, including station wagons, vans and sport utility vehicles, but not pick-up trucks. The levy will be based on the vehicle's fuel efficiency rating, with weighted average fuel consumption based on 55% city driving and 45% highway driving. These factors will be applied to the government's fuel efficiency statistics published in the 2007 EnerGuide. The levy will be applied at the following rates:

Weighted average fuel consumption	Proposed levy
At least 13, but less than 14, litres per 100 kilometers	$1,000
At least 14, but less than 15, litres per 100 kilometers	$2,000
At least 15, but less than 16, litres per 100 kilometers	$3,000
16 or more litres per 100 kilometers	$4,000

The Green Levy will be payable by the manufacturer or importer at the time that the vehicle is delivered to the purchaser (usually the dealer) or is imported. The levy will apply to new vehicles delivered or imported after March 19, 2007. The inventory of vehicles held by dealers on budget day will not be subject to the levy, allowing dealers to sell these vehicles to consumers without the imposition of the levy. This levy will also apply to imported used vehicles put into service after March 19, 2007. Concurrent with the introduction of the new levy, the heavy vehicle tax will be repealed for vehicles delivered or imported after March 19, 2007.

Foreign convention and tour incentive program

The budget confirms the elimination of the Visitor Rebate Program effective April 1, 2007. The budget also proposes a new Foreign Convention and Tour Incentive Program that will 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.

Exports of Intangible personal property

The budget proposes that all supplies of intangible personal property made after March 19, 2007 to non-residents who are not registered for GST/HST purposes be zero rated, subject to five specific exceptions.

Excise tax exemption for renewable fuels

The budget proposes to repeal the Excise Tax Act exemptions for renewable fuels, including biodiesel and alcohol based fuels. These fuels will be included within the excise tax structure that applies to gasoline and diesel fuel, effective April 1, 2008.

T3 trust information returns

The government is working with the investment funds industry to develop a new process that balances the needs of taxpayers to file returns on a timely basis with the desire of commercial trusts to have sufficient time to compute their income and prepare T3 information slips. It is expected that the government will issue draft regulations outlining a more efficient process for 2007 T3 slips in the near future.

PST harmonization

The budget indicated that the federal government was willing to work with provinces that would like to eliminate their retail sales taxes by harmonizing them with the GST, similar to the HST concept in the Maritime Provinces.

Elimination of provincial capital taxes

The budget proposes to provide a financial incentive to those provinces that pass legislation to eliminate capital taxes before January 1, 2011.

Previously announced measures

A number of provisions proposed prior to the 2007 budget have not yet been enacted. The budget confirms the government's intention to proceed with the following measures:

- functional currency reporting referred to in the 2006 budget;
- the Tax Fairness Plan announced on October 31, 2006;
- a GST/HST exemption for midwifery services, announced on December 28, 2006;
- improvements to the taxation of financial institutions, also announced on December 28, 2006;
- proposed improvements to the application of GST/HST to the financial services sector, announced on January 26, 2007; and
- tobacco manufacturers' surtax relief for tobacco processors, announced on February 2, 2007.

WE CAN HELP

Your Assante Advisor can help you assess the impact of these proposals on your personal finances or business affairs, and show you ways to take advantage of their benefits or ease their impact. Among the tools at their disposal to assist you, your Advisor can access United Financial Corporation's Wealth Planning Group, a multi-disciplinary group of Accountants, Lawyers, and Financial Planners, who are available to assist them in serving your needs.

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