



Proposed Income Tax Changes Announced in Federal Budget Speech

[Kevin Fritz](#)
[Andrea Shreeram](#)

Yesterday, the federal government released its proposed budget for 2009. The following is a summary of certain income tax related highlights of the proposed budget. It remains to be seen whether these budget proposals will ultimately be supported by the opposition and be adopted as law by Parliament.

Corporate/Business Tax Measures

Small Business Limit. The small business limit, which applies a reduced tax rate to the first \$400,000 of qualifying active business income of eligible Canadian-controlled private corporations ("CCPCs"), will be increased so that the reduced tax rate will apply to the first \$500,000 of such income.

Manufacturing and Processing: Accelerated Capital Cost Allowance. A 50% straight-line accelerated capital cost allowance ("CCA") treatment will apply for certain machinery and equipment purchased in 2010 and 2011 and used in the manufacturing or processing of goods for sale or lease. In addition, the "half-year rule" will not apply to this class of property.

Computers: Accelerated CCA. A temporary 100% CCA rate will apply for eligible computers and software acquired after January 27, 2009 and before February 2011.

Interest Deductibility in Double Dip Transactions. Proposed section 18.2 of the *Income Tax Act* (Canada), which was to limit the deductibility of interest in certain circumstances, will be repealed. The section was originally proposed in order to limit interest deductions in so-called "double dip" transactions where a Canadian corporation uses borrowed funds to finance a foreign affiliate and an additional interest deduction is available in a foreign jurisdiction.

Mineral Exploration Tax Credit for Flow-through Shares. The eligibility for the mineral exploration tax credit will be extended by one year to flow-through share agreements that are entered into on or before March 31, 2010, so that the credit will apply in

respect of certain eligible exploration expenses incurred by companies until the end of 2011. The federal mineral exploration tax credit is available to individuals who invest in flow-through shares and is equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to the flow-through share investors.

Acquisition of Control of a Corporation: Time of Acquisition. The deeming rule regarding the timing of the acquisition of control of a corporation will be amended so that it will not affect the status of a corporation as a CCPC until the actual time of the acquisition. The purpose of this measure is to address certain technical tax anomalies created by the existing deeming rule, which applies to treat the acquisition of control as occurring at the beginning of the day and not at the actual time of the disposition by the vendor. For example, in certain circumstances this disqualified a vendor of CCPC shares from using the \$750,000 lifetime capital gains exemption.

Mandatory Electronic Filing for Corporations and Related Penalties. Corporations with annual gross revenues in excess of \$1,000,000 for taxation years after 2009 will be required to file their income tax returns electronically. Taxpayers who file more than 50 information slips will be required to file information returns electronically for returns required to be filed after 2009. A penalty will apply for corporate income tax returns required to be filed after 2010 and that are not filed in the correct format. However, penalties related to the late filing of information returns and the filing of such returns in the incorrect format will be reduced. Such reduced penalties will apply for information returns required to be filed after 2009.

Personal Income Tax Measures

Personal Amounts and Income Tax Brackets. The basic personal amount of income which is exempt from tax will increase for 2009 from \$9,600 to \$10,320. The upper limit of the first personal tax bracket (taxed at 15%) will increase to \$40,726 in 2009 and the upper limit of the second personal income tax bracket (taxed at 22%) will increase to \$81,452 in 2009. These are 7.5% increases in the amounts subject to these lower tax rates.

Canada Child Tax Benefit and the National Child Benefit Supplement. The income level at which the phase out of the Canada Child Tax Benefit and the

National Child Benefit begin will increase to \$40,726 (from \$37,885).

Working Income Tax Benefit. The federal government proposes to expand the Working Income Tax Benefit (“WITB”) so as to provide additional tax relief for the 2009 and subsequent taxation years. The WITB is a refundable tax credit intended to provide tax relief for eligible working low-income individuals and families who are already in the workforce and to encourage other Canadians to enter the workforce.

Age Credit. The federal income tax credit for Canadians who are 65 and older will increase for 2009 and subsequent taxation years. The amount will be increased by \$1,000 effective January 1, 2009 and indexed thereafter. The income level at which the Age Credit applies will increase to \$75,032 from \$68,365.

Home Renovation Tax Credit. A temporary, non-refundable tax credit will apply only to the 2009 taxation year. The Home Renovation Tax Credit will be 15% of eligible expenditures in respect of eligible dwellings. The maximum amount of the credit is \$1,350. The federal government was careful to note that expenditures on items such as new TVs or new curtains do not count as “eligible expenditures”.

Home Buyers’ Plan. The withdrawal limit from registered retirement savings plans (“RRSPs”) of buyers who purchase or build a first-time home is increased to \$25,000 from \$20,000. The withdrawal limit will apply to the 2009 and subsequent calendar years for withdrawals made after the 2009 budget announcement date, i.e., January 27, 2009.

First Time Home Buyers’ Tax Credit. A new non-refundable tax credit for first-time home buyers will be available, in certain circumstances, for homes purchased after January 27, 2009. The credit will be claimable in the taxation year in which the home is purchased. The credit will be based on an amount of \$5,000 and will be calculated in reference to the lowest personal income tax rate for the year.

RRSP/RRIF Losses After Death. Where the value of RRSPs or registered retirement income funds (“RRIFs”) has decreased after an annuitant’s death but before it is distributed to beneficiaries, the amount of any such decreases will be permitted to be carried back and deducted in certain circumstances. Such decreases will generally be deductible against the income inclusion to a deceased in the year that represents the fair market value of investments held in a RRSP or a RRIF. This measure will apply in situations where the final distribution to beneficiaries from a RRSP or RRIF occurs after 2008.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

Wildeboer Dellelce LLP

Wildeboer Dellelce Place
365 Bay Street, Suite 800
Toronto, ON M5H 2V1
Phone: (416) 361-3121
Fax: (416) 361-1790

72 Victoria Street South, Suite 401
Kitchener, Ontario N2G 4Y9
Phone: (519) 741-8708
Fax: (519) 741-9576



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