



## Federal Budget – March 19, 2007

### BUDGET OVERVIEW

On March 19, 2007, Finance Minister Jim Flaherty delivered the 2007 federal budget (the “Budget”). For the 2006-07 fiscal year, the Finance Minister is projecting a budgetary surplus of \$9.2 billion, taking into account the Budget proposals. The Budget proposes to legislate the “Tax Back Guarantee”, namely that all interest savings related to the reduction in the federal debt will be directed to personal income tax reductions, including over \$1 billion in personal tax savings for 2007-08 related to the projected reduction of interest on the federal debt in 2006-07.

While most of the tax proposals are favourable “election year” type changes, the Budget proposes significant tightening up of certain aspects of the taxation of international business operations, which may adversely affect the cost of financing foreign business operations of Canadians.

The Budget proposes the following significant tax changes:

- To increase the capital cost allowance (“CCA”) rate for certain depreciable property. For non-residential buildings acquired on or after March 19, 2007, the CCA rate will be 10% for buildings used for manufacturing or processing (“M&P”) and 6% for other non-residential buildings, an increase from the current 4% rate.
- To increase the CCA rate for M&P machinery and equipment acquired between March 19, 2007 and December 31, 2008 to a 50% straight-line rate (subject to the half-year rule) from the present 30% declining balance rate.
- To increase the CCA rate for computer equipment acquired on or after March 19, 2007 to 55% from 45%.
- To increase to \$750,000, from \$500,000, the lifetime capital gains exemption for capital gains realized on dispositions on or after March 19, 2007 of qualified small business corporation shares or of qualified farm and fishing properties.

- To restrict the deductibility of interest expense payable on or after March 19, 2007 on debt incurred to invest in business operations outside of Canada. Transitional rules will generally defer the implementation of this rule until after 2008 for existing non-arm's length debt, and until after 2009 for existing arm's length debt.
- To tax certain Canadian shareholders on a current basis, under the Canadian foreign affiliate property income ("FAPI") rules, in respect of the active income earned by certain foreign corporations in non-treaty countries that do not have a comprehensive tax information exchange agreement with Canada.
- To eliminate withholding tax on interest paid between persons in Canada and the U.S., phased in over a three-year period, and to eventually eliminate Canadian withholding tax on all arm's length interest payments.
- To increase the age limit, from 69 to 71, at which one's Registered Retirement Savings Plans and Registered Pension Plans mature, commencing in 2007. Special rules will extend this measure to those who turn 70 or 71 in 2007.
- To eliminate capital gains tax arising from the donation of publicly-listed securities to private foundations for gifts made on or after March 19, 2007. A similar rule will apply to eliminate the tax on donations of certain stock options to a private foundation.
- To provide a new child tax credit of \$2,000 per child under the age of 18 at the end of the year, beginning in 2007. This tax credit will be calculated by reference to the lowest personal tax rate for the year, and accordingly, will provide up to \$310 of federal tax relief per child in 2007.
- To increase the spousal and wholly dependent relative credit to match the basic personal amount, effective commencing in 2007.
- To introduce a new investment tax credit in respect of new employer-provided day care spaces.
- To introduce a new "Registered Disability Savings Program", based on the existing Registered Education Savings Plan design, to assist families to provide for the long-term financial security of an individual with severe disabilities.
- To eliminate the annual contribution limit (subject to a lifetime maximum of \$ 50,000), and to enhance the Canada Education Savings Grant limits, under the Registered Education Savings Plan program.

The highlights of the tax changes announced in the Budget are summarized below. In addition, our commentary discusses important administrative requirements for corporations paying "eligible dividends" and an update regarding the filing deadline for Scientific Research and Experimental Development claims.

**BUSINESS TAX MEASURES****Capital Cost Allowance (“CCA”) Rate Changes*****Enhanced CCA Rates***

The Budget proposes to enhance the CCA rates for the following assets acquired on or after March 19, 2007:

<b>Asset</b>	<b>Current Rate</b>	<b>New Rate</b>
Buildings used for manufacturing or processing (“M&P”)	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 half-year rule, which limits the CCA claim in the year an asset is acquired to one-half of the normal CCA deduction, will continue to apply.

To qualify for the enhanced 10% CCA rate for buildings used for M&P in Canada of goods for sale or lease, at least 90% of the building (based on square footage) must be used for the designated purpose at the end of the taxation year. Buildings used for M&P that do not meet the 90% usage requirement will still be eligible for the 6% non-residential building rate, provided that at least 90% of the building is used for non-residential purposes. In order to be eligible for the enhanced 6% or 10% CCA rate, the building will be required to be placed in a separate CCA class, otherwise the 4% CCA rate will continue to apply.

The enhanced CCA rates will be available for buildings acquired on or after March 19, 2007 (including new buildings, any portion of which is acquired by a taxpayer on or after March 19, 2007, where the building was under construction on March 19, 2007) that have neither been used, nor acquired for use, before March 19, 2007. While not free from doubt, it appears that capital improvements made on or after March 19, 2007, to buildings which are owned and used before March 19, 2007, will not qualify for the enhanced CCA rates.

### ***Temporary Enhanced CCA for M&P Machinery and Equipment***

The Budget proposes to increase the CCA rate for M&P machinery and equipment, acquired on or after March 19, 2007 and before 2009, to a 50% straight-line rate, from the current 30% declining balance rate. The half-year rule will continue to apply in the year of acquisition, such that the cost of the M&P equipment may be depreciated by 25% in the first year, 50% in the second year, and 25% in the third year.

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

The Budget proposes to extend the eligibility for the accelerated CCA rates applicable to clean energy generation equipment in class 43.1 and 43.2 to include wave and tidal energy and to a broader range of applications such as active solar heating, photovoltaics, stationary fuel cells, production of biogas from organic waste, pulp and paper waste fuel cogeneration systems, biomass drying and other fuel upgrading equipment and waste-fuelled thermal energy systems.

High-efficiency and renewable energy generation equipment acquired before 2020 will be eligible for the class 43.2 enhanced 50% CCA rate.

### **International Taxation**

The Budget proposes significant changes to the international tax system, including a restriction on the deductibility of interest, where such interest is incurred in order to finance the acquisition of shares of foreign affiliates, as well as the elimination of withholding taxes on payments of interest to arm's-length non-residents. In addition to the foregoing, the Budget proposes to amend its system of foreign affiliate taxation, in order to entice countries who do not have tax treaties with Canada to enter into comprehensive tax information exchange agreements. Finally, the Budget proposes to introduce certain technical changes to its system of FAPI taxation.

### ***Interest Deductibility***

In general terms, a Canadian resident has an investment in a foreign affiliate ("FA") where the person's equity percentage is 1% or more, and the equity percentage of the person, together with related persons, is 10% or more. Under Canada's tax system, dividend income received by a Canadian corporation, that was paid by a FA from its exempt surplus account, is not subject to Canadian income tax. In general terms, under the current rules, an FA will have an exempt surplus account to the extent that it had earned foreign active business income, and the foreign corporation is resident in a country which has a tax treaty with Canada (hereafter referred to as a "designated treaty country"). Moreover, unless the FA is also considered to be a controlled foreign affiliate ("CFA"), and provided the CFA has not earned foreign accrual property income ("FAPI"), the income earned by the FA does not give rise to Canadian income tax consequences, until such time as the FA has paid a dividend to a Canadian resident shareholder.

The existing rules permit Canadian corporations to deduct interest expense incurred to finance foreign affiliates, even though the income generated in those foreign affiliates may never be subject to Canadian tax. In order to combat this perceived abuse, the Budget proposes to limit the ability of a person to deduct interest relating to an investment in a foreign affiliate incurred after March 18, 2007. Where such interest is denied, it will be carried forward indefinitely, and will only become deductible to the extent of the following sources of income which have been included in computing the taxpayer's income for a taxation year, namely:

- (a) dividend income and/or FAPI received from the shares of the FA, in excess of certain special deductions which may otherwise have been claimed by the taxpayer for the year,
- (b) a taxable capital gain from the disposition of shares or debt of the FA, or
- (c) certain interest income received from the FA.

Grandfathering rules will apply to debt that was incurred prior to March 19, 2007, or a borrowing that was agreed to in writing before that date. If the grandfathered debt is owing to a non-arm's length person, this new rule will generally only come into effect for interest payable on or after January 1, 2009, whereas if the grandfathered debt is owing to an arm's length person, this new rule will generally only come into effect for interest payable on or after January 1, 2010.

#### ***Withholding Taxes on Payments of Interest to Non-Residents***

Currently, a 25% rate of withholding tax applies to the payment of interest and other types of payments by a Canadian resident to non-residents of Canada. Where, however, the non-resident lives in a country which has entered into a tax treaty with Canada, the withholding tax rate is generally reduced. For example, under the Canada-U.S. Tax Treaty (the "Treaty"), the current rate of withholding on interest payments made by a Canadian resident to an American resident is 10%.

Concurrent with the Budget, the Minister of Finance announced that Canadian representatives have entered into negotiations with its counterparts in the U.S. to revise the present Treaty. One of the major changes under the revised Treaty is that cross-border interest payments made between arm's length persons will be exempt from the imposition of withholding tax. On the other hand, where the cross-border interest is paid between non-arm's length persons, a phased reduction of the withholding tax will be implemented over a three-year period, following the entry into force of the revised Treaty, such that the withholding tax rate will be reduced to 7% in the first year, to 4% in the second year, and will be completely eliminated by the third year.

The Budget proposes that, once the exemption from withholding tax is fully implemented on both arm's length and non-arm's length interest payments under the Treaty, Canadian withholding taxes will be eliminated on interest paid to all arm's-length non-residents under Canada's tax system, regardless of their country of residence.

### *Exempt Surplus & FAPI*

As previously mentioned, a key condition to enable an FA to pay a dividend from its exempt surplus account is that the FA must be a resident of a designated treaty country. The Budget proposes that an FA be able to accumulate an exempt surplus account, even if it is not a resident of a designated treaty country, provided that the FA's country of residence has entered into a comprehensive tax information exchange agreement ("TIEA") with Canada.

Under Canada's present tax system, FAPI is taxed to the Canadian shareholder on a current basis, as it is earned by a CFA. In general terms, FAPI is comprised of investment income, as well as certain business income which is deemed under the Act not to be active business income. The Budget proposes to extend the FAPI system to tax active business income earned by an FA, where:

- (a) the FA was resident in a non-treaty, non-TIEA country; or
- (b) the source of the active business income earned by the FA was from a non-treaty, non-TIEA country.

For this purpose, a non-treaty, non-TIEA country is a country, or other jurisdiction, that:

- (a) does not have a tax treaty with Canada,
- (b) does not have a TIEA with Canada, and
- (c) more than 60 months before that time, had not begun, nor was invited to enter into, TIEA negotiations with Canada. Where TIEA negotiations between the foreign country and Canada had begun prior to March 19, 2007, then this condition will not apply prior to 2014.

The purpose of these legislative amendments is to provide a carrot and stick approach for non-treaty countries to enter into a TIEA with Canada. The Department of Finance announced that it will be approaching non-treaty countries to request that they enter into TIEAs with Canada, and that the TIEA be completed within five years of being approached to do so. By agreeing to a TIEA, Canadian shareholder corporations will benefit from exempt surplus treatment on dividends paid by FAs resident in those countries who have earned foreign source active business income, thus making investment in those non-treaty countries more attractive to Canadians. On the other hand, should the non-treaty country refuse to enter into a TIEA with Canada, then an investment by a Canadian corporation in such countries will be made much less attractive, since the business income earned by the FA will now be taxed by Canada on a current basis, rather than delaying the taxation of such income until such time as a dividend is eventually distributed by the FA.

In addition to the foregoing, the Department of Finance announced that no new tax treaties will be entered into, nor will any revised tax treaties be signed, unless they include comprehensive TIEA provisions.

***FAPI Amendments***

Under present legislation, certain interaffiliate charges which would normally be regarded as FAPI (i.e. interest, royalties, leasing income, etc.) can be recharacterized as active business income, with the result that such income will not be subject to taxation in Canada on a current basis, and that such income may be repatriated to Canada on a tax-free basis.

The Budget indicates that the foregoing recharacterization is inappropriate, where the Canadian taxpayer has little or no equity interest in the payor non-resident corporation. Consequently, the Budget proposes to amend the present legislation to permit the recharacterization only where the Canadian taxpayer has a qualifying interest in the FA. A qualifying interest would generally include a direct or indirect interest of at least 10% in the foreign corporation.

These changes will apply for the taxation years of FAs that begin after 2008.

**Investment Tax Credit (“ITC”) for New Child Care Spaces**

The Budget proposes to provide eligible taxpayers with a non-refundable ITC equal to 25% of eligible expenditures incurred on or after March 19, 2007, to a maximum credit of \$10,000 per child care space created in a new or existing child care facility. An eligible taxpayer will be one that carries on a business in Canada, and the creation of child care spaces are ancillary to one or more businesses of the taxpayer, which do not include the creation of such spaces.

Eligible expenditures will include the cost or incremental cost of the building or portion of the building in which the child care facility is located, as well as the cost of furniture, appliances, computer equipment, audio-visual equipment, playground structures and playground equipment. In addition, initial start-up costs such as landscaping costs for the children’s playground, architect’s fees, costs of initial regulatory inspections, initial licensing fees, building permit costs and costs to acquire children’s educational material will also be eligible for the ITC.

All or a portion of the ITC will be recaptured if, at any time within the five calendar years after the creation of the new child care space, the new child care space ceases to be available, or property that was an eligible expenditure in respect of the child care space is sold, or leased, to another person, or is converted to another use.

Unused ITCs may be carried back 3 years and forward 20 years, to reduce federal income taxes otherwise payable in those years.

### **Donation of Medicines for the Developing World**

Donations of inventory by corporations to qualified donees are currently eligible for a charitable donations deduction, equal to the fair market value of the inventory donated. The Budget proposes to allow corporations that make donations of medicines from their inventory to a registered charity that has received a disbursement under a Canadian International Development Agency program, provided the donated inventory will be used by the charity in respect of charitable activities that will be carried on outside Canada, to claim a special additional deduction equal to the lesser of:

- (a) 50% of the amount, if any, by which the fair market value of the donated medicine exceeds its cost; and
- (b) the cost of the donated medicine.

This measure will apply to donations made on or after March 19, 2007.

### **Prescribed Stock Exchanges**

The Budget proposes, effective upon the legislation receiving Royal Assent, to replace the concept of "prescribed stock exchange" that is currently used for a variety of purposes under the Income Tax Act, such as, securities lending arrangements, stock option plans, RRSPs, withholding tax etc., with a new 3-tier system: "stock exchange", "recognized stock exchange", and "designated stock exchange". The 3-tier system will allow flexibility in recognizing different stock exchanges for different purposes.

### **Increase in Thresholds for Income Tax Instalments, GST/HST Annual Filing, and GST/HST Annual Remittance**

The Budget proposes the following changes:

- (a) Effective for taxation years that begin after 2007, to increase the threshold amount above which corporations are required to pay income tax by instalment from \$1,000 to \$3,000.
- (b) Effective in the 2008 calendar year, to increase the threshold amount above which individuals are required to remit personal income tax instalments from \$2,000 to \$3,000.
- (c) Effective for taxation years that begin after 2007, to reduce the frequency of income tax instalments from monthly to quarterly for small Canadian-controlled private corporations, as adjusted to take into account groups of associated corporations, which meet all of the following four conditions:

1. the taxable income of the corporation for either the current or previous year does not exceed \$400,000;
2. the corporation qualified for the small business deduction for either the current or previous year;
3. the taxable capital employed in Canada of the corporation does not exceed \$10 million, in either the current or previous year; and
4. the corporation has no income tax or G.S.T. compliance irregularities during the preceding 12 months.

There will be three methods available to determine the quarterly instalment amounts:

1. four instalments equal to 1/4 of the estimated tax payable for the current taxation year;
  2. four instalments equal to 1/4 of the tax payable for the previous taxation year; or
  3. a first instalment equal to 1/4 of the tax payable for the second preceding year, with the remaining three instalments being equal to 1/3 of the amount, if any, by which the tax payable for the previous taxation year exceeds the first instalment paid for the current taxation year.
- (d) Commencing in the 2008 calendar year, to increase the threshold amount above which employers with a perfect compliance history are required to remit source deductions on a quarterly basis, from \$1,000 to \$3,000.
- (e) Effective for fiscal years that begin after 2007, to increase the revenue threshold at or below which GST/HST registrants can file GST/HST returns annually from \$500,000 to \$1,500,000. In addition, the net GST threshold below which GST/HST registrants can make annual remittances will be increased from \$1,500 to \$3,000.

## **PERSONAL TAX MEASURES**

### **Increase to the Lifetime Capital Gains Exemption (“LCGE”)**

For dispositions occurring on or after March 19, 2007, the Budget proposes to increase the LCGE on dispositions of qualified small business corporation shares or of qualified farming and fishing properties, from \$500,000 to \$750,000.

**Increase in Age for Maturity of Registered Retirement Savings Plans (“RRSPs”), Registered Pension Plan (“RPP”) and Deferred Profit Sharing Plan (“DPSP”)**

The Budget proposes to increase, for 2007 and subsequent calendar years, the person’s age at which his or her RRSPs, RPPs and DPSPs mature from 69 years to 71 years. The Budget proposal will also allow individuals to continue contributing to their RRSPs until they reach 71 years of age (previously 69 years). Minimum withdrawals required under Registered Retirement Income Funds (“RRIFs”) will be waived for 2007 and 2008 for annuitants who turn 70 years of age in 2007, and will be waived for 2007 for annuitants who turn 71 years of age in 2007. A RRIF annuitant who is 71 years of age or younger at the end of 2007 may convert the RRIF back to an RRSP, provided the plan is converted back to a RRIF before the end of the year in which the annuitant turns 71 years of age.

As well, employers will be allowed to amend their RPPs and DPSPs to allow benefits to accrue, and contributions to be made, in respect of employed members who are 71 years of age or younger at the end of 2007.

**Elimination of Tax on Donation of Publicly Traded Securities to Private Foundations**

Capital gains derived from the donations of publicly traded securities to registered charities and public foundations have been tax-free since May 2, 2006. The Budget proposes to eliminate the capital gains tax, as well as the employment benefit under certain employee stock option plans, on donations of publicly listed securities to private foundations, subject to certain excess business holdings restrictions.

These measures will be effective for donations made on or after March 19, 2007.

**New Child Tax Credit**

Effective 2007, the Budget proposes a new non-refundable child tax credit of \$2,000 for each child under the age of 18. This tax credit will be calculated by reference to the lowest personal tax rate for the year, and accordingly, will provide up to \$310 of federal tax relief per child in 2007. The credit will be indexed for 2008 and beyond.

Where the child resides together with the child’s parents throughout the year, either of the parents can claim the credit. Any unused portion of credit can be transferred to the spouse or common law partner. For separated parents, only the parent who is eligible to claim the eligible dependent tax credit may claim the new child tax credit.

**Spousal and Other Amounts**

Effective 2007, the spousal or common law partner credit and wholly dependant relative credit will be increased from \$7,581 to \$8,929 in order to match the basic personal credit amounts. For 2008 and subsequent years, these credits will be increased to the respective years' basic personal amount.

**Registered Disability Savings Plan ("RDSP")**

The Budget proposes to introduce a new RDSP program for individuals eligible for the disability tax credit. The RDSP will provide the following three potential benefits:

- Investment income earned in a RDSP will be deferred for tax purposes until it is paid out to the disabled beneficiary.
- It will qualify for the Canada Disability Savings Grant ("CDSG").
- It may qualify for the Canada Disability Savings Bond ("CDSB").

Contributions to an RDSP will be non-deductible, and will be limited to a lifetime maximum of \$200,000 in respect of a beneficiary. There will be no annual contribution limit, and anyone can contribute to the plan. Contributions can be made until the end of the year the beneficiary reaches age 59.

The CDSG will be 300% of the first \$500 of RDSP contributions, and 200% on the next \$1,000 of RDSP contributions for families with net income under \$74,357 (to be indexed after 2007). For families with net income over \$74,357 (to be indexed after 2007), the CDSG will be 100% of the first \$1,000 of RDSP contributions. The CDSG will only be payable until the end of the year in which the beneficiary reaches age 49, and is subject to a lifetime maximum of \$70,000.

In addition, the Budget proposes to make CDSB payments by the Government to the RDSP's of low-income beneficiaries and families, regardless of contributions. A maximum CDSB of \$1,000 will be payable to RDSP's for families with net income below \$20,883, and will be completely phased out at net family income of \$37,178. These income thresholds are subject to indexation after 2007. The CDSB will only be payable until the end of the year in which the beneficiary reaches age 49, and is subject to a lifetime maximum of \$20,000.

Some portion of the CDSG and the CDSB may have to be repaid upon cessation of beneficiary's eligibility for the disability tax credit, or upon the death of the beneficiary.

**Registered Education Savings Plan ("RESP")**

Effective 2007, the Budget proposes the following changes to RESP's:

- The \$4,000 annual contribution limit will be eliminated.
- The lifetime contribution limit will be increased from 42,000 to \$50,000.
- The maximum annual contribution qualifying for the 20% Canada Education Savings Grant will be increased from \$2,000 to \$2,500.
- An extension of RESP eligibility for part-time studies.

### **Expansion of Qualified Investments for RRSP and Other Registered Plans**

Effective March 19, 2007, the Budget proposes to extend the definition of eligible qualified investments for RRSPs and other registered plans to include investments in any debt obligations that have an investment grade rating and that are part of a minimum \$25 million issuance, and any securities (other than future contracts) listed on a designated stock exchange.

### **Phased Retirement Programs for Employees Enrolled in a Defined Benefit RPP**

To provide more flexibility to employers to offer phased retirement programs, and to increase the reward to older workers from full-time work, the Budget proposes to amend the Income Tax Regulations to allow an employee to receive pension benefits from a defined benefit RPP and simultaneously accrue further benefits, subject to certain constraints.

Effective 2008, the Budget proposes to allow employees, who are at least 55 years of age and are otherwise eligible for full pension benefits, to receive up to 60% of their pension benefits from a defined benefit RPP, and simultaneously accrue additional benefits on a current service basis in respect of their post-pension commencement employment, regardless of whether the employees are working full-time or part-time. The 60% limit will be based on the amount of pension benefit (including bridging benefits) that would be paid from the plan, if the employee were fully retired.

This proposed change will not extend to designated plans (i.e. pension plans for a single person, small plans for groups of executives, owner-managers, or other highly compensated employees), and persons who are “connected” with their employer.

### **Extension of the Mineral Exploration Tax Credit (“METC”)**

The Budget proposes to extend eligibility for the METC to flow-through share agreements entered into on or before March 31, 2008. The METC was formerly scheduled to expire on March 31, 2007.

### **Working Income Tax Benefit (“WITB”)**

Effective 2007, the Budget proposed to introduce a refundable WITB credit for low-income Canadian individuals who are at least 19 years of age at end of the year. The WITB will be equal to 20% of earned income in excess of \$3,000, to a maximum credit of \$500 for single individuals and \$1,000 for families. Earned income will be comprised of employment and business income.

The WITB credit will be phased out at the rate of 15% when net family income exceeds \$9,500 for single individuals and \$14,500 for families. An additional disability supplement is available for individuals (other than a dependant) who are eligible for the disability tax credit, up to a maximum amount of \$250.

### **Public Transit Tax Credit**

Presently, the public transit tax credit may only be claimed in respect of monthly passes, or passes of longer duration, of public transit authorities. In light of many public transit authorities introducing electronic payment cards, the Budget proposes to extend the transit credit to the cost of electronic payment cards that are used for at least 32 one-way trips during an uninterrupted period of 31 days. Furthermore, the transit credit will also be extended to weekly passes, where at least four consecutive weekly passes are purchased by the individual.

### **Increase in Deductible Portion for Meal Expenses of Truck Drivers**

The Budget proposes to increase the deductible portion of the cost of meals and beverages consumed by eligible long-haul truck drivers during eligible periods of travel, from 50% to 80% over a 5-year period. This measure will also apply to employers of long-haul truck drivers that pay, or reimburse, such costs. The scheduled increase in the deductible portion is as follows:

	Prior to March 19, 2007	Proposed				
		March 19 to December 31, 2007	2008	2009	2010	2011 and later
% deductible	50	60	65	70	75	80

To parallel the increased deductibility for income tax purposes, the Budget also proposes to similarly increase the GST input tax credit claim on these expenses.

## **SALES AND EXCISE TAX MEASURES**

### **Foreign Convention and Tour Incentive Program**

The government previously announced proposed amendments to the *Excise Tax Act* that would eliminate the Visitor Rebate Program effective April 1, 2007. The Budget confirms this elimination, and proposes a new Foreign Convention and Tour Incentive Program, which comprises of the following significant proposals:

- (a) A sponsor or non-GST registered organizer of a foreign convention in Canada (generally, a convention where at least 75% of participants are non-residents, and the sponsor is a non-resident) held after March 31, 2007, will be eligible for a rebate of GST in respect of the convention facility or supplies related to the convention. In addition, a sponsor of a foreign convention will not be required to charge GST on any admission to the convention, regardless of whether the attendee is a resident or non-resident.

For Canadian conventions that begin after March 31, 2007, sponsors will not be required to charge GST to non-resident attendees for the portion of the admission that is reasonably attributable to the convention facility or related convention supplies, and on 50% of the portion of the admission fee that is reasonably attributable to food and beverages.

- (b) A non-resident exhibitor at a foreign or Canadian convention that begins after March 31, 2007 will either not be required to pay GST, or will be eligible for a rebate of GST, in respect of the use of the convention site and any related convention supplies acquired by the exhibitor in respect of the convention.
- (c) A non-resident individual who acquires a tour package, where the first night of accommodation in Canada is after March 31, 2007, will be entitled to a rebate of GST in respect of the accommodation. Likewise, a non-GST registered, non-resident supplier that supplies a tour package to a non-resident, where the first night of accommodation in Canada is after March 31, 2007, will be entitled to a rebate of GST in respect of the accommodation.

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

The Budget proposes to increase the travellers' exemption to \$400 from \$200 for returning Canadian residents who are away from Canada for 48 hours or more, effective in respect of travellers returning to Canada on or after March 20, 2007. The dollar limits that apply to the 24-hour and 7-day travellers' exemptions will remain unchanged at \$50 and \$750, respectively. Volume and quantity limits on alcohol and tobacco products will also remain unchanged.

#### **Exports of Intangible Personal Property ("IPP")**

The Budget proposes that all supplies of IPP made after March 19, 2007, to non-residents who are not registered for GST purposes for use outside Canada, be zero-rated, i.e. not subject to GST. Certain limited exceptions to this general rule will apply.

The Budget further proposes that a purchaser of IPP must self assess the GST on property that was acquired on a zero-rated basis under the proposed measures, and then subsequently used in carrying on a commercial activity in Canada.

### **Vehicle Efficiency Rebates and Levies**

The Budget proposes a vehicle efficiency incentive (“VEI”), designed to promote the purchase of fuel-efficient vehicles in Canada. The VEI structure includes a rebate of up to \$2,000 for new highly fuel-efficient vehicles, neutral treatment for vehicles of average fuel efficiency and a new Green Levy on fuel-inefficient vehicles. The Green Levy will apply to new automobiles and imported used vehicles which are designed primarily to carry passengers, including station wagons, vans and sport utility vehicles, but not to pickup trucks.

The Green Levy will be imposed as follows:

<b>Levy</b>	<b>Consumption (per 100 kms.)</b>
\$ 1,000	13 - less than 14 litres of gas
\$ 2,000	14 – less than 15 litres of gas
\$ 3,000	15 – less than 16 litres of gas
\$ 4,000	16 or more litres of gas

The levy will be imposed upon the manufacturer or importer at the time the vehicles are delivered to a purchaser, or are imported. The levy will not apply, however, to vehicles that are manufactured in Canada and exported for sale in other countries, or to vehicles that are imported and subsequently exported.

The levy will apply to new vehicles delivered or imported after March 19, 2007. Therefore, dealer inventory on hand as of March 19, 2007 can be sold off, without being subject to the new levy system. Grandfathering will also apply to vehicles sold under signed agreements that were entered into before March 20, 2007 between the dealer and consumer, provided the consumer takes possession of the vehicle before July, 2007. Concurrent with the new Green Levy, the current heavy vehicle tax will be repealed for vehicles delivered or imported after March 19, 2007.

## **OTHER MEASURES**

### **Provincial Capital Taxes**

The Budget proposes a temporary financial incentive for provincial governments to eliminate or restructure their capital taxes on financial institutions. The elimination or restructuring must take effect on or before January 1, 2011, and the enabling legislation must be enacted on or after March 19, 2007 and before 2011. For a restructuring to qualify, the existing capital tax would have to be changed into a minimum tax, which would be reduced or eliminated to the extent that the financial institution pays income tax.

## **Trust T3 Information Returns**

The Government is working with the investment funds industry to develop a process that appropriately balances the desire of taxpayers for sufficient time to prepare their tax returns and the desire of commercial trusts (including income trusts) for sufficient time to compute their income and to prepare their T3 information slips. It is expected that draft regulations to give effect to a more efficient process for 2007 T3 slips will be released in the near future.

## **OTHER MATTERS OF INTEREST**

### **Important Administrative Requirement for Corporations Paying “Eligible” Dividends**

In response to the growth of Canada’s income trust sector, the Department of Finance introduced a new regime for the taxation of dividend income, which commenced in 2006. Under the new regime, a dividend paid by a Canadian resident corporation to its shareholders can be designated as an eligible dividend. Where an individual shareholder receives an eligible dividend, such dividend is subject to a lower personal rate of tax than it would have been if the dividend had not been so designated. For 2007, for example, that spread in tax rates for an Ontario resident individual who is subject to tax at the top marginal rate, would amount to 6.7%.

In general terms, the retained earnings of a Canadian-controlled private corporation (“CCPC”), which could be designated as an eligible dividend, would primarily be comprised of the corporation’s after-tax earnings since its 2001 fiscal year, that was neither subject to tax at the federal small business deduction rate for Canadian active business income, nor subject to tax under the federal refundable dividend tax system for investment income, and would include any eligible dividends received from other Canadian resident corporations. For the corporation’s 2001 to 2005 fiscal years, the after tax earnings that are available to be designated as an eligible dividend would be reduced by any taxable dividends paid, and thereafter, by any eligible dividends paid. For a Canadian resident corporation that is not a CCPC, it would generally be able to pay out all of its retained earnings as eligible dividends.

If a Canadian resident corporation wishes to pay an eligible dividend, it must meet an administrative requirement by “designating” it as such, at the time of the dividend payment. The designation may not be filed late, be amended or be revoked.

The designation requirement would be met where the corporation paying an eligible dividend notifies each shareholder in writing, to whom it pays all or any part of the dividend, that the dividend is an eligible dividend. For eligible dividends paid by a CCPC, the Canada Revenue Agency (“CRA”) has stated that an acceptable form of designation would be the identification of the eligible dividend through letters to shareholders, or where all the shareholders are directors of a corporation, a notation of such in the corporation’s minute book. For dividends paid in 2006 only, the CRA will

administratively permit a valid designation of eligible dividends to be made by simply identifying such eligible dividends on the T3/T5 slip issued to the dividend recipient. Furthermore, for dividends paid between January 1, 2007 and February 21, 2007, the corporation may make the requisite designation by May 22, 2007, and still be considered timely filed by the CRA.

**Filing Deadline for a Scientific Research and Experimental Development (“SR&ED”) Claim**

A taxpayer’s deadline to file an SR&ED claim is 12 months after the filing deadline for the taxpayer’s tax return, in respect of the taxation year in which the taxpayer incurred the pertinent SR&ED expenditures. For example, in the case of a corporation, it would have 18 months in total from the end of its taxation year to submit its SR&ED claim with the CRA, since the filing deadline for a corporation to submit a corporate income tax return is 6 months subsequent to its fiscal year-end.

Prior to November 17, 2005, a taxpayer could file a late SR&ED claim, pursuant to the so-called “fairness” legislation, in circumstances where the taxpayer could demonstrate that the timely filing of the SR&ED claim was beyond the taxpayer’s control. However, commencing on November 17, 2005, the CRA will no longer have the discretion to provide an extension for a late-filed SR&ED claim, under proposed legislation.

It is worth noting that the CRA does not consider an SR&ED claim as being timely filed, unless all of the prescribed forms containing all of the required information are filed on time, and the forms reflect actual rather than estimated figures. Assuming the proposed legislation becomes enacted into law, SR&ED claims should be filed by taxpayers well before the 18-month deadline, in order to allow time for the CRA to review the submission made and determine if any additional information is required to be provided to them, in order to ensure that the SR&ED claim is considered to be timely filed.

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To discuss the impact of the Budget on your business, please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP.

## COMBINED FEDERAL AND ONTARIO CORPORATE TAX RATES

The Budget does not change the Federal corporate tax rates. The following combined Federal and Ontario tax rates continue to apply to corporations subject to Ontario tax:

		2006	2007	2008	2009	2010	2011
Small business rate on active income up to \$300,000*	Federal	13.12%	13.12%	11.50%	11.00%	11.00%	11.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		18.62%	18.62%	17.00%	16.50%	16.50%	16.50%
Small business rate on active income from \$300,000 to 400,000*	Federal	22.12%	13.12%	11.50%	11.00%	11.00%	11.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		27.62%	18.62%	17.00%	16.50%	16.50%	16.50%
Manufacturing & processing rate (income not eligible for the small business rate)	Federal	22.12%	22.12%	20.50%	20.00%	19.00%	18.50%
	Ontario	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>
		34.12%	34.12%	32.50%	32.00%	31.00%	30.50%
General rate (active income not eligible for the small business rate)	Federal	22.12%	22.12%	20.50%	20.00%	19.00%	18.50%
	Ontario	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>
		36.12%	36.12%	34.50%	34.00%	33.00%	32.50%
Investment income (other than dividend income from taxable Canadian corporations)**	Federal	35.79%	35.79%	34.67%	34.67%	34.67%	34.67%
	Ontario	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>
		49.79%	49.79%	48.67%	48.67%	48.67%	48.67%

\* These rates do not take into account the effect of the clawback of the Ontario small business deduction. The clawback applies where taxable income of the corporation and those corporations associated with it, falls between \$400,000 and \$1,128,519. The Ontario clawback rate is 4.67%.

In addition, the table does not take into account that a corporation's business limit for federal tax purposes is clawed back where the corporation, together with any associated corporations, had taxable capital, as computed for federal Large Corporation Tax purposes, in excess of \$10 million in the preceding year.

The rates are presented on a calendar-year basis. Where a corporation's fiscal year straddles two calendar years, its corporate income tax rate will be pro-rated for the number of days in its fiscal year that falls into each calendar year.

\*\* These rates apply to investment income earned by a CCPC, and include refundable dividend tax of 26.67%.