



**The following is a summary of significant initiatives proposed by the 2007 Federal Budget. Please note that as these measures have been proposed by a minority government, caution must be exercised in relying on the proposals until and unless they receive Royal Assent.**

## **PERSONAL TAX MEASURES**

### **1. Change in Age Limit for Maturing RPPs and RRSPs**

The Budget proposes that the maturity of RRSPs be changed from the end of the calendar year in which an individual attains age 69 to the end of the calendar year in which the individual attains age 71. In other words, individuals will have an additional two years before they are required to convert their RRSPs into a retirement income plan such as a RRIF. This was rule until 1996, when the age 71 threshold was scaled back to 69 under the former government.

Consequently, the RRIF minimum withdrawal amounts for individuals attaining ages 70 and 71 in 2007 or 2008 have been reduced to nil. Individuals will also have the option of reestablishing RRSPs that previously had been converted to RRIFs, as long as the annuitant re-converts the plan back to a RRIF by the end of the year in which they turn 71.

Concurrently with this change, the commencement date for Registered Pension Plan (RPP) or Deferred Profit Sharing Plan (DPSP) annuity payments may also be deferred until the end of the year in which the payment recipient reaches age 71.

### **2. Registered Education Savings Plans**

The Government proposes to relax and sweeten RESPs. Starting in 2007,

- The annual RESP contribution limit of \$4,000 will be eliminated. The lifetime RESP contribution limit for each beneficiary will be increased to \$50,000 from \$42,000.
- The annual maximum Canada Education Savings Grant (CESG) will be increased to \$500 from \$400. Therefore, the first \$2,500 of RESP contributions in a year will be CESG eligible. If a beneficiary has unused grant room from a prior year, the maximum CESG for a year will be \$1,000. The lifetime CESG limit of \$7,200 will remain unchanged (although this increase in CESGs applies to contributions made after 2006, the increases will not be paid to RESPs until the enabling legislation has received Royal Assent and the delivery systems are put in place).
- More part-time students will qualify to receive Education Assistance Payments (EAP) from their RESPs. Part-time students 16 years of age or older, who do not meet the present requirement of at least 10 hours per week of courses or work but have at least of 12 hours per month of courses, will be able to receive EAPs of up to \$2,500 for each 13-week semester of part-time study (or a greater amount approved by Human Resources and Social Development Canada).

Quebec announced in its latest budget in February 2007 a new education incentive program similar to the CESG program. The Quebec government will pay a tax credit

to an RESP of 10% of the first \$2,000 in annual contributions. Beneficiaries in low and modest income families will be eligible for additional tax credits paid to the RESP. In the Budget, the federal Government announced its commitment to implement federal legislative changes to ensure the Quebec program is “treated in a manner consistent with the CESG program”. Although it is not clear, this hopefully means that the administration of the new Quebec program will be integrated into the existing systems infrastructure for CESGs and CLBs, similar to the administration of Alberta’s Community Education Savings grants.

### 3. Registered Plan Qualified Investments Changes

The list of Qualified Investments for RRSPs and other registered plans is proposed to expand effective March 19, 2007 to include:

(a) any debt obligation that has an investment grade rating from a recognized credit rating agency and that is part of a minimum \$25 million issuance; and

(b) any security that is listed on a designated stock exchange, other than a futures contract or other derivative instrument in respect of which the holder’s risk of loss may exceed the holder’s cost.

The change to include all listed securities appears to address a significant problem for clients holding units of foreign trusts that track assets other than stock indices in their registered plans. Prior to the present amendment, this type of security, including U.S. and Canadian listed foreign trusts that track the value of precious metal holdings, was not a qualified investment for registered plans.

### 4. Registered Disability Savings Plan

The Government proposes a new savings vehicle for disabled persons. The proposed RDSP is intended to provide for the financial security of persons with severe disabilities. The RDSP will be a more generous version of the existing RESP. The key aspects of the RDSP are:

- Contributions will not be deductible and will not be taxable when withdrawn from the RDSP. Contributions will be subject to a lifetime maximum of \$200,000 in respect of a plan beneficiary, with no annual limit. Anyone can contribute to the plan. Contributions can be made until the end of the year in which the beneficiary reaches age 59.
- The Government will provide monies in the form of Canada Disability Savings Grants (CDSGs) (max. \$3,500 per year) and Canada Disability Savings Bonds (CDSBs) (max. \$1,000 per year).
- Investment income, CDSGs and CDSBs will accrue tax free within an RDSP but will be taxable income for the plan beneficiary when withdrawn.
- The plan beneficiary must be eligible for the disability tax credit and resident in Canada.

- Withdrawals from an RDSP must commence by the end of the year in which the beneficiary attains age 60, subject to a maximum annual limit based on the beneficiary's life expectancy and the value of the RDSP.

CDSGs will match contributions at a rate of 100%, 200% or 300%, depending on the beneficiary's family net income. If family net income is \$74,357 or less, the first \$500 of contributions in a year will be matched at a rate of 300% and next \$1,000 will be matched at 200%. If family net income exceeds \$74,357, only the first \$1,000 of contributions in a year is matched at a rate of 100%. Once the beneficiary turns 18 years of age, the relevant income for family net income is that of the beneficiary and their spouse or common-law partner. The lifetime limit on CDSGs will be \$70,000 for each beneficiary. An RDSP can receive CDSGs until the end of the year in which the beneficiary reaches age 49.

CDSBs of up to \$1,000 annually will be paid to RDSPs of low and modest-income beneficiaries and families. Families with net income of less than \$20,883 will receive the full \$1,000 CDSB. Those with family net income of more than \$37,178 will not be eligible for any CDSBs. There will be a lifetime limit of \$20,000 on CDSBs for each beneficiary. An RDSP can receive CDSBs until the end of the year in which the beneficiary reaches age 49 (please note that all of the income thresholds for CDSBs and CDSGs are in 2007 dollars and will be indexed to inflation for 2008).

Once a beneficiary ceases to qualify for the disability tax credit or dies, the RDSP must be collapsed by (1) repaying to the Government all CDSGs and CDSBs (and associated investment income) paid to the plan in the ten years preceding and (2) paying the remaining funds to the beneficiary or the beneficiary's estate. That payment of the remaining funds (less the total amount of contributions) will be included in the income of the beneficiary for tax purposes.

Withdrawals from an RDSP will not be relevant for calculating federal income-tested benefits provided through the tax system, Old Age Security or Employment Insurance. The Government will work with provincial and territorial governments to minimize or eliminate any impact by the RDSP on provincial means-tested benefits.

It is the Government's stated desire that financial institutions begin offering RDSPs as soon as possible in 2008. The Government intends to work with financial institutions to develop the necessary administrative mechanisms (such as the payment of government monies to RDSPs).

## 5. Public Transit Tax Credit

The 2006 Federal Budget introduced a non-refundable tax credit for monthly passes purchased in connection with the use of public transit. The 2007 Budget proposes, effective the beginning of 2006, to modify this non-refundable tax credit in two ways. First, in response to certain transit authorities' proposals to introduce cost-per-trip electronic payment cards, such cards will be eligible, subject to certain conditions, for the non-refundable tax credit. Second, while the current tax credit is only applicable to 'monthly' public-transit passes, the 2007 Budget proposes that the non-refundable



tax credit be extended to individuals purchasing at least four consecutive 'weekly' public-transit passes.

## **6. Lifetime Capital Gains Exemption**

The Income Tax Act currently provides for a lifetime capital gains exemption of up to \$500,000 of capital gains realized in respect of dispositions of certain types of property including qualified farm and fishing property and qualified small business corporation shares. The 2007 Budget does not extend the types of property eligible for such exemption but proposes increases to the amount of the exemption to cover \$750,000 of capital gains realized on or after March 19, 2007. The Budget proposal also contains transitional rules for 2007.

## **7. Enhanced Tax Remittance Thresholds**

Individuals are generally required to remit their income taxes in quarterly installments. However, no installments are required when the individual's net tax owing for the year or for each of the two preceding taxation years does not exceed installment threshold for the year. The Budget proposes that, commencing in 2008, the personal tax remittance threshold will be increased from \$2,000 to \$3,000 (\$1,800 for residents of Quebec).

## **8. Enhanced Spousal Credit**

The Budget proposes to increase the Spousal Amount to \$8,929, resulting in a tax savings of \$209 to families in which one spouse has very little income.

## **9. New Child Tax Credit**

It is proposed that parents of children under age 18 at year end will now qualify for the new Child Tax Credit, worth \$310 per child per year. This new tax benefit is in addition to the Canada Child Tax Benefit (for children under the age of 16) and the Universal Child Care Benefit (for children under the age of 7).

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## **CORPORATE TAX MEASURES**

### **1. Pension Payment Flexibility to Encourage Phased Retirement Options**

Under present regulations, employees are prohibited from accruing defined benefit pension benefits if they are already receiving such benefits. For this reason, retiring employees are discouraged from remaining with their employers as part-time employees, since they can no longer accrue pension benefits for their work. The



Budget proposes to change this regime and to permit an employee to receive pension benefits from a defined benefit RPP while simultaneously accruing further benefits, subject to certain restrictions. For example, the measure will apply only to employees aged 55 and over who are otherwise entitled to an unreduced pension.

## **2. Increase in Capital Cost Allowance (CCA) Rates**

CCA is the income tax equivalent of depreciation and provides for the cost of capital assets to be deducted on an amortized basis so that, in theory, the cost of such assets is matched with the income earned therefrom. The 2007 Budget proposes to increase certain CCA rates (including for certain buildings and computer equipment) so that the rates are more realistically aligned with the useful life of the assets involved.

## **3. Investment Tax Credit for Child Care Spaces**

The Budget proposes to provide employers with a tax credit equal to 25% of expenditures incurred in the creation of child care spaces, to a maximum of \$10,000 per space.

## **4. Enhanced Employer Withholding Tax Remittance Thresholds**

Small employers with a perfect compliance record are presently permitted to withhold and remit employee income and payroll taxes on a quarterly basis if their average monthly withholding amount is less than \$1,000. The budget proposes that this threshold amount be increased to \$3,000.

## **5. Enhanced Corporate Tax Remittance Thresholds**

Corporations are generally required to remit income tax in monthly installments, unless the total of all taxes owing does not exceed \$1,000. The Budget proposes to increase this threshold amount to \$3,000 for corporate tax years commencing after 2007.

The Budget also proposes the tax remittance installment schedule for small Canadian-controlled private corporations be changed from monthly to quarterly.

## **6. Provincial Capital Taxes**

As an incentive to encourage the provinces to eliminate capital taxes in an expeditious manner, the Budget proposes a temporary financial incentive. In order to be eligible, a province must eliminate its existing general capital tax by 2011 and, in the case of capital tax imposed on financial institutions, the province must either eliminate such tax or restructure it so that it operates as a minimum tax as is currently the case under federal legislation. Provinces successfully achieving such

goal will receive a federal incentive equal to the federal corporate income tax revenue gain from qualifying provincial capital tax reductions.

## 7. T3 Slips

The Government intends to release draft regulations in the near future to create a "more efficient process" for the issuance of T3 slips for 2007, while balancing the interests of both investors and trust administrators. The existing T3 deadline for most mutual funds and income trusts is at or near the end of March. However, from an investor perspective, they are not receiving their T3 slips until about a month after receiving their T5 and other tax slips. From a trust administrator perspective, the extra time is needed to compute the trust's income and prepare the trust's tax return.

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## INTERNATIONAL TAX MEASURES

### 1. Canada-U.S. Tax Treaty: Elimination of Withholding Tax on Interest

Under the Income Tax Act, subject to certain exceptions, payments of interest made by a resident of Canada to a non-resident of Canada are subject to 25% withholding tax. Such withholding tax rate can be reduced by bilateral tax treaties. In the case of the Canada-U.S. Treaty, the rate is reduced to 10%. In the 2007 Budget, it is disclosed that Canada and the United States have agreed in principle to eliminate withholding tax on interest so that cross-border interest payments will no longer be subject to withholding tax in the payor jurisdiction.

Notably, any such changes require approval of both the Canadian and U.S. government by official adoption of the proposals into domestic law. Moreover, the proposals provide for different implementation timelines depending on whether the debt is between arm's length or non-arm's length persons. In respect of interest paid between arm's length persons, withholding tax will be eliminated in the first calendar year beginning the year after both countries have formally adopted the treaty changes into domestic law. For example, if both the Canadian and the U.S. governments legally adopt the changes into domestic law in 2007, the elimination of withholding tax on interest paid in an arm's length context will be effective in 2008. For non-arm's length party interest payments, elimination of withholding tax will be phased in over three years as follows: (i) in the first year following Canada and the U.S. legally adopting the treaty changes into domestic law, the withholding tax rate will be reduced from 10% to 7%; (ii) in the second year following Canada and the U.S. legally adopting the treaty changes into domestic law, the withholding tax rate will be reduced from 7% to 4%; and (iii) in the third year following Canada and the U.S. legally adopting the treaty changes into domestic law, the withholding tax rate will be reduced from 4% to 0%.

Significantly, the 2007 Budget also proposes that once the exemption from withholding tax on interest is fully phased in the context of Canada and the U.S.,



Canadian withholding tax will be unilaterally eliminated on interest paid to all arm's length non-residents, regardless of their country of residence.

## 2. International Tax Fairness Initiative

In response to concerns that Canadian residents were financing the activities of foreign affiliates by way of debt, the Budget proposes eliminating the deductibility of interest paid on debt used to finance a foreign affiliate. This will be effective for interest paid after 2007 on new debt incurred after March 19, 2007 for a period that begins after 2007. Existing non-arm's length debt will be grandfathered until 2008. Existing arm's length debt will be grandfathered until 2009.

Certain passive income earned by a foreign affiliate is taxable in the hands of the Canadian parent company. The Budget proposes narrowing the exemptions to these rules to require as a prerequisite that income be earned in either a country with which Canada has entered into either a tax treaty or a comprehensive tax information exchange agreement (TIEA). Note that countries will be grandfathered for these purposes where negotiations for a TIEA have commenced prior to March 19, 2007 and are concluded prior to 2014.

Where TIEA negotiations begin after March 19, 2007, the proposals will apply if those negotiations are not successfully completed after the passage of five years from the earlier of the commencement of TIEA negotiations and the date on which Canada proposed the negotiations.

Further, a minimum 10% economic interest must be held in the foreign affiliate in order for the exemptions to apply.

On a positive note, the Budget proposes expanding the scope of income, which can be repatriated to Canada as exempt surplus without the imposition of Canadian tax. Currently, only active business income earned in treaty countries can be so repatriated. It is now proposed that repatriated income also be exempt from Canadian tax if it is earned in a TIEA country.

## 3. Prescribed Stock Exchanges

The *Income Tax Act* (Canada) (the Act) currently utilizes the concept of "prescribed stock exchange" for a number of purposes, including whether an investment is qualified to be held within a registered plan, whether a security can be the subject of a securities lending arrangement and whether an investment will give rise to tax under the proposed foreign investment entity (FIE) rules. The Budget proposes segregating prescribed stock exchanges into three distinct categories.

The first category, to be used in determining whether a security can be the subject of a securities lending arrangement, is that of a "stock exchange". As the general legal and commercial meaning of this term is to be used, this should expand considerably the types of securities eligible for securities lending.



The second category, which is to be used for most purposes including determining whether an investment is qualified to be held within a registered plan, and determining the applicability of the FIE rules, is that of a “designated stock exchange”. This will include all exchanges currently prescribed, as well as those subsequently designated by the Minister of Finance by way of public notice.

The final category, “recognized stock exchange”, is to be used in determining whether tax must be withheld on the sale of an asset to a non-resident of Canada.

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