

TAX TALK

2009 FEDERAL BUDGET HIGHLIGHTS

On Tuesday, January 27, 2009, the Honourable Jim Flaherty, Minister of Finance, presented his Budget¹ Statement to Parliament. Set out below are highlights of the budget that we believe to be of most interest to you.

ECONOMIC OVERVIEW

	2008/2009 Estimate (\$billion)	2009/2010 Forecast	Growth %
Revenue	236.4	224.9	(4.8)
Expenditure			
Public debt	30.7	29.5	(3.9)
Other	206.8	229.1	10.8
Debt reduction	0.0	0.0	
Surplus	(1.1)	(33.7)	
Net Public Debt	458.7	492.4	

	2008 Estimate %	2009 Forecast %	2010 Forecast %
Inflation	2.4	0.7	1.9
3 Month Treasury Bill Rate	2.3	0.8	1.7
Unemployment Rate	6.0	7.5	7.7
Real Growth in GDP	0.7	(0.8)	2.4

The Budget projects a deficit of \$1.1 billion this year and large deficits of \$33.7 billion for 2009/10 and \$29.8 for 2010/11. Deficits totalling \$85 billion are projected for the next 5 years, reflecting the severity of the weakness in the world economy. The deficits will be higher if the slowdown in the Canadian economy is worse than projected – this could lead to higher unemployment and lower tax revenues.

As was widely expected, the Budget presents a wide-ranging package of provisions to stimulate the economy through dramatically increased, although mostly time-limited, spending on infrastructure and targeted programs. It also proposes a variety of tax measures aimed at increasing consumer spending and business investment, boosting employment and providing some relief to those most affected by the current economic downturn.

¹ With a minority government, there is some uncertainty that any budget tax proposals will be passed into law.

There are no changes proposed to personal or corporate tax rates, nor to sales taxes. Specific tax measures include modest increases to certain personal tax credits and an increase in the income thresholds for the two lowest personal income tax brackets. A new non-refundable credit was introduced to spur home renovations.

Business tax measures include an increase in the small business income limit to \$500,000 and accelerated capital cost allowance for certain eligible manufacturing and processing.

The government's program spending increased 6.9% in the current year, which is in excess of what the government forecast in the 2008 Budget. The growth rate forecast for 2009/10 is 10.8%, reflecting expenditure plans to stimulate and solidify the economy.

Real growth in GDP for 2009 is forecasted to decline by 0.8%, but is then expected to increase to 2.4% in 2010. This projected growth is significantly less than projected in the 2008 Budget (2.9% and 3.1% respectively), reflecting many of the "economic challenges ahead".

PERSONAL TAX MEASURES

Personal Income Tax Rates

The 2009 Budget does not introduce any new personal tax rate changes. The top marginal rate for individuals remains at 46.41%. This rate starts to apply when taxable income exceeds \$126,265².

² In general, the tax brackets are indexed for inflation to protect taxpayers from automatic tax increases that would otherwise result. For 2009, the brackets have increased by 2.5%. As a result, the top tax rate will apply in 2009 when taxable income exceeds \$126,265 (2008 - \$123,184).

The federal income tax brackets were scheduled to increase for 2009 using a factor of 2.5%. The Budget proposes to increase the upper income thresholds for the first and second federal tax brackets (by 7.5%) as follows:

- 15% bracket: from \$38,832 to \$40,726
- 22% bracket: from \$77,664 to \$81,452

For a taxpayer with taxable income of \$81,452, there will be a federal tax saving of \$284 due to the increase in the tax brackets.

The following table summarizes marginal tax rates (on regular income, i.e., salary, interest, etc.) that apply to the income tax brackets for 2009.

Taxable Income	Federal Rate %	Ontario Rate %	Total %
\$ 10,320 to \$ 36,020	15.00	6.05	21.05
\$ 36,021 to \$ 40,726	15.00	9.15	24.15
\$ 40,727 to \$ 63,421	22.00	9.15	31.15
\$ 63,422 to \$ 72,040	22.00	10.98	32.98
\$ 72,041 to \$ 74,728	22.00	13.39	35.39
\$ 74,729 to \$ 81,452	22.00	17.41	39.41
\$ 81,453 to \$126,264	26.00	17.41	43.41
\$126,265 and over	29.00	17.41	46.41

Basic Personal and Spousal Credits

The basic personal amount, the spouse or common-law partner amount and the eligible dependant amount will be increased to \$10,320 (from \$10,100) for the 2009 taxation year and indexed to inflation for subsequent years. This will result in a federal tax savings of \$33 in 2009 for each applicable credit.

Age Credit

For 2009, effective January 1, the amount on which the age credit is based will be increased from \$5,408 to \$6,408 and indexed thereafter. This increase will provide up to an additional \$150 of federal tax savings, depending upon the individual's taxable income for the year. The income level at which this credit is fully phased out will increase from \$68,365 to \$75,032.

Home Renovation Tax Credit (HRTC)

The Budget proposes a 15% non-refundable tax credit to individuals for eligible expenditures of between \$1,000 and \$10,000, made in respect of eligible dwellings. This will result in a maximum federal credit of \$1,350 (\$9,000 x 15%) per family. Work must be performed or goods

acquired between January 28, 2009 and January 31, 2010 and agreements must be entered into after January 27, 2009.

The credit may be claimed in the individual's 2009 personal tax return, even with respect to qualifying expenditures incurred in 2010.

Home Buyers' Plan

The maximum eligible withdrawal for eligible home buyers³ permitted from an RRSP has been increased from \$20,000 to \$25,000 after January 27, 2009.

First-Time Home Buyer's Tax Credit

The Budget proposes a new non-refundable tax credit for first-time home buyers who acquire a qualifying home after January 27, 2009. The tax credit is 15% of \$5,000 (or \$750 for 2009) and is claimable in the year in which the home is acquired. The home must be intended to be the principal residence of that individual within one year after its acquisition.

The credit will also be available for a home acquired by, or for the benefit of, an individual who is eligible for the disability tax credit to enable the individual to live in a more accessible dwelling or in a better suited environment.

Registered Retirement Savings Plans (RRSP)

In the absence of a spousal or dependant rollover, the fair market value of investments held in an RRSP or Registered Retirement Income Fund (RRIF) at the time of an annuitant's death is fully included in the income of the deceased for the year of death.

The Budget proposes to allow a deduction for a decrease in value of the investments held in an RRSP or RRIF subsequent to the annuitant's death and before the final distribution of the property. This deduction would be carried back and deducted against the year-of-death RRSP/RRIF income inclusion. This measure will apply where the final distribution from the RRSP or RRIF occurs after 2008.

³ An individual is generally considered to be a first-time home buyer if neither the individual nor the individual's spouse or common-law partner owned and lived in another home in the calendar year in which the HBP withdrawal is made or in any of the four preceding calendar years.

Mineral Exploration Tax Credit (METC)

The METC provides an additional tax benefit of 15% of specified mineral exploration expenses renounced by corporations to individual investors on the issue of flow-through shares. The METC, which was to expire at the end of March 2009, has been extended until the end of 2011, for flow-through agreements entered into before April 1, 2010.

BUSINESS TAX MEASURES

Corporate Income Tax Rate

The 2009 Budget does not introduce any new corporate tax rate changes. However, corporate rates are scheduled to decrease pursuant to previously enacted or announced measures.

The following table summarizes federal and Ontario corporate tax rates, with respect to active business income (ABI) earned by a Canadian controlled private corporation in Ontario, and reflects federal and Ontario tax rate reductions to apply in 2009:

Based on a December 31, 2009 year end

Active Business Income	Federal Rate %	Ontario Rate %	Total Rate %
up to \$500,000	11.00	5.50	16.50
from \$500,001 to \$1,500,000*	19.50	18.25	37.75
> \$1,500,000	19.50	14.00	33.50
> \$1,500,000 with M&P **	19.50	12.00	31.50

* includes claw back of Ontario small business deduction

**M & P - manufacturing and processing tax credit

Small Business Deduction (SBD)

The SBD reduces the *federal* corporate income tax rate to 11% on the first \$400,000 of qualifying active business income earned by a group of associated companies in a year. The Budget proposes to increase this limit to \$500,000 for taxation years ending after December 31, 2008⁴. For taxation years that straddle December 31, 2008 the \$100,000 increase is prorated based on the number of days after December 31, 2008.

⁴ The increase in the SBD limit to \$500,000 will match the current Ontario SBD limit.

Partnerships allocate their income eligible for the SBD to corporate partners based on the percentage of income allocated, multiplied by the annual business limit. The Budget proposes to increase the business limit to \$500,000 for partnership fiscal periods ending in 2009. The proration rules for non-calendar years will also apply.

Acquisition of Control

Where there has been an acquisition of control of a corporation, subsection 256(9) deems the acquisition to have occurred at the commencement of the day unless the corporation elects that the acquisition be treated as having occurred at the time that it actually happened. A general lack of awareness of this provision has resulted in a number of unintended consequences.

For example, a Canadian resident individual would normally claim the \$750,000 capital gains exemption (CGE) on the sale of "qualified small business corporation shares" (QSBC shares). However, if the sale were to a non-resident, the CGE would not be available because the corporation would have ceased to be a "Canadian-controlled private corporation" (CCPC) at the commencement of the day. Therefore, its shares would not be QSBC shares at the time of sale later in the day.

The Budget proposes that, for acquisitions of control after 2005, subsection 256(9) will not apply for purposes of determining the status of a corporation as a small business corporation (SBC) or CCPC.

Taxpayers are, however, entitled to elect on or before their 2009 filing-due-date to have the existing rules apply. Furthermore, taxpayers will be deemed to have made this election if it is evident that they assumed that the corporation was an SBC or CCPC at the actual time of transfer of the shares.

Capital Cost Allowance (CCA)

Taxpayers acquiring new manufacturing equipment after March 19, 2007 and before 2010 were able to treat these assets as Class 29 assets (50% straight-line CCA rate, subject to the half-year rule⁵). The Budget proposes to extend this treatment to qualifying assets acquired in 2010 and 2011. Manufacturing equipment additions included in Class 29 are allowed only half the CCA in the first year.

⁵ Manufacturing equipment additions included in Class 29 are allowed only half the CCA in the first year.

Eligible computers and software acquired after January 27, 2009 and before February 2011 will be eligible for a 100% write-off in the first year the equipment is available for use. This 100% CCA rate will not be subject to half of the CCA in the first year.

COMPLIANCE

Electronic Filing of Corporate Income Tax Returns

The Budget proposes that corporations with gross revenue exceeding \$1 million (other than atypical situations, such as non-resident corporations and corporations reporting in a functional currency) must file their T2 corporate income tax returns electronically for taxation years ending after 2009. Failure to comply with these rules will make offending corporations liable for penalties depending on the corporation's year-end. The penalties will be \$250 in 2011, \$500 in 2012, and \$1,000 in subsequent years. These penalties will also apply for returns that are filed in an incorrect format.

Information Returns

There will be a lower threshold requiring taxpayers to file information returns (such as T4s) electronically after 2009. The new threshold for T4s will be \$50 (versus the current \$500). Failure to comply with these new rules will make a taxpayer liable for a penalty, based on the number of information slips. Similarly, taxpayers may be liable for penalties for filing information returns in the incorrect format. The proposed penalties will range from \$250 to \$2,500 depending on the number of slips or information returns.

INTERNATIONAL TAXATION

Interest Deductibility

When a Canadian corporation (Canco) borrows to invest in a foreign corporation (Forco) within the corporate group, it is common to structure the transaction so that Canco and Forco can each claim an interest deduction for the same borrowing. Section 18.2 was enacted, to be effective in 2012, to prevent taxpayers from claiming such "double dip" interest deductions. The Budget proposes to repeal section 18.2.

Foreign Trusts and Other Foreign Investment Vehicles — Further Delay in Implementation

The 1999 federal budget introduced measures intended to curtail the use of foreign trusts and other vehicles to avoid Canadian tax. The latest implementation date was supposed to have been January 1, 2007. The Budget proposes to once again delay implementation, pending further review.

The Budget also proposes to defer the implementation of certain legislation announced in February 2004 in connection with the foreign affiliate rules.

Scientific Research and Experimental Development (SR&ED)

Under the current system, certain Canadian-controlled private corporations (CCPCs) are entitled to a tax credit or a cash refund of investment tax credits (ITCs) based on the following formula:

Amount of Current Expenditure	ITC Rate	Refund of ITC
First \$3,000,000	35%	100% ⁶
Amount over \$3,000,000	20%	40%

CCPCs earn investment tax credits at an enhanced rate of 35% on up to \$3 million of SR&ED expenditures.

The \$3 million SR&ED expenditure limit will begin to decrease at where corporate income is at the proposed small business limit of \$500,000 (versus \$400,000) and will be fully eliminated when taxable income in the previous year reaches \$800,000 (versus \$700,000). That is, if corporate income is \$800,000, the ITC rate will be 20%, not 35%. This change will apply to taxation year ends after 2009⁹.

⁶ Capital SR&ED expenditures that qualify for the 35% ITC rate are eligible for a refund of the ITC at 40%.

The reduction of the expenditure limit based upon taxable capital was previously increased to \$50 million and has not changed.

	Current	Previous
Expenditure Limit	\$3,000,000	\$3,000,000
Taxable income phase-out range ⁷	\$500,000-\$800,000	\$400,000-\$700,000
Taxable capital phase-out range	\$10,000,000-\$50,000,000	\$10,000,000-\$50,000,000

The new phase-out limits, like the old ones, are prorated for short taxation years.

OTHER MEASURES

Employment Insurance

The EI benefit entitlement period was increased by five weeks by the 2009 Federal Budget applicable to 2009 and 2010. This results in an increased maximum benefit period of 50 weeks as opposed to the previous 45. The Budget also maintained the 2009 EI premium rates at \$1.73 per \$100 for 2010.

For EI benefits for workers willing to enter into work-sharing agreements, the Budget extended the work-sharing agreement period by 14 weeks for 2009 and 2010. The agreement period is up to a maximum of 52 weeks.

Potential Increased Access to Automobile Financing

Financing for auto purchases and leases has been severely reduced. The Government proposes to create a Canadian Secured Credit Facility to make financing for vehicle purchases and leases more available.

CDIC and the TFSA

CDIC deposit insurance insures Canadian savings to protect against the event of bankruptcy of a CDIC member bank or other financial institution. CDIC only covers bank deposits and GICs. Bonds, equities and mutual funds are not covered by CDIC.

⁷ The phase-out will be prorated for taxation years that straddle December 31, 2008.

Tax-Free Savings Accounts (TFSAs) will be considered a separate category of deposits insurable by the Canada Deposit Insurance Corporation (CDIC). The coverage provided will be similar to the \$100,000 coverage provided for registered accounts (RRSPs and RRIFs).

Canada Small Business Financing Program

Under this program, the government guarantees 85 percent of loans made by eligible institutions to qualifying businesses. The plan is to increase the maximum eligible loan amount accessible to small business from \$250,000 to \$350,000, and to \$500,000 for loans made to acquire real property.

PREVIOUSLY ANNOUNCED MEASURES

The Federal Budget established that the government will proceed with certain previously announced tax measures, including:

- Implementation of measures included in the *Notice of Ways and Means Motion* dated November 28, 2008 including the 25% reduction of the minimum RRIF withdrawal for 2008 and the variable benefits under the RPP's;
- Extension of the 2008 deadline for Registered Disability Savings Plan (RDSP) contributions to March 2, 2009;
- Conversion of specified investment flow through (SIFT) entities into a corporation without negative income tax results;
- Extension of carry forward period for unused ITCs earned from 1998 to 2005 from 10 years to 20 years; and
- Modifications to increase the number of Canadian amateur athletes eligible to defer income tax on income from endorsements, prizes and other remuneration related to the athlete's athletic endeavours.

A memorandum of this nature cannot be all encompassing and is not intended to replace professional advice. Its purpose is to highlight tax-planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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