

Federal budget highlights

March 19, 2007

The Minister of Finance, **James M. Flaherty**, presented the 2007 budget in the House of Commons on March 19, 2007. The following is a summary of the highlights contained in the budget.

Economic context

- The Finance Minister is projecting a surplus of \$9.2 billion for the 2006-07 fiscal year after taking into account measures proposed in this budget.
- Canada's unemployment rate of 6.1% (February 2007) is the lowest in 32 years and is expected to continue at historically low rates.
- Real GDP growth for 2007 is expected to be down from prior forecasts to 2.3%, but is expected to increase to 2.9% in 2008.
- Risks to the Canadian economy include lower productivity growth, concern that the slowdown in the U.S. housing market will reduce U.S. consumer spending more than anticipated, and the volatility of oil prices.
- The budget proposes increased spending in a number of areas, including the environment, health care, farming and fishing, science and technology, transfers to provinces and infrastructure.

Measures concerning businesses

- The **rate of capital cost allowance (CCA)** for certain assets acquired on or after March 19, 2007, will be changed as follows:
 - Buildings used for manufacturing or processing, to 10% from 4%.
 - Other non-residential buildings, to 6% from 4%.
 - Computer equipment, to 55% from 45%.
 - Natural gas distribution pipelines, to 6% from 4%.
 - Liquefied natural gas facilities, to 8% from 4%.
 - Manufacturing and processing machinery and equipment, to 50% from 30% for equipment acquired prior to 2009 (straight-line depreciation).
- The accelerated rate of CCA for **oil sands** projects will be phased out over the period from 2011 to 2015.
- The eligibility for accelerated CCA rates for **clean energy generation** assets in class 43.1 and 43.2 will be extended to wave and tidal energy and to a broader range of applications involving active solar heating, photovoltaics, stationary fuel cells, production of biogas from organic waste, and pulp and paper

waste fuels for assets acquired on or after March 19, 2007. The eligibility for class 43.2 will be extended to assets acquired before 2020.

- Corporations making a **donation of medicines** from their inventory to a qualifying donee for use in the developing world will be eligible for an additional deduction equal to the lesser of its cost or 50% of the amount by which the fair market value exceeds its cost.
- The budget announces that treaty negotiations between Canada and the United States have resulted in the **elimination of withholding tax on interest** paid between the two countries for persons dealing at arm's length, beginning in the first calendar year following the entry into force of changes to the treaty. For non-arm's-length interest payments, the maximum withholding rate will be reduced to 7%, 4%, and 0% for the first year, second year and third and subsequent years following entry into force of the treaty. It is intended that withholding tax be eliminated on interest paid to all arm's-length non-residents, regardless of their country of residence.
- Other announced Canada-U.S. tax treaty developments include the extension of treaty benefits to **limited liability companies**, further harmonization of the tax treatment of pension contributions in the two countries and new rules to clarify the treatment of stock options.
- Budget 2007 proposes the adoption of an **International Tax Fairness Initiative** that will:
 - Eliminate the deductibility of **interest on debt incurred by corporations to finance foreign affiliates**. Instead, interest expense will be pooled for deduction (net of exempt surplus received) if the foreign affiliate's shares generate non-exempt income for the corporation. The restriction will apply to interest payable after 2007 on new debt incurred on or after March 19, 2007, after 2008 for existing non-arm's-length debt, and after 2009 for existing arm's-length debt.
 - Require a Canadian taxpayer to hold at least a 10% interest in a foreign paying entity in order to have the payments treated as **active business income** for taxation years of the foreign entity that begin after 2008.
 - Require all new tax treaties and revisions to existing treaties to include the new Organisation for Economic Co-operation and Development (OECD) standards in relation to **exchange of tax information**.
 - Extend the definition of **exempt surplus** to active business income from non-treaty jurisdictions with which Canada has entered into a tax information exchange agreement.
- The concept of a **prescribed stock exchange** will, effective on Royal Assent, be replaced with a new three-tier system which will, among other things, ease the section 116 clearance certificate requirements.
- The budget introduces an **investment tax credit for child care spaces** to encourage businesses to create licensed child care spaces for the children of their employees, equal to 25% of eligible expenditures to a maximum credit of \$10,000 per child care space created. The credit will be available for eligible expenditures incurred on or after March 19, 2007.

- The threshold amount, above which corporations are required to pay corporate **income tax instalments**, will be raised to \$3,000 for taxation years beginning after 2007. In addition, the frequency of instalment payments for small Canadian-controlled private corporations (CCPCs) will be changed to a quarterly basis. Similar changes apply to payroll remittances for calendar years beginning in 2008. Changes affecting the goods and services tax/harmonized sales tax (GST/HST) filing and remittance requirements for small- and medium-sized businesses are also introduced, applicable to taxation years beginning after 2007.
- Over the coming year, the government will identify opportunities to improve the **scientific research and experimental development (SR&ED) program**, including its administration, to further encourage research and development within the business sector in Canada.
- The budget proposes a temporary financial incentive for provincial governments that eliminate their general **capital tax**, or eliminate or restructure their capital tax on financial institutions. To be eligible for the federal payment, a province must eliminate or restructure its existing capital tax system by January 1, 2011.

Measures concerning individuals

- The budget proposes to introduce the **Working Income Tax Benefit (WITB)**, effective for the 2007 taxation year. The WITB will provide up to \$500 for single individuals (\$1,000 for families) and will be phased out at a rate of 15% of net family income in excess of \$9,500 (\$14,500 for families). The WITB will include an additional disability supplement for individuals eligible for the disability tax credit (DTC).
- The budget proposes a new **Registered Disability Savings Plan (RDSP)** for individuals eligible for the DTC based on the existing registered education savings plan (RESP) design. Contributions will be limited to a lifetime maximum of \$200,000 with no annual limit. RDSP contributions will qualify for a Canada Disability Savings Grant at varying rates depending on family net income and the amount contributed. Annual Canada Disability Savings Bond payments of up to \$1,000 will be paid annually to the RDSPs of low and modest-income beneficiaries and families regardless of contributions to an RDSP.
- Budget 2007 proposes to eliminate the taxation of capital gains arising from donations of publicly listed securities to **private foundations** made on or after March 19, 2007. At the same time, the budget contains proposals requiring private foundations to monitor the percentage of each class of shares held by the foundation and non-arm's-length persons and, under certain circumstances, to divest of the excess holdings.
- The \$4,000 annual **registered education savings plan (RESP)** contribution limit will be eliminated and the lifetime RESP contribution limit will be increased to \$50,000 from \$42,000. The maximum annual Canada Education Savings Grant (CESG) will be increased to \$500 from \$400, beginning in 2007.
- **Scholarships and bursaries** to attend elementary and secondary schools will be fully exempted from income starting in 2007.
- The budget proposes a new \$2,000 **child tax credit** which will

provide tax relief of up to \$310 for each child under the age of 18, effective beginning in 2007.

- Beginning in 2007, the **spousal and related credits** will be increased to the same level as the basic personal credit.
- The **non-refundable public transit tax credit** for the cost of monthly public transit passes will be extended to accommodate new electronic fare products and weekly passes used on an ongoing basis.
- The **lifetime capital gains exemption** realized on the disposition of qualified farm or fishing property or qualified small business corporation shares will be increased from \$500,000 to \$750,000. This increase will apply to dispositions of property that occur on or after March 19, 2007.
- The budget proposes to increase, over five-years, the **deductibility of truck drivers' meal expenses** from 50% to 80%.
- The 2007 budget proposes to accommodate **phased retirement** by allowing an employee to receive pension benefits from a defined benefit pension plan (RPP) while simultaneously accruing further pension benefits, subject to certain constraints.
- Budget 2007 proposes to increase, for the 2007 and subsequent years, the **conversion age for RPPs and RRSPs** to 71 years of age from 69 years of age. Transitional measures will benefit individuals who turn 69, 70 or 71 in 2007.
- **Qualified investments for RRSPs** and other registered plans will be extended to include a debt obligation that has an investment grade rating and that is part of a minimum \$25 million issuance and any security (other than a futures contract) that is listed on a designated stock exchange.
- Budget 2007 proposes to extend the eligibility for the **mineral exploration tax credit** to flow-through share agreements entered into on or before March 31, 2008.
- **Instalment thresholds for individuals** will be raised to \$3,000 (\$1,800 for individuals resident in Quebec) applicable to the 2008 and subsequent taxation years.

GST and other measures

- The budget confirms the elimination of the Visitor Rebate Program effective April 1, 2007. A new **Foreign Convention and Tour Incentive Program** will replace the Visitor Rebate Program.
- The budget proposes to increase the **travellers' exemption** to \$400 from \$200 for returning Canadian residents who are out of the country for 48 hours or more.
- Budget 2007 proposes that all supplies, made after March 19, 2007, of **intangible personal property (IPP)** made to non-residents who are not registered for GST/HST purposes be zero-rated subject to certain exceptions.
- The Excise Tax Act will be amended to repeal the **excise tax exemptions for renewable fuels**, including biodiesel and alcohol-based fuels. These fuels will be included within the excise tax structure that applies to gasoline and diesel fuel. This change is applicable to fuels delivered on or after April 1, 2008.

- The budget introduces a **Vehicle Efficiency Incentive** structure that will include a new rebate of up to \$2,000 for the purchase of a new fuel-efficient vehicle along with a Green Levy of up to \$4,000 for new fuel-inefficient vehicles. The Green Levy will replace the current heavy vehicle tax.
- The budget proposes to clarify the legislative authority that underlies the Canada Revenue Agency's long-standing administrative practice of paying end-user refunds for **diesel fuel**.
- The budget proposes to waive any non-resident withholding tax liability of the International Olympic Committee and the International Paralympic Committee. In addition, non-resident athletes and other non-resident individuals will not be taxed as a result of their participation in the **2010 Games in Vancouver**.

For further details, we refer you to the Department of Finance web site, where you can access the official budget documents without charge.

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