



2006 FEDERAL BUDGET ANALYSIS

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Info

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SALES AND EXCISE TAX MEASURES

Reducing the GST to 6 Per Cent

The budget proposes to reduce the GST rate by one percentage point, from 7 to 6 per cent, effective July 1, 2006. Budget 2006 also proposes to maintain the GST credit at current levels for low- and modest-income Canadians and to retain the existing GST rebate rates for new housing and purchases made by public service bodies.

To facilitate the transition to the lower rate, the budget proposes transitional rules for determining the GST rate applicable to transactions that straddle the July 1, 2006 implementation date.

In addition to the application of the general transitional rule described above, certain types of transactions will have specific transitional rules described below.

(a) Sales of Real Property

Under the proposed measures, the following specific transitional rules will apply in respect of sales of real property.

Ownership or Possession Transferred before July 1, 2006:

The 7 per cent rate will apply to all of the consideration for a supply by way of sale of real property if ownership of the property, or possession of it under the agreement of purchase and sale, is transferred to the buyer before July 1, 2006.

Ownership and Possession Transferred on or after July 1, 2006:

The 6 per cent rate will apply to all of the consideration for a supply by way of sale of real property if under an agreement of purchase and sale entered into after May 2, 2006, both ownership of the property, and possession of it under the agreement, are transferred to the buyer on or after July 1, 2006.

Written Agreement Entered Into on or before May 2, 2006:

For sales of houses, apartment buildings and other residential complexes, made pursuant to a written agreement entered into on or before May 2, 2006, GST will apply at the rate of 7 per cent, even if ownership and possession of the real property are both transferred on or after July 1, 2006. In these circumstances, where transfer of ownership and possession both take place on or after July 1, 2006, the purchaser will be entitled to file a claim with the Canada Revenue Agency to be paid a Transitional Adjustment that reflects the GST rate reduction to 6 per cent net of any corresponding rebate adjustment.

(b) Deemed Supplies

(c) Imported Goods and Imported Taxable Services and Intangibles

(d) Taxable Benefits; Passenger Vehicles and Aircraft; and Employee/Partner Rebates

The prescribed rate for calculating the GST on the automobile operating expense benefit, which is currently 5 per cent, will be 4.5 per cent for the 2006 taxation year and 4 per cent thereafter, and for calculating the HST, the prescribed rate, which is currently 11 per cent, will be 10.5 per cent and 10 per cent respectively.

Other Measures

A number of consequential amendments are proposed as a result of the GST rate reduction.

Housing Rebates:

Individuals who purchase or construct a new home, or substantially renovate an existing home, for use as their primary place of residence are generally entitled to a rebate of part of the GST that they pay in the course of the purchase, construction or substantial renovation. The maximum amount of the rebate is equal to the lesser of 36 per cent of the GST paid and \$8,750. For homes that cost more than \$350,000, the rebate is phased out so that no rebate is available for homes valued at more than \$450,000. The rebate was introduced to reduce the GST rate on new homes to approximately 4.5 per cent, which was consistent with the effective tax rate under the predecessor of the GST, the Federal Sales Tax.

The maximum dollar value of the rebate, which is currently set at \$8,750, will be adjusted to \$7,560

Streamlined Accounting Methods:

Small businesses, as well as eligible public service bodies, can use a Quick or Special Quick Method of Accounting to simplify compliance.

As a result of the proposed rate reduction, the specified percentages will change. The new percentages will apply to reporting periods that begin on or after July 1, 2006.

Tobacco Excise Levies

In line with the Government's promotion of health and wellness. The budget proposes to increase tobacco excise duties to offset the impact of the GST rate reduction.

Alcohol Excise Levies

The budget proposes to increase alcohol excise duties to offset the impact of the GST rate reduction.

Air Travellers Security Charge (ATSC) Rates

As a result of the GST/HST rate reduction, certain technical adjustments to ATSC rates are required in order to ensure that consumers receive the full benefit of the rate reduction. The proposed rates are shown in the following table.

The new rates will apply to tickets purchased on or after July 1, 2006.

ATSC Rate Structure*

	Current rates	Proposed new rates
Domestic (one-way)	\$5.00	\$4.95
Domestic (round-trip)	\$10.00	\$9.90
Transborder	\$8.50	\$8.42
Other international	\$17.00	\$17.00

* The above amounts include the GST or the federal portion of the HST where applicable.

Excise Tax on Jewellery

There is a proposed repeal of the excise tax that applies to deliveries or importation of jewellery, clocks and articles made of semi-precious stones, on or after May 2, 2006.

Vintners and Small Brewers

The budget proposes to support vintners and small- and medium-sized brewers by reducing the excise duties on certain wines and beer.

PERSONAL INCOME TAX MEASURES

Personal Income Tax Rates

The lowest personal income tax rate was reduced to 15 per cent from 16 per cent effective January 1, 2005. The rate will be 15.5 per cent effective July 1, 2006. Accordingly, the full-year rate for 2005 was 15 per cent. For 2006 the rate will be 15.25 per cent and, for the 2007 and subsequent taxation years, will be 15.5 per cent. For the 2005 taxation year the 15-per-cent rate applied to taxable incomes of up to \$35,595. For the 2006 taxation year the 15.25-per-cent rate will apply to taxable incomes of up to \$36,378. The upper limit for the application of the 15.5-per-cent rate will be indexed for taxation years after 2006. These rates will also be generally used to calculate non-refundable tax credits and the alternative minimum tax for the 2005 and subsequent taxation years.

Basic Personal Amounts

The basic personal amount—the amount that an individual can earn without paying federal personal income tax—was increased by \$500 to \$8,648 for the 2005 taxation year. For the first half of 2006 it will then be increased by indexation plus a further \$200, for a total of \$9,039. The basic personal amount will be reduced by \$400 to \$8,639 on July 1, 2006.

Personal amounts in respect of a spouse or common-law partner or wholly dependant relative will also be adjusted. Specifically, for the 2005 taxation year these amounts were increased by \$425 to \$7,344. For the first half of 2006 they will then be increased by indexation plus a further \$170, for a total of \$7,675. The amount will be reduced by \$340 to \$7,335 on July 1, 2006.

Canada Employment Credit

A new credit will take effect July 1, 2006, and will provide tax relief on the lesser of \$500 and the individual's employment income for the year. Because this measure will take effect mid-year, the maximum amount on which the credit is calculated will be \$250 for the 2006 taxation year. For the 2007 and subsequent taxation years, the maximum amount on which the credit is calculated will be increased to \$1,000. The tax credit for a taxation year will be calculated by reference to the lowest personal income tax rate for the taxation year.

Universal Child Care Benefit

The budget proposes to introduce, effective July 2006, the Universal Child Care Benefit (UCCB), to provide all families with \$100 per month (\$1,200 per year) for each child under the age of 6 years.

Amendments to the Income Tax Act will be made to provide that amounts received under the UCCB will be taxable in the hands of the lower-income spouse or common-law partner.

Amendments will, however, be made to the structure of the Canadian Child Tax Benefit (CCTB) to reflect the introduction of the UCCB

Capital Gains of Fishers

The budget proposes a number of income tax measures concerning the disposition of property by an individual used in a family fishing business to allow for a \$500,000 lifetime capital gains exemption.

Intergenerational Rollover: Transfers of Fishing Property to a Child

The budget proposes to allow a tax deferral in certain circumstances where an individual's fishing property is transferred to the individual's child or grandchild.

Mineral Exploration Tax Credit for Flow-Through Share Investors

The budget proposes to reintroduce the mineral exploration tax credit, effective for flow-through share agreements entered into on or after May 2, 2006 and on or before March 31, 2007

Tradespeople's Tool Expenses

The budget proposes that the total cost of eligible new tools acquired by an employed tradesperson in a taxation year, in excess of \$1,000 (indexed after 2007), be deductible up to a maximum of \$500 for that year. For the cost of tools to qualify for the deduction, the employer will have to certify that the employee is required to acquire those tools as a condition of, and for use in, the employment. This deduction will be in addition to the proposed new Canada Employment Credit described above.

This measure will apply to new tools acquired on or after May 2, 2006.

Textbook Tax Credit

To provide better tax recognition to post-secondary students for the cost of textbooks, the budget proposes to introduce a non-refundable textbook tax credit. The textbook tax credit will be in addition to the education tax credit. The amount on which the textbook tax credit is calculated will be:

- \$65 for each month for which the student qualifies for the full-time education tax credit amount; and
- \$20 for each month the student qualifies for the part-time education tax credit amount.

Unused textbook tax credit amounts will be added to unused tuition and education tax credit amounts for the purposes of the carry forward to a future year as well as the transfer of unused amounts to a spouse or common-law partner, parent, or grandparent.

This measure will apply to the 2006 and subsequent taxation years.

Scholarship and Bursary Income

The budget proposes to fully exempt such scholarship, fellowship or bursary income from tax. The full exemption will apply only to amounts received by a student in connection with the student's enrolment in a program which entitles the student to claim the education tax credit. Generally, this includes programs at the post-secondary level and programs at educational institutions that are certified by the Minister of Human Resources and Social Development as providing skills in an occupation.

This measure will apply to the 2006 and subsequent taxation years.

Children's Fitness Tax Credit

The budget proposes to allow parents to claim a non-refundable tax credit in respect of up to \$500 in eligible fees for the enrolment of a child under the age of sixteen years in an eligible program of physical activity. The measure will apply to the 2007 and subsequent taxation years. The credit will be calculated by reference to the lowest personal income tax rate for the taxation year and can be claimed by either parent for eligible fees incurred during the calendar year.

Pension Income Credit

The budget proposes to provide greater tax relief to pensioners by increasing to \$2,000 from \$1,000, the maximum amount of eligible pension income that can be used in calculating the pension income credit.

This measure will apply to the 2006 and subsequent taxation years.

Child Disability Benefit

The CCTB is the main federal instrument for the provision of financial assistance to families with children. The CCTB has three components: the CCTB base benefit, the National Child Benefit (NCB) supplement, and the Child Disability Benefit (CDB). The CDB is payable in respect of children, in low- and modest-income families, who meet the eligibility criteria for the disability tax credit (DTC).

The budget proposes two changes to the CDB to enhance assistance to families with children eligible for the DTC.

First, the budget proposes to increase the maximum annual CDB to \$2,300 from \$2,044, starting in July 2006. The benefit will continue to be indexed for inflation thereafter.

Second, the budget proposes to extend the CDB to more families caring for a child eligible for the DTC by reducing the rates at which the CDB is reduced as family income rises.

Refundable Medical Expense Supplement

The refundable medical expense supplement (RMES) improves work incentives for Canadians with disabilities by helping to offset the loss of coverage for medical and disability-related expenses when individuals move from social assistance to the paid labour force.

The budget proposes to increase the maximum amount of the RMES to \$1,000 from \$767 for the 2006 taxation year. The maximum amount will continue to be indexed for inflation thereafter.

The budget also proposes to set the income threshold at which the RMES starts to be reduced at its level for 2005—\$21,663—to ensure that the supplement continues to be targeted to low- and modest-income Canadians. The threshold will be indexed for inflation thereafter. For 2006, it will be \$22,140.

Tax Credit for Public Transit Passes

The budget proposes to allow individuals to claim a non-refundable tax credit for the cost of monthly public transit passes or those passes of a longer duration (e.g., annual passes). Public transit will include transit by local bus, streetcar, subway, commuter train, commuter bus and local ferry. It will be claimable by the individual or the individual's spouse or common-law partner in respect of eligible transit costs of the individual, the individual's spouse or common-law partner, and the individual's dependent children that are under 19 years of age.

Individuals making claims will be required to retain their receipts or passes for verification purposes. Consultations will take place with transit authorities to develop appropriate receipting practices.

This measure will apply in respect of that portion of the cost of public transit passes that is in respect of transit on or after July 1, 2006.

Donations of Publicly-Listed Securities to Public Charities

The budget proposes to reduce the capital gains inclusion rate for such donations to zero.

These measures will apply to donations of eligible securities made on or after May 2, 2006.

Donations of Ecologically-Sensitive Land

The budget proposes to reduce the capital gains inclusion rate for such donations to zero.

This measure will apply to donations of ecologically-sensitive land made on or after May 2, 2006.

Large Corporation Dividends

The budget confirms the government's intention to proceed with measures consistent with those announced in a Notice of Ways and Means Motion tabled on November 23, 2005, which would enhance the gross-up and DTC for eligible dividends. Eligible dividends will generally include dividends paid after 2005 by public corporations (and other corporations that are not Canadian-controlled private corporations (CCPCs)) that are resident in Canada and subject to the general corporate income tax rate. In addition, CCPCs will be able to pay eligible dividends to the extent that their income (other than investment income) is subject to tax at the general corporate income tax rate.

Specifically, in respect of eligible dividends, shareholders will include 145 per cent of the eligible dividend amount in income (that is, a 45 per cent gross-up), and the federal DTC with respect to eligible dividends will be approximately 19 per cent of the grossed-up amount (reflecting the general corporate income tax rate that will apply beginning in 2010).

This measure will apply to eligible dividends paid after 2005.

BUSINESS INCOME TAX MEASURES

General Corporate Income Tax Rate and Corporate Surtax

The budget proposes to reduce the general corporate income tax rate (after the 10-per-cent abatement for income earned in a province) to 19 per cent from 21 per cent by 2010.

The rate reductions will apply to income that is taxed at the general corporate income tax rate. This income does not include small business income that is already eligible for the small business deduction; investment income of Canadian-controlled private corporations (CCPCs), which income is eligible for a special refundable tax.

The elimination of the surtax for small- and medium-sized corporations in 2008 has already been legislated. The budget proposes to eliminate the corporate surtax for all remaining corporations effective January 1, 2008. Its elimination is equivalent to a 1.12 percentage point reduction in corporate income tax rates and will simplify the tax system.

The following table presents the federal corporate income tax rates reflecting the proposed rate reductions. The rate will be prorated for taxation years that include any of those dates.

Federal Corporate Income Tax Rates, 2006–2010

	Proposed Rates (%)				
	2006	2007	2008	2009	2010
General corporate income tax rate	21.0	21.0	20.5	20.0	19.0
Corporate surtax	1.12	1.12	0.0	0.0	0.0

Small Business Limit and Tax Rate

In order to provide additional tax relief to small businesses, the budget proposes that the annual amount of active business income eligible for the reduced tax rate—generally referred to as the “small business limit”—be increased as of January 1, 2007 to \$400,000.

The budget also proposes a 1-percentage point reduction in the 12 per cent tax rate. The reduction will be achieved as follows:

- for 2008, the rate will be reduced to 11.5 per cent; and
- as of January 1, 2009, the rate will be reduced to 11 per cent.

The increase to the small business limit, and the rate reductions, will be pro-rated for corporations with taxation years that do not coincide with the calendar year.

As a consequence of the proposal to increase the small business limit, the \$2 million expenditure limit on scientific research and experimental development (SR & ED) will be reduced where taxable income for the previous taxation year is between \$400,000 and \$600,000.

The following table presents the small business limit and tax rate reflecting the proposed changes.

Small Business Limit and Tax Rates, 2006–2010

	Proposed Limit and Rates				
	2006	2007	2008	2009	2010
Small business limit	\$300,000	\$400,000	\$400,000	\$400,000	\$400,000
Small business tax rate ¹	12	12	11.5	11	11

¹ Small businesses also pay the corporate surtax, which currently is equivalent to a tax rate of 1.12%. It will be eliminated in 2008.

Non-Capital Losses and Investment Tax Credits

Non-capital losses can currently be carried back up to 3 years and can also be carried forward 10 years. The budget proposes to extend the non-capital loss carry-forward period of all taxpayers to 20 years.

Currently, ITCs can be carried back up to 3 years and forward up to 10 years. The budget also proposes to extend the ITC carry-forward period to 20 years.

This measure will apply to non-capital losses, farm losses, restricted farm losses, losses applied under Part IV of the Income Tax Act, and Canadian life investment losses under Part XII.3 of the Act. It will also apply to ITCs earned for SR&ED, Atlantic investment, and mineral exploration. The measure is proposed to apply to losses incurred and credits earned in taxation years that end after 2005.

Federal Capital Tax

The tax is currently levied at a rate of 0.125 per cent on taxable capital in excess of \$50 million.

The budget proposes to eliminate the federal capital tax as of January 1, 2006. The federal capital tax rate will be prorated for taxation years that do not coincide with the calendar year.

Minimum Tax on Financial Institutions

The budget proposes to increase the threshold above which the tax begins from \$200 million to \$1 billion and to adopt a single tax rate of 1.25 per cent on taxable capital employed in Canada over that threshold.

Apprenticeship Job Creation Tax Credit

The budget proposes to introduce an Apprenticeship Job Creation Tax Credit in order to encourage employers to hire new apprentices in eligible trades. This measure will provide eligible employers with a non-refundable tax credit equal to 10 per cent of the salaries and wages paid to qualifying apprentices to a maximum credit of \$2,000 per year per apprentice (i.e., the credit would be available on up to \$20,000 of an apprentice's salaries and wages).

As proposed above, unused credits may be carried back 3 years and forward 20 years by the employer to reduce federal income taxes otherwise payable in those years.

The Apprenticeship Job Creation Tax Credit will be available to eligible employers in respect of salaries and wages that are paid to qualifying apprentices on or after May 2, 2006.

Capital Cost Allowance for Tools

The budget proposes that the cost limit for access to the 100-per-cent Class 12 treatment be increased to \$500 from \$200 for such tools acquired on or after May 2, 2006.

The budget also proposes to clarify the description of tools eligible by specifically excluding electronic communication devices and electronic data processing equipment.

Consequential to the increase in the cost limit for tools, the budget also proposes that the cost limit for kitchen utensils and medical or dental instruments under be increased to \$500 from \$200 for such utensils and instruments acquired on or after May 2, 2006.

OTHER MEASURES

Administrative Provisions (Standardized Accounting)

The Government has, for a number of years, been working on an initiative referred to as “Standardized Accounting”, which aims to simplify tax compliance, primarily for business persons, by harmonizing various administrative, interest and penalty provisions across federal tax statutes. The goal of this initiative is an integrated set of rules for the payment of tax, calculation of interest, and penalties that simplifies the tax system for both tax filers and government administration and ultimately leads to increased efficiency and cost savings.

The budget proposes measures that harmonize a number of other administrative, interest and penalty provisions, primarily as they relate to the Excise Tax Act (GST), but also affecting the Excise Tax Act (non-GST), Excise Act, 2001, Income Tax Act, and the Air Travellers Security Charge Act.

Measures Announced in the 2005 Budget

A limited number of tax measures that were originally proposed in the 2005 budget and the Notice of Ways and Means Motion tabled on November 17, 2005 were not legislated before Parliament prorogued as a result of the election call. The budget confirms the Government’s intention to proceed with measures which would introduce a tax deferral in respect of certain dividends paid after 2005 by agricultural cooperatives, and would for the 2005 and subsequent taxation years,

- introduce a new tax credit for adoption expenses,
- respond to recommendations of the Technical Advisory Committee on Tax Measures for Persons with Disabilities concerning the eligibility criteria for the disability tax credit and the expenses eligible for the disability supports deduction,
- expand the list of expenses eligible for the medical expenses tax credit, and clarify the eligibility of home renovation and construction expenses, and
- double the amount of disability-related and medical expenses that can be claimed by a caregiver.

The budget also confirms the Government’s intention to enact regulations to implement the changes to the capital cost allowance (CCA) provisions proposed in the 2005 budget.

Functional Currency Tax Reporting

The budget proposes to explore allowing corporations, required for financial reporting purposes to report in a functional currency other than the Canadian dollar, to determine their income for Canadian tax purposes in that functional currency. To this end, the Department of Finance intends to release a discussion draft of legislative proposals for comment.