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Personal and Small Business Tax Announcements By Jamie Golombek

Federal Budget 2009 introduced specific tax measures geared towards lower and middle-income Canadians as well as several key incentives for individuals and small business owners to stimulate spending, particularly on the home front.

The focus of this report is to outline a few key elements of the 2009 Budget as they relate to personal and small business tax announcements.

GENERAL PERSONAL TAX CHANGES

Basic personal / spousal / partner amount

The “basic personal amount” is the amount of income that an individual can earn before paying any federal income tax. The 2009 federal budget proposes to increase the basic personal amount, which is also used for the spousal and partner amounts, by 7.5% to \$10,320 in 2009 from \$9,600 in 2008.

Personal tax brackets

To provide broad-based tax relief, especially for lower and middle-income individuals, the upper personal tax limits of both the first and second tax brackets are proposed to be increased by 7.5%.

The table below shows the new 2009 (proposed) vs. 2008 tax brackets:

2009 (Proposed)	2008	Rate
Less than \$40,726	Less than \$37,885	15%
\$40,726 to \$81,452	\$37,885 to \$75,769	22%
\$81,452 to \$126,264	\$75,769 to \$123,184	26%
Over \$126,264	Over \$123,184	29%

Although the change is retroactive to January 1, 2009, employees who have taxes deducted at source likely won't see the benefit of these tax reductions until after the new payroll tables are utilized by their employers for pay periods ending after July 1, 2009.

Age Credit (for 65 and older)

As promised by the Conservatives in their pre-election campaign, the age credit will be increased in 2009. This non-refundable credit is available to Canadians who are 65 years or older and is calculated by multiplying the age amount by 15%. The credit is income-tested and begins to be phased out when net income exceeds \$32,312.

For 2009, the budget proposes that the amount on which the age credit is based be increased by \$1,000 to \$6,408. The phase-out, calculated at a 15% rate, means that the age credit is fully phased out when net income reaches \$75,032.

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TAX MEASURES TO SUPPORT HOMEOWNERS

The 2009 Budget introduced three positive tax changes to support home ownership: the new Home Renovation Tax Credit, the new First-Time Home Buyers' Tax Credit and improvements to the existing Home Buyers' Plan.

Introduction of a Temporary Home Renovation Tax Credit

Perhaps the most exciting personal tax measure for many Canadians will be the introduction of the new temporary (*after January 27, 2009 and before February 1, 2010*) Home Renovation Tax Credit (HRTC).

According to the government, the purpose of the new HRTC is to "stimulate economic growth and encourage Canadians to invest in improvements to their homes."

For 2009 only, individuals will be able to claim a 15% non-refundable tax credit for eligible expenditures made in respect of their homes.

The credit applies to any expenditures above \$1,000 and up to \$10,000. As a result, the value of this new federal credit is equal to a maximum of \$1,350 ($[\$10,000 - \$1,000] \times 15\%$).

Only expenditures made after January 27, 2009 and before February 1, 2010, will be eligible for the 2009 credit. Since the purpose of the credit is to stimulate new renovations not previously contemplated, it won't be available if the expenditure is made pursuant to an agreement entered into before January 28, 2009.

As with various other credits, eligibility for the HRTC is family-based. For this purpose, a family will consist of an individual and his or her spouse or common-law partner (if applicable) and any children under age 18.

While only one family member will likely claim the entire credit, it can be shared among family members if necessary, perhaps where it cannot be fully utilized by one individual. The total amount claimed, however, cannot exceed \$1,350 per family, no matter how it is allocated.

If more than one family share the ownership of one property, they can each claim the credit. For example, two sisters living together in a co-owned property, who each contribute at least \$10,000 towards renovating their shared kitchen could each claim their own \$1,350 credit.

What if you rent part of your home?

You can still claim the credit for the full amount of any expenditures made in respect of the personal-use portion of the home. For common-area expenses that benefit the home as a whole, such as a new roof, an allocation of the amount spent between business and personal may be required.

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What expenses qualify?

According to the Budget, it is any expenditure that is "incurred in relation to a renovation or alteration...provided that the renovation or alteration is of an enduring nature and is integral to the eligible dwelling." This would include both the cost of labour and professional services, as well as building materials, fixtures, equipment rentals, and permits.

Examples of non-qualifying expenses include the cost of routine repairs and maintenance that are generally done on annual (or more frequent basis) as well as appliances, furniture, drapery or audio-visual electronics. Also specifically excluded is interest expense associated with financing that renovation.

One final restriction meant to prevent potential abuse: expenditures won't be eligible if they are provided by a non-arm's length person, unless that person is legally registered for GST/HST purposes.

First-Time Home Buyers' Tax Credit

There is also a new proposed non-refundable tax credit based on a \$5,000 amount for "first-time home buyers" who purchase or construct a new home after January 27, 2009.

For the purposes of this credit, an individual will be considered a first-time home buyer if neither the individual nor his or her spouse or partner owned and lived in another home in the calendar year of purchase or any of the four preceding calendar years.

Any unused First-Time Home Buyers' Tax Credit can be claimed by the individual's spouse or partner. Note, however, that even if each spouse or partner uses his or her own funds to jointly purchase a new home, the First-Time Home Buyers' Tax Credit is still limited to one credit of \$5,000 (as opposed to \$5,000 for each spouse or partner).

The credit is also available for the purchase of a home either by or on behalf of an individual eligible for the disability tax credit if the home enables the disabled individual to live "in a more accessible dwelling or in an environment better suited to the personal needs and care of that person."

Home Buyers' Plan

The federal Home Buyers' Plan (HBP) currently allows a first-time home buyer to withdraw up to \$20,000 from his or her RRSP to purchase or construct a new home without having to pay tax on that withdrawal.

The Budget proposes to increase the maximum amount that can be withdrawn to \$25,000 for RRSP withdrawals under the HBP made after January 27, 2009.

Under the HBP, any funds withdrawn must be used to acquire a home before October 1st of the following year. Amounts withdrawn under the HBP must be repaid over a maximum of 15 years or the amount not repaid in a year is added to the participant's income for that year.

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As with the new First Time Home Buyers' Tax Credit, an individual will be considered a first-time home buyer if neither the individual nor his or her spouse or partner owned and lived in another home in the calendar year of purchase or any of the four preceding calendar years.

There are also special rules for disabled beneficiaries to enable them to purchase a home even if the first time buyer requirement is not met.

RRSP / RRIF LOSSES AFTER DEATH

Under the current tax rules, when the annuitant of an RRSP or RRIF dies, absent a tax rollover to a surviving spouse, partner, dependent minor child or dependent disabled child, the fair market value (FMV) of his or her RRSP or RRIF immediately before death must be included in his or her final tax return (the "terminal return") for the year of death.

But what if the FMV of an RRSP or RRIF that was included on the deceased annuitant's terminal tax return declines in value after death but before it's paid out?

In such a case, the estate ends up having to pay tax on an amount that is actually greater than the amount that is received on the ultimate windup of the RRSP or RRIF.

For example, assume Gary held XYZ Inc. shares in his RRSP that were worth \$200,000 when he died in June 2008. By the time his RRSP was finally paid out in January 2009, market conditions deteriorated and the FMV of the XYZ shares had fallen by 40% to \$120,000.

Under current rules, there is no mechanism to be able to claim the \$80,000 loss. In other words, Gary's estate would pay tax on the fair market value of the RRSP at the date of his death (i.e. \$200,000), notwithstanding the fact that the estate only received \$120,000 of proceeds after ultimately selling the shares.

Budget 2009 proposes to solve this problem by allowing the amount of post-death decreases in value of the RRSP or RRIF to be carried back and deducted against the year-of-death RRSP/RRIF income inclusion on the deceased's terminal return.

The amount that can be carried back is simply the difference between the amount included in income of the deceased annuitant and the amount paid out of the RRSP or RRIF after death.

This measure applies to all final RRSP or RRIF payouts from January 1, 2009.

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SMALL BUSINESS TAX CHANGES

Small Business Limit

The small business deduction allows private corporations to pay a low rate of federal tax (11%) on the first \$400,000 of annual active (non-investment) business income.

The 2009 federal Budget proposes to increase this amount, generally known as the “small business limit,” to \$500,000, effective January 1, 2009.

Computers: Accelerated Tax Depreciation

To encourage investment by businesses in computer systems and related peripherals, the 2009 Budget proposes a temporary 100% tax depreciation rate for eligible computers and software acquired after January 27, 2009 and before February 2011.

This 100% write-off rate will not be subject to the traditional “half-year rule” which generally restricts the amount of tax depreciation that can be claimed to half the normal amount in the year of purchase.

As a result of this temporary change, a business can essentially write off the cost of an eligible computer in the year of acquisition, as long as it's purchased before February 2011.

As with all planning strategies, you should seek the advice of a qualified financial planner or tax advisor to discuss how the changes in the federal budget could impact your financial plans.

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