

Tax Memo

2009 Federal Budget: Big Spending, Little Tax Relief

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Introduction

Federal Minister of Finance Jim Flaherty presented the minority government's budget on January 27, 2009, against the backdrop of a deepening global economic crisis. The stated goals of Budget 2009 – Canada's Economic Action Plan are to stimulate economic growth, support Canadians and invest in Canada's long-term growth. To this end, the budget provides an economic stimulus of almost \$40 billion over two years, contributing to projected deficits of \$33.7 billion in 2009-10 and \$29.8 billion in 2010-11. Although the budget is big on spending, it provides little in the way of new corporate and personal tax relief.

The budget does not revise corporate or personal tax rates. It does, however, offer tax assistance to manufacturers and Canadian-controlled private corporations, and proposes the repeal or review of previously announced international tax measures. It also provides modest tax savings to all personal taxpayers, while introducing targeted tax credits to encourage home ownership by first-time home buyers and renovations by all homeowners.

Business Tax Measures

International taxation

The budget acknowledges receipt of the final report of the Advisory Panel on Canada's System of International Taxation in December 2008. The government is studying the report and has committed to provide its response to the Panel's recommendations "in due course," and will hold consultations thereafter. The government noted, however, certain matters that warranted a more immediate response.

Interest deductibility: repeal of section 18.2

Section 18.2 of the *Income Tax Act* restricts the deductibility of certain interest and other borrowing costs paid or payable in respect of periods that begin after 2011. Generally, this provision was to apply when a Canadian corporation used borrowed funds to finance a foreign affiliate and a second deduction relating to the financing was available in a foreign jurisdiction.

The budget repeals section 18.2 based on the Panel's conclusions regarding the potential negative effects the provision would have on foreign investment by Canadian multinational companies – particularly in light of the current economic environment. The repeal of section 18.2 will be a welcome change for many Canadian companies with foreign subsidiaries.

Outstanding proposals

The budget confirms the need to consider the Panel's recommendations (and other submissions received) before proceeding with the outstanding proposals for non-resident trusts and foreign investment entities as well as the remaining foreign affiliate measures announced in February 2004.

Corporate tax rates

The budget does not change federal corporate income tax rates. The following rates apply to December 31 year ends:

	General and M&P income ¹	CCPCs	
		Active business income up to \$500,000 ² (\$400,000 before 2009)	Investment income
2008	19.5%	11%	34.67%
2009	19%		
2010	18%		
2011	16.5%		
2012	15%		

1. The rates do not apply to the income of certain credit unions, most deposit insurance corporations, mutual fund corporations, mortgage investment corporations and investment corporations.

2. See **Small business limit** below.

Canadian-controlled private corporations

The budget includes several measures that provide tax relief for Canadian-controlled private corporations (CCPCs).

Small business limit

The CCPC small business limit will increase as follows:

Effective ¹	Threshold	
	January 1, 2007	\$400,000
January 1, 2009	\$500,000	

1. For taxation years straddling January 1, 2009, the small business limit will be prorated with the original threshold applying for the number of days in the year before that date.

The increase in the small business limit is not substantively enacted for accounting purposes as of January 27, 2009.

Balance-due deadline and instalments

CCPCs that claim the small business deduction may be able to pay their balance of corporate income tax owing three months after the end of the taxation year – a month later than other corporations. In addition, certain CCPCs that claim the small business deduction and have taxable income not exceeding the small business limit are eligible to pay income tax instalments quarterly instead of monthly.

As a result of the increase in the small business limit:

- after 2008, a CCPC with taxable income exceeding \$400,000, but less than \$500,000, could have an additional month to pay any balance of tax owing; and
- commencing for 2009 taxation years, a CCPC with taxable income of \$500,000 or less may be eligible for quarterly instalments.

Refundable investment tax credits

CCPCs earn refundable investment tax credits at an enhanced rate of 35% on up to \$3 million of scientific research and experimental development (SR&ED) expenditures. Consistent with the proposal to increase the small business limit, the \$3 million SR&ED expenditure limit will begin to decrease at the proposed small business limit of \$500,000 (previously \$400,000) and will be fully eliminated when taxable income in the previous year reaches \$800,000 (previously \$700,000). This change will apply if the previous taxation year ends after 2008. The reduction of the expenditure limit based upon taxable capital is not changed.

Acquisition of control

Currently, absent the filing of an election, control of a corporation is deemed to have been acquired at the beginning of the day on which control of the corporation was acquired, instead of the particular time of the day the actual share transfer takes place. This difference between the time of the deemed acquisition of control and the actual time of the share transfer has resulted in anomalies.

For example, in **La Survivance**, [2007] 1 C.T.C. 189 (FCA), a public corporation was able to realize an allowable business investment loss on the sale of a subsidiary to a private corporation, because the purchaser was deemed to control the subsidiary at the time of the share transfer. An impact of this decision was that an individual selling shares of a CCPC that is a small business corporation (SBC) to a public corporation or non-resident might not qualify for the lifetime capital gains exemption.

The budget introduces a change to ensure the deeming rule described above does not apply for purposes of determining if a corporation is a SBC or a CCPC. This new rule applies in respect of acquisitions of control that occur after 2005, unless the acquisition of control occurs before January 28, 2009 and the taxpayer files an election. To avoid excessive administration, a taxpayer is deemed to have made this election if it has relied on the **La Survivance** interpretation in a filing before January 28, 2009.

Manufacturing and processing: accelerated capital cost allowance

The enhanced annual capital cost allowance (CCA) deduction for eligible manufacturing and processing (M&P) machinery and equipment acquired before 2010, proposed in the 2007 and 2008 budgets, is extended to such assets acquired in 2010 and 2011. The 50% straight-line rate will apply rather than the accelerated CCA treatment on a declining basis that had been proposed in the 2008 budget.

The “half-year rule,” which generally restricts CCA for the first year an asset becomes available for use to one-half of the amount otherwise deductible, will continue to apply to assets covered by this proposal.

Computers: accelerated capital cost allowance

Computer equipment, including related systems software, included in Class 50 is currently eligible for a 55% declining balance CCA rate. The budget temporarily increases this rate to 100% for eligible computers and systems software acquired after January 27, 2009, and before February 2011. The half-year rule will not apply, so businesses will be entitled to a full deduction for the cost of these assets in the taxation year CCA is first available.

Eligible assets will include new computer equipment and software described in Class 50 that is:

- situated in Canada; and
- acquired for use, or leased for use, in a business carried on in Canada or for the purpose of earning income from Canadian property.

The computer tax shelter property rules will apply to assets eligible for this 100% CCA rate, to prevent investors from using these CCA deductions to shelter other sources of income.

Carbon capture and storage: capital cost allowance

To promote investment in clean-energy generation technologies, the government will consult with stakeholders to identify specific assets used in carbon capture and storage with a view to providing accelerated CCA in respect of these investments.

Electronic filing

Taxpayers are currently allowed to make certain income tax filings with the Canada Revenue Agency (CRA) in electronic format, if certain criteria are met. The budget requires electronic filing in the following circumstances:

- for taxation years ending after 2009, corporations with gross revenues in excess of \$1 million for a taxation year will generally be required to file their income tax returns for that year in electronic format (the CRA may provide exceptions); and
- for information returns required to be filed after 2009, the quantity threshold at which a taxpayer is required to file income tax information returns electronically under an existing income tax provision will be reduced to 50 from 500.

Penalties

The budget introduces penalties for filing corporate income tax returns in an incorrect format, as follows:

- taxation years ending in 2010 – nil;
- taxation years ending in 2011 – \$250;
- taxation years ending in 2012 – \$500; and
- thereafter – \$1,000.

For information returns required to be filed after 2009, the budget also proposes to reduce penalties applicable to late or incorrectly filed information returns. Currently, penalties would be the greater of \$100 per failure and \$25 per day during which the failure continues (limited to \$2,500). When a large number of similar information returns are filed late, these penalties can be excessive.

For information returns filed in an incorrect format, penalties will be as follows:

- 50 to 250 returns – \$250;
- 251 to 500 returns – \$500;
- 501 to 2,500 returns – \$1,500; and
- more than 2,500 returns – \$2,500.

For information returns that are filed late, penalties will be the greater of \$100 and:

- fewer than 51 returns – \$10 per day;
- 51 to 500 returns – \$15 per day;
- 501 to 2,500 returns – \$25 per day;
- 2,501 to 10,000 returns – \$50 per day; and
- more than 10,000 returns – \$75 per day.

The penalty for late-filed information returns will be limited to 100 days. Therefore, the maximum penalty per type of return will range from \$1,000 to \$7,500, depending on the number of returns required to be filed.

Personal Tax Measures

Personal tax rates

The budget does not change personal tax rates. Top combined 2009 personal tax rates are outlined in the following table.

Top 2009 Personal Tax Rates

(Taxable income above \$126,264)	Ordinary income & interest	Capital gains	Canadian dividends	
			Eligible	Non-eligible
Federal only	29.00%	14.50%	14.55%	19.58%
Alberta	39.00%	19.50%	14.55%	27.71%
British Columbia	43.70%	21.85%	19.92%	32.71%
Manitoba	46.40%	23.20%	23.83%	38.21%
New Brunswick	46.95%	23.48%	23.18%	35.40%
Newfoundland and Labrador	44.50%	22.25%	27.38%	32.71%
Non-resident ¹	42.92%	21.46%	21.53%	28.98%
Northwest Territories	43.05%	21.53%	18.25%	29.65%
Nova Scotia	48.25%	24.13%	28.35%	33.06%
Nunavut	40.50%	20.25%	22.24%	28.96%
Ontario	46.41%	23.20%	23.06%	31.34%
Prince Edward Island	47.37%	23.69%	24.44%	38.15%
Quebec	48.22%	24.11%	29.69%	36.35%
Saskatchewan	44.00%	22.00%	20.35%	30.83%
Yukon	42.40%	21.20%	17.23%	30.49%

1. Non-resident rates for interest and dividends apply only in limited circumstances.

Personal income tax thresholds

The following table shows changes to federal income tax thresholds.

	2008	2009	
		Previous	Revised ¹
Federal income tax rates and thresholds	Highest	29%	
		\$123,184	\$126,264
		26%	
		\$75,769	\$81,452
		22%	
		\$37,885	\$40,726
Lowest		15%	
		\$0	

1. The higher income thresholds will be indexed after 2009.

The table below shows the federal tax payable at various income levels.

	2008	Amount of tax		Tax saving (2009 v. 2008)
		Previous rates	New rates	
Taxable income	\$500,000	\$134,182	\$133,872	\$133,555
	\$250,000	\$61,682	\$61,372	\$61,055
	\$150,000	\$32,682	\$32,372	\$32,055
	\$100,000	\$18,877	\$18,660	\$18,343
	\$50,000	\$6,908	\$6,767	\$6,601
	\$30,000	\$3,060	\$2,985	\$2,952

Basic personal credit

The budget increases the basic personal tax credit and spouse/equivalent-to-spouse (or wholly dependent relative) amounts as follows:

	2008	2009	
		Previous	Revised
Personal amounts	\$9,600	\$10,100	\$10,320 ¹
Tax credits	\$1,440	\$1,515	\$1,548

1. The personal amount will be indexed after 2009.

Age credit

The budget increases the age amount as follows:

	2008	2009	
		Previous	Revised
Age amount	\$5,276	\$5,408	\$6,408 ¹
Tax credit	\$791	\$811	\$961
Income threshold²	\$66,697	\$68,365	\$75,032

1. The higher age amount will be indexed after 2009.

2. Income threshold at which the credit is fully phased out.

Tax relief for homeowners

The budget introduces two new tax credits for homeowners and makes changes to an existing plan.

First-Time Home Buyers' Tax Credit

First-time home buyers who acquire a qualifying home after January 27, 2009, will be eligible for a \$5,000 non-refundable First-Time Home Buyers' Tax Credit, providing up to \$750 in federal tax relief. The home must be eligible for the existing Home Buyers' Plan and be intended for occupancy as the buyer's principal place of residence within one year of the purchase.

This tax credit will also be available for a home acquired by an individual qualifying for the disability tax credit (or by a related individual for the benefit of such a person) if the home is more accessible or better suited to the needs and care of that person.

Home Renovation Tax Credit

Homeowners can claim a 15% non-refundable tax credit on eligible home improvement expenditures made after January 27, 2009, and before February 1, 2010, under agreements entered into after January 27, 2009.

The tax credit is available on expenses exceeding \$1,000. The maximum credit is \$1,350 per family. Therefore, up to \$10,000 in expenses will qualify. The credit can be

claimed only on 2009 tax returns, even for January 2010 expenses.

Eligible expenditures will require receipts and the goods and services must be provided by arm's length persons, unless the non-arm's length person is registered for Goods and Services Tax/Harmonized Sales Tax purposes under the *Excise Tax Act*.

Eligible home alterations and renovation projects include:

- renovating a kitchen, bathroom or basement;
- installing new carpet or hardwood floors;
- building an addition, deck, fence or retaining wall;
- replacing a furnace or water heater;
- painting the interior or exterior of a house;
- resurfacing a driveway; and
- laying new sod.

Ineligible projects include:

- making general repairs or maintenance;
- purchasing furniture and appliances; and
- purchasing tools.

The tax credit is in addition to other grants and tax credits, such as the ecoENERGY Retrofit program and available medical expense tax credits.

Home Buyers' Plan

The Home Buyers' Plan (HBP) allows first-time home buyers to withdraw amounts from their Registered Retirement Savings Plans (RRSPs) to purchase or build a home, without paying tax on the withdrawal. Qualifying individuals who are joint purchasers can each withdraw the maximum amount.

The budget increases the withdrawal limit under the HBP to \$25,000 from \$20,000 effective January 28, 2009.

The HBP program is also available to acquire a home that is more accessible or better suited to the needs and care of an individual who qualifies for the disability tax credit.

Canada Child Tax Benefit/National Child Benefit supplement

Beginning in 2009, the income levels on which the income-testing of the benefit under the Canada Child Tax Benefit (CCTB) and the National Child Benefit supplement (NCBs) are based will increase in line with the increase in the upper limit of the lowest personal income tax bracket. The CCTB will begin to be phased out at an income level of \$40,726, while the NCBs limit will be raised so that it

will not be completely phased out until that income level for the majority of families.

Working Income Tax Benefit

The 2007 budget introduced the Working Income Tax Benefit (WITB), a refundable tax credit available to low-income individuals aged 19 or older. The 2009 budget enhances the tax relief provided by the WITB through additional funding. The federal government will accept proposals from provincial and territorial governments for province- or territory-specific changes to the program.

RRSP/RRIF losses after death

The fair market value of investments in an RRSP or Registered Retirement Income Fund (RRIF) at the time of death of the annuitant is generally included in the deceased's income for the year of death unless a rollover is available. Any subsequent increase in the value of the investments is generally included in the income of the RRSP or RRIF beneficiaries upon final distribution from the RRSP or RRIF. Decreases in value are, however, not deductible.

Where the final distribution from a deceased annuitant's RRSPs or RRIFs occur after 2008, the budget proposes to allow the amount of post-death decreases in value of RRSP or RRIF investments to be carried back and deducted against the year-of-death RRSP or RRIF income inclusion.

Mineral exploration tax credit for flow-through shares

The mineral exploration tax credit equals 15% of specified mineral exploration expenses incurred in Canada. The budget extends the credit by one year to flow-through share agreements entered into before April 1, 2010. Therefore, the credit is available for expenditures that are incurred before 2011, or in 2011 with respect to funds raised with the credits in the first three months of 2010 pursuant to the existing "look-back" rules.

Sales and Excise Tax Measures

Direct selling industry

Currently, direct selling organizations (referred to as "network sellers") that employ a network of sales representatives who receive commissions for arranging

for the sale of goods to consumers are not eligible for a simplified method of GST/HST compliance.

For fiscal years beginning after 2009, network sellers will be allowed to use a simplified GST/HST method, if:

- all or substantially all of the sales of the network seller in the fiscal year:
 - are expected to be made through sales representatives; and
 - that sales representatives arrange for are expected to be made to final consumers;
- all or substantially all of the sales representatives of the network seller are expected to receive commissions and bonuses from the network seller of \$30,000 or less in the fiscal year; and
- joint elections are made with each new sales representative.

When the above conditions are met and the network seller jointly elects with all of the network seller's sales representatives:

- the commissions and bonuses received by the sales representatives:
 - will not be subject to GST/HST; and
 - will be ignored for purposes of determining whether sales representatives qualify as small suppliers who are not required to register for GST/HST;
- certain supplies by network sellers of sales aids to sales representatives and supplies of host gifts to the sales representatives will not be subject to GST/HST; and
- the sale of goods by the network seller to the final consumer will continue to be subject to the GST/HST under the normal rules.

Provincial sales tax harmonization

The budget indicates that the government "remains committed" to working cooperatively with provinces that still have retail sales taxes (British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island) to harmonize these taxes with the federal GST.

Tariff reductions on machinery and equipment

To reduce the cost of acquiring machinery and equipment imported from outside North America, the budget eliminates or reduces tariffs on 214 tariff items for imports into Canada after January 27, 2009. A few new tariff items have also been created.

Arrivals Duty-Free

To promote purchases in Canada and enhance the competitiveness of Canada's major airports, the government will undertake consultations with stakeholders and provinces to assess the benefit of implementing an Arrivals Duty-Free program at Canada's international airports.

Other Measures

Employment Insurance

The budget increases all regular Employment Insurance (EI) benefit entitlements for 2009 and 2010 by five weeks, resulting in an increase in the maximum benefit duration to 50 weeks from 45 weeks.

It also freezes the EI premium rates for 2010 at the 2009 rate of \$1.73 per \$100. Rates for 2011 and beyond will be set on a break-even basis.

Currently, the EI program offers benefits to qualifying workers willing to enter into work-sharing agreements. For 2009 and 2010, work-sharing agreements will be extended by 14 weeks, to a maximum of 52 weeks.

Aboriginal tax policy

The budget reaffirms the government's willingness to discuss and implement direct taxation arrangements with Aboriginal governments.

Previously Announced Measures

The budget confirms that the government will proceed with the following previously announced tax measures:

- implement measures included in the Notice of Ways and Means Motion tabled on November 28, 2008, including the reduction by 25% of the 2008 minimum withdrawal amounts under RRIFs and variable benefits under a Registered Pension Plan;
- amend the functional currency tax reporting rules, which were released on November 10, 2008 (see our *Tax Memo*, "Functional Currency Tax Reporting: Proposed Amendments and Extended Deadline" at www.pwc.com/ca/taxmemo);
- extend the 2008 deadline for Registered Disability Savings Plan contributions to March 2, 2009;
- modify the provisions relating to the amateur athletic trusts;
- improve the application of the GST/HST to the financial services sector; and
- modify the customs tariff applicable to milk protein concentrates.

For More Information

For more information on how the budget changes affect you or your business, please contact your PricewaterhouseCoopers tax adviser or:

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