The J Thomas McCallum Letter

advancing the understanding of income tax and valuation matters

Federal Budget Edition February 26, 2008

This special release reviews only the income tax measures contained in today's federal budget. It also ignores the items already announced and re-iterated in the budget. Those interested in other aspects of the budget can download the budget document from www.budget.gc.ca/2008

Personal Tax Changes

Tax Free Savings Account

Starting in 2009 Canadians age 18 and over can contribute up to $5,000 annually (with a carry forward of unused contribution room) to a TFSA. Contributions are not tax deductible, ***but*** the investment income earned inside the plan, including capital gains, will not be taxable, *even on withdrawal*. Amounts can be withdrawn from the TFSA at any time, and in fact, such withdrawals can be re-contributed without reducing contribution room. Eligible investment will generally be the same as those for RRSPs.

None of the income earned in the TFSA, nor withdrawals, will count as income for income tested benefits such as the GST credit, Guaranteed Income Supplement and the Child Tax Benefit. There will be a spousal TFSA (avoids attribution rule that would otherwise apply on property transferred to a spouse), and on death a TFSA can be 'rolled over' to the surviving spouse.

RESPs

A number of modifications are proposed to Registered Education Savings Plans, all starting in 2008.

- the 21-year time limit for contributions is changed to 31-years (35-years for those eligible for the Disability Tax Credit)
- the 25th anniversary year for termination of the plan is changed to 35-years (40-years for those eligible for the Disability Tax Credit), and
- the age 21 maximum for beneficiaries is changed to age 31.

Additionally, a six-month 'grace' period will be added to Educational Assistance Payments. That is, the student can receive EAPs for up to six months after leaving a qualifying education program.

Northern Residents Deduction

The existing (daily) limits of $7.50 and $15.00 are increased, starting in 2008, to $8.25 and $16.50.

Medical Deduction

The following items are added to the list of eligible expenses:—

- altered auditory feedback devices for the treatment of a speech disorder
- electrotherapy devices for the treatment of a medical condition or a severe mobility impairment
- standing devices for standing therapy in the treatment of a severe mobility impairment, and
- pressure pulse therapy devices for the treatment of a balance disorder.

Also, those suffering from autism or epilepsy will be allowed to claim the cost, care and maintenance of service animals, including travel expenses to receive training.

The *Income Tax Act* will also be amended to ensure the wording for eligible drugs and medications *excludes* non-prescription items such as vitamins and supplements.

These changes begin in 2008, except the 'clarification' proposal is effective for expenses after February 26th.

Dividend Tax Credit

As those of you who've attend my Tax Update seminar are aware, the dividend tax credit is too generous in light of reduced corporate tax rates. Budget 2008 is revising the credit, and the related 'gross-up' on eligible dividends:—

	Gross-up	**Tax Credit***
Currently	45%	11/18
2010	44%	10/17
2011	41%	13/23
2012	38%	6/11

* of the gross-up

Business Tax Changes

SR&ED

A number of modifications to the Scientific Research & Experimental Development tax credit are proposed:—

- maximum qualified expenditure limit (for the 35% rate) increased to $3 million from $2 million (fully refundable ITCs now $1.05 million, up from $700,000)
- upper limit taxable income phase-out increased to $700,000 from $600,000, and
- upper limit taxable capital phase-out range increased to $50 million from $15 million.

The above changes apply to any taxation years ending on or after February 26, 2008, with a proration based on days in the year after 26-2-08.

Also, eligible salary and wages will now include those of Canadian-resident employees carrying on SR&ED outside Canada, provided those are in support of SR&ED carried on in Canada.

M&P Equipment/Machinery

The 50% accelerated CCA rate (introduced in last year's budget) for machinery and equipment used in manufacturing/processing is extended to 2009.

Additionally, there will be a new two year transition for such assets acquired in 2010 and 2011. Year 2010 acquired assets CCA (on a declining balance basis) will be available at 50% the first year, 40% the next, and then 30% (the usual rate) thereafter. For 2011 acquisitions, the rate will be 40% the first year, and then 30% (the usual rate) thereafter.

These accelerated rate assets will go into a *separate* Class 43, but once the accelerated rates have expired, the asset reverts to the 'main' Class 43.

Other CCA Changes

The list of assets eligible for Class 43.2 (Clean Energy) is expanded. The CCA rate on railway locomotives (Class 7) is increased to 30% from 15%. The CCA rate on carbon dioxide pipelines (Class 1) is increased to 8% from 4%, and the CCA rate for related pumping and compression equipment is also increased to 15%.

Late Source Deduction Payments

The present 10% penalty is to be replaced, beginning with remittances due on or after February 26th, with a 'graduated penalty' of 3% for one to three days late, 5% if four to five days late, 7% for six to seven days late, and 10% if more than seven days late.

Large remitters are required to remit their source deductions to a financial institution rather than directly to CRA. It is now proposed that large remitters will not be penalized if the remittance is sent directly to CRA and received at least one full-day before its due date.

Business Number Sharing

Subject to consultations with the Privacy Commissioner, it is proposed that a taxpayer's BN and BN-related information will be shared with other government departments and with other levels of government, such as municipalities.

Taxable Canadian Property of A Non-Resident

Currently section 116 of the *Income Tax Act* does not consider the impact of Tax Treaties. Three changes are proposed:—

1. Treaty-protected property will be exempt from withholding tax,

2. The 'safe harbour' of reasonable enquiry regarding a vendor's non-resident status will be expanded to include a vendor residing in a country where the property is Treaty-protected, and

3. Subject to some conditions, non-residents will not be required to file a Canadian income tax return where the property is Treaty-protected.

Corporate Medicine Donations

The requirement that the registered charity be one which has received a disbursement under a CIDA program, is relaxed. Also, there will be a new requirement that the medicine must be donated at least six months prior to its expiry date. These two changes apply to donations made after June 30, 2008.

SIFTs

For the 2009 and subsequent taxation years, the 13% provincial/territorial component of the income taxes levied on SIFTS (Special Investment Flow Throughs, i.e. "Income Trusts") will instead be the actual general tax rate levied by the particular province/territory.

Other Changes

- modification of the rules regarding mandatory collapse of a Registered Disability Savings Plan
- extension of the Mineral Exploration Tax Credit
- extension of capital gains exemption on donated securities to include unlisted securities which are exchangeable for publicly-traded securities
- revisions to the rules regarding donation of securities to private foundations

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