

Tax highlights from the 2009 federal budget

Finance Minister James Flaherty tabled the 2009 federal budget on January 27, 2009. For the first time since the 1996-1997 fiscal year, the government has indicated that there will be a deficit in the current budget year. It expects the amount to be approximately \$1.1 billion. Not surprisingly, projections indicate that the deficit for the 2009 and 2010 fiscal years will be approximately \$33.7 billion and \$29.8 billion respectively. Given the current state of the world's economy, and particularly that of our closest neighbour and largest trading partner, the United States, it was inevitable that deteriorating economic conditions would eventually impact Canada. As a result, the federal government had indicated that it would be prepared to go into deficit in order to provide the fiscal stimulus necessary to try to reduce the severity of the domestic downturn. Notwithstanding the magnitude of the projected deficits over the next few years, the government expects to return to a surplus position in the 2013 fiscal year.

This budget was preceded by a rather unorthodox parade of announcements highlighting many of the spending initiatives that are being used to attempt to stimulate the economy. These include the expected initiatives regarding infrastructure, social housing, training and education, municipalities, and hard-hit industries, among others. Many of these areas being specifically targeted are in response to demands from the opposition parties.

Even on the tax relief side, there were a few hints this week of what was to come. Tax relief for taxpayers in the two lowest tax brackets is welcome, although the jury is still out on the economic stimulus that this measure will provide. While there have been the usual threats by the opposition parties to defeat the budget and the minority Conservatives, it waits to be seen whether or not at least one of the opposition parties will support the government to ensure that the budget passes, and thus defer the inevitable chaos that will occur if the government is defeated.

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 this budget, although as noted below, several changes were announced with respect to the basic personal amount and the two lower income tax brackets. The effective rates for 2009 and corresponding tax bracket thresholds are shown in the following table.

Taxable income range	Tax rate
\$10,320 - \$40,726	15%
\$40,727 - \$81,452	22%
\$81,453 - \$126,264	26%
\$126,265 or more	29%

Basic personal amount

The 2009 budget proposes to increase each of: the basic personal amount, the spousal and common-law partner amount, and the eligible dependent amount by 7.5% over the 2008 level of \$9,600. This is the amount of income that an individual can earn before federal income tax applies. Effective January 1, 2009, these three amounts will be set at \$10,320. This new amount will be indexed to the rate of inflation for 2010 and subsequent years.

Personal income tax brackets

The 2009 budget proposes to increase the upper limits of each of the two lowest tax brackets by 7.5% over the 2008 levels. Effective January 1, 2009, the new thresholds will be as follows:

- the upper limit of the lowest tax bracket (15% tax rate) will be increased to \$40,726 from \$37,885 in 2008; and
- the upper limit of the second tax bracket (22% tax rate) will be increased to \$81,452 from \$75,769 in 2008.

These new limits will be indexed to the rate of inflation for 2010 and subsequent years.

Canada child tax benefit / National child benefit supplement

As a consequence of increasing the upper limit of the lowest tax bracket, the income level at which Canada Child Tax Benefit (CCTB) benefits begin to be phased out will increase to \$40,726. Similarly, the National Child Benefit Supplement (NCBS) will now be completely phased out at an income level of \$40,726.

Age credit

The 2009 budget proposes to increase the age credit for those 65 years of age and over by \$1,000 to \$6,408, effective January 1, 2009. This new amount will be indexed to the rate of inflation for 2010 and subsequent years. The income level at which the credit begins to be phased out remains unchanged at \$32,312 and the phase-out rate remains at 15%. However, the proposed increase in the amount of the credit results in the credit being fully phased out at an income level of \$75,032 (up from \$68,365 in 2008). This measure could save an affected taxpayer up to \$150 in 2009.

First time home buyers' credit

This budget proposes a new non-refundable income tax credit on an amount of \$5,000 for first time home buyers who acquire a qualifying home after January 27, 2009. The credit will be calculated at the non-refundable tax credit rate and is claimable in the year of acquisition. In 2009, this 15% credit would generate tax savings of \$750.

This credit is also proposed to be available for certain acquisitions of homes for the benefit of individuals who qualify for the disability tax credit. The government intends to provide further details on this measure at a later date.

Home buyers' plan

The 2009 budget proposes to increase the Home Buyers' Plan withdrawal limit from \$20,000 to \$25,000, in respect of withdrawals made by first time home buyers after January 27, 2009. This new limit will also apply to qualifying withdrawals made by buyers of homes that are better suited to the needs and care of individuals who qualify for the disability tax credit, even if the first time buyer requirement is not met.

Home renovation tax credit

As part of the government's fiscal stimulus package, the budget proposes a temporary non-refundable tax credit for homeowners who make improvements to their property. Details of the credit are as follows:

- individuals will be able to claim a 15% non-refundable tax credit for eligible expenditures made to their principal residence;

- the credit will apply to expenditures in excess of \$1,000, to a maximum of \$10,000. Accordingly, the maximum tax savings will be \$1,350 (\$9,000 x 15%);
- the credit will apply to only the 2009 taxation year, in respect of goods or services acquired pursuant to an agreement entered into after January 27, 2009;
- the expenditures must be incurred in the period beginning on January 28, 2009 and ending on January 31, 2010;
- eligibility will be family based, which means that only one \$10,000 expenditure limit applies per family unit. A family will generally consist of an individual; his or her spouse or common-law partner, and their children under the age of 18;
- ownership of a property by two or more family units – for example, ownership of a house by two siblings–would result in the ability of each sibling to claim their own credit;
- eligible expenditures must be for renovations of an enduring nature. These expenditures include the costs of professional services, labour, building materials, fixtures, equipment rentals and permits. They will not include costs related to routine maintenance, the purchase of appliances or audio-video electronics, or interest costs relating to financing the renovation;
- goods or services provided by non-arm's length individuals will not be eligible for the credit unless the provider is registered for GST/HST purposes; and
- all eligible expenditures must be supported by receipts.

Government documents indicate that examples of eligible projects include: renovating a kitchen, bathroom or basement; new carpet or hardwood floors; building an addition, deck, fence, or retaining wall; new windows and doors; a new furnace or water heater; painting the interior or exterior of a house; resurfacing a driveway; or laying new sod.

This credit will not be reduced by any tax credits or grants received from other government programs, such as the ecoENERGY Retrofit program or the medical expense tax credit.

Registered plan losses after death

In recognition of current financial market conditions and an existing anomaly under the *Income Tax Act*, this budget proposes to allow post death decreases in the value of a deceased's Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) to be carried back and deducted from the year of death RRSP/RRIF income inclusion.

For example, assume that Bob's RRIF held securities valued at \$300,000 when he died in September 2008. After his death, his RRIF was ultimately distributed to his children in February 2009 when the market value had decreased to \$200,000. Under current tax rules, the \$100,000 loss could not be claimed. Bob would report \$300,000 of income on his final 2008 tax return, notwithstanding the fact that there was only \$200,000 available to distribute to his children. This budget proposal would allow the \$100,000 loss to be carried back to Bob's final tax return so that the taxable income inclusion from his RRIF would be equal to the proceeds received by his children.

This measure will be effective where the final distribution from the deceased's RRSP or RRIF occurs after 2008.

Working income tax benefit

The 2009 budget proposes to add an additional \$580 million to the benefits provided by the Working Income Tax Benefit, essentially doubling the size of this program. Further details on the changes to this provision will be announced following consultations with the provinces and territories this summer.

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, 2009. The credit will continue to be available for flow-through share arrangements entered into on or before March 31, 2010.

CORPORATE TAX CHANGES

General corporate income tax rate

There were no changes announced with respect to the general corporate income tax rate in this budget. The effective rates for 2009 and subsequent years are shown in the following table.

Year	Income tax rate
2009	19%
2010	18%
2011	16.5%
2012	15%

The federal government has indicated that it still intends to achieve a maximum combined federal-provincial corporate income tax rate of 25% by 2012.

Small business deduction

The 2009 budget increases the annual business limit from \$400,000 to \$500,000, effective January 1, 2009. This proposal increases the amount of active business income that can be earned by a Canadian controlled private corporation (CCPC) that is eligible for the 11% small business tax rate. The \$100,000 increase will be pro-rated for corporations with non-calendar year-ends.

One consequence of this change is that CCPCs with taxable incomes between \$400,000 and \$500,000 will now have an additional month in which to pay any tax owing for the previous year. These corporations may also be eligible to make their corporate tax instalments on a quarterly basis rather than monthly.

There has been no change proposed to the 11% small business tax rate and the small business deduction will continue to be phased out for corporations having between \$10 million and \$15 million of taxable capital in Canada.

In addition, the \$3 million expenditure limit for scientific research and experimental development (SR&ED) will begin to be reduced when taxable income of the previous year exceeds \$500,000 and will be fully eliminated when taxable income reaches \$800,000. Both of these amounts are increased by \$100,000 from the previous limits. This change is effective where the preceding taxation year ends after 2008.

Temporary incentive for manufacturing and processing equipment

The 2007 budget increased the capital cost allowance (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) resulted in a full write-off of qualifying new M&P equipment costs over three years. The 2008 budget extended applicability to acquisitions before 2010, and brought in declining balance rates for acquisitions in 2010 and 2011.

In order to provide further stimulus to the manufacturing sector, this budget proposes to extend applicability of the 50% straight-line method to acquisitions in 2010 and 2011. The half-year rule will continue to apply, resulting in a full write-off of the cost of qualifying M&P equipment over three years.

Accelerated capital cost allowance for computer equipment

The 2009 budget proposes a temporary 100% CCA rate on the purchase of eligible computer equipment, including systems software, between January 28, 2009 and January 31, 2011. This CCA rate will not be subject to the half-year rule, resulting in a full write-off of the cost in the year of acquisition.

Mandatory electronic filing of returns

In order to achieve greater processing efficiencies at Canada Revenue Agency (CRA), most corporations with gross revenues in excess of \$1 million in a taxation year will be required to file their income tax returns electronically, for taxation years that end after 2009.

Electronic filing will also be required where a taxpayer files more than 50 information slips (T4s or T5s for example). This threshold is reduced from the current minimum limit of 500 slips and will be applicable for information returns that must be filed after 2009.

Penalties

In order to ensure compliance with the proposed electronic filing regime, the 2009 budget proposes penalties for filing using an incorrect format.

The budget proposes the following penalties for non-electronic filing of a corporate income tax return:

Year	Penalty
Before 2011	\$0
2011	\$250
2012	\$500
After 2012	\$1,000

While penalties will also be imposed for failure to file information returns in the correct format and for late filing of these returns, these penalties will be reduced from current levels. The new penalties will be calculated based on the number and type of returns required to be filed and will apply to filings required to be made after 2009.

Acquisition of control

An acquisition of control is deemed to occur at the beginning of the day on which a corporation is acquired, unless a corporation makes an election to have the acquisition occur at a specific time. In certain cases, this provision could result in a taxpayer not being able to claim the \$750,000 lifetime capital gains deduction for small business corporation shares.

Responding to a 2006 Federal Court of Appeal decision and in order to remedy this unintended technical result, the budget proposes that the timing of the acquisition of control will not occur until the actual time of acquisition for the purposes of the status of the corporation for CCPC and small business corporation purposes. This change will be effective for acquisitions of control after 2005, except that it will not apply to acquisitions that occur before January 28, 2009 if the taxpayer otherwise elects.

Interest deductibility

This budget proposes to repeal the recently introduced section 18.2 of the Income Tax Act, which was to come into force in 2012. This section was introduced to restrict Canadian corporations from deducting interest expense in certain situations when funds were borrowed to finance a foreign affiliate.

Non-resident trusts and foreign investment entities

These proposals which were first introduced in the 1999 budget will be subject to further comment and review, before the government proceeds with measures in this area.

Foreign affiliate proposals

These proposals which were first introduced in the 2004 budget will be subject to further comment and review, before the government proceeds with measures in this area.

OTHER PROPOSALS

Employment insurance

The budget proposes to extend the maximum EI benefit period by five weeks, bringing the maximum benefit period to 50 weeks. This measure is proposed to be a temporary measure and will be effective for the next two years.

For the next two years, the budget proposes to extend work-sharing agreements by 14 weeks, to a maximum of 52 weeks.

The budget proposes to freeze EI premiums at the current level of \$1.73 per \$100 for 2009 and 2010.

The government intends to establish an expert panel to advise on the best way to provide maternity and parental EI benefits to self-employed individuals.

Tariff relief on machinery and equipment

The budget proposes to permanently eliminate tariffs on certain machinery and equipment imported into Canada.

Simplification of GST/HST for direct sellers

The budget proposes a new simplified GST/HST accounting method for direct sellers who sell through a network of self-employed sales representatives. This method may be used where none of the sales representatives are expected to earn over \$30,000 per fiscal year and a joint election is filed between the network seller and the sales representative. This measure is proposed to be effective for fiscal years of a network seller that begin after 2009.

Other legislation

The prorogation of Parliament in December 2008 resulted in the demise of a number of previously introduced tax measures. The government noted that it intends to reintroduce a number of these measures in the current session of Parliament. These include items contained in the November 28, 2008 Notice of Ways and Means motion, which contained draft legislation implementing remaining tax measures from the 2008 federal budget, as well as provisions to reduce the 2008 minimum RRIF withdrawal by 25%, and to extend the 2008 deadline for Registered Disability Savings Plan contributions to March 2, 2009.

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.

Although this material has been compiled from sources believed to be reliable, we cannot guarantee its accuracy or completeness. All opinions expressed and data provided herein are subject to change without notice. The information is provided solely for informational and educational purposes and is not intended to provide, and should not be construed as providing individual financial, investment, tax, legal or accounting advice. Professional advisors should be consulted prior to acting on the basis of the information contained in this publication.

The Assante symbol and Assante Wealth Management are trademarks of United Financial Corporation, used under license.

© 2009 United Financial Corporation. All rights reserved.

02659 (01/09)