

# 2006 Budget Brief

Finance Minister Jim Flaherty tabled his first Federal Budget on Tuesday, May 2, 2006. The new Conservative government, under Prime Minister Stephen Harper, announced spending initiatives in addition to a number of tax amendments, including substantial changes to personal tax credits, a reduction in GST and a reduction in corporate tax rates.

In terms of tax changes, some of the most significant measures include the following:

- Reducing the GST by 1% to 6%;
- An increase in the small business deduction limit;
- Reducing corporate tax rates; and
- Increasing personal tax credits and announcing a modest increase in the lowest personal tax rate.

## CORPORATE AND BUSINESS MEASURES

### *Small Business Deduction*

The small business deduction limit, which represents a lower tax rate for active business earned in Canada by a Canadian Controlled Private Corporation (“CCPC”), will be increased from \$300,000 to \$400,000. The limit will be increased as of January 1, 2007 to \$400,000 and prorated where the taxation year of the corporation does not coincide with the calendar year.

There will continue to be a requirement to allocate the small business limit among associated corporations and access to the small business deduction will continue to be phased out, on a straight-line basis, for CCPC’s having between \$10 million and \$15 million of taxable capital employed in Canada.

### *Small Business Tax Rate*

The federal small business tax rate, the income tax rate applied on active business income earned by a CCPC below the small business deduction limit, will be reduced. The following table reflects the current rate and the proposed changes:

	2006	2007	2008	2009
Small business limit	\$300,000	\$400,000	\$400,000	\$400,000
Small business tax rate	12.00%	12.00%	11.50%	11.00%
Surtax	1.12%	1.12%	0.00%	0.00%
Alberta tax rate	3.00%	3.00%	3.00%	3.00%
Total combined rate	16.12%	16.12%	14.50%	14.00%

The rate reductions will be prorated where the taxation year does not coincide with the calendar year.

### *General Corporate Income Tax Rate*

The current general corporate income tax rate is 21%. The budget proposes to reduce the rate to 20.5% effective January 1, 2008, 20% January 1, 2009 and 19% effective January 1, 2010. These rate reductions will only apply to income that is taxed at the general corporate tax rate and will not apply to small business income eligible for the small business deduction and investment income of a CCPC.

The rate reductions will be prorated for taxation years that include any of the effective dates for a rate reduction.

### ***Corporate Surtax***

Corporate surtax, which is effectively an additional 1.12% tax, will be fully eliminated for all corporations effective January 1, 2008 (prorated for taxation years that include that date).

The reduction in the general corporate tax rate and the corporate surtax is outlined in the table below:

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
General Corporate income tax rate	21.00%	21.00%	20.50%	20.00%	19.00%
Corporate Surtax	1.12%	1.12%	0.00%	0.00%	0.00%
Alberta tax rate	10.40%	10.00%	10.00%	10.00%	10.00%
Total combined rate	32.52%	32.12%	30.50%	30.00%	29.00%

### ***Federal Capital Tax***

Federal capital tax is currently levied at a rate of 0.125% of taxable capital in excess of \$50 million. Legislation had previously been proposed to fully eliminate the capital tax in 2008. The current budget proposes to eliminate the capital tax as of January 1, 2006 and will be prorated for taxation years that do not coincide with the calendar year.

### ***Non-capital losses and Investment Tax Credits***

The budget proposes to extend the carry-forward period for non-capital losses from the current 10 years to 20 years. This measure will apply to losses that arise in taxation years that end after 2005. Losses that were incurred for taxation years ending after March 22, 2004 and before 2006 may be carried forward 10 years. For losses incurred in taxation years ending before March 23, 2004 the carry-forward period remains at 7 years.

Similar measures will apply to Investment Tax Credits earned in taxation years that end after 2005 to extend the carry-forward period to 20 years.

### ***Capital Cost Allowance for Tools***

Currently tools that cost less than \$200 are eligible for a 100% CCA rate. Tools that cost more than \$200 are eligible for a 20% rate.

The budget increases the cost limit for access to the 100% CCA rate to \$500 for tools purchased on or after May 2, 2006.

### ***Apprenticeship Job Creation Tax Credit***

This will provide a non-refundable tax credit to eligible employers equal to 10% of salaries and wages paid after May 2, 2006 to qualifying apprentices. A maximum credit of \$2,000 per year per apprentice is available.

Unused credits may be carried back 3 years and forward 20 years to reduce federal income taxes payable in those years.

### ***Large Corporation Dividends***

The budget confirms an earlier announcement to provide for an enhanced tax credit on dividends from large corporations. It was meant to achieve a more balanced tax treatment between corporations and income trusts.

In Canada, corporate income is subject to corporate income tax and on distribution as dividends to individuals, personal income tax. This results in corporate income that was subject to tax at the general corporate rate, and where it was not eligible for the small business deduction, a combined tax rate (personal and corporate) in excess of the tax rate on trust income distributions.

In order to rectify this inequity the budget confirms the decrease in the overall federal tax rate on qualifying dividends by increasing both the dividend gross-up and the dividend tax credit. It should be noted that for the inequity that income trusts currently have to be fully resolved the provincial taxation of qualifying dividends must also be amended.

This measure applies to eligible dividends paid after 2005.

## **PERSONAL INCOME TAX MEASURES**

### ***Personal Income Tax Rates***

The lowest personal income tax rate was reduced to 15% from 16% effective January 1, 2005. The rate will be increased to 15.5% effective July 1, 2006. Accordingly, the full-year rate for 2005 will be 15%, for 2006, 15.25% and for the 2007 and subsequent taxation years, 15.5%.

For the 2005 taxation year the 15% rate applied to taxable income of up to \$35,595. For the 2006 taxation year the 15.25% rate will apply to taxable income of up to \$36,378.

The upper limit for the application of the 15.5% 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 at the same time as the GST rate is reduced. (See our comments below regarding the reduction in the GST rate). For the purpose of calculating personal income taxes for the 2006 taxation year, these two half-year amounts will be applied as an annual average of \$8,839. For the 2007 and 2008 taxation years, the basic personal amount will be increased by inflation, plus an additional amount of \$100 and \$200 respectively. For 2009, it will be increased by indexation plus the greater of \$600 and the amount required to raise the basic personal amount to \$10,000.

Personal amounts in respect of a spouse or common-law partner or wholly dependant relative will also be adjusted.

### ***Canada Employment Credit***

The budget proposes to introduce a new Canada Employment Credit in recognition of work-related expenses incurred by employees.

The 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 will be calculated by reference to the lowest personal income tax rate for the taxation year (i.e. 15.25% for 2006 and 15.5% for 2007 and subsequent taxation years). The amount on which the credit is based will be indexed after 2007.

### ***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.

Amounts received under the UCCB will be taxable in the hands of the lower-income spouse or common-law partner. However, amounts received under the UCCB will not be taken into account for the purposes of calculating income-tested benefits delivered through the income tax system. In addition, the UCCB will not reduce Old Age Security or Employment Insurance benefits, and will not reduce the amount of expenses claimable under the child care expense deduction.

Amendments will be made to the structure of the Canada Child Tax Benefit ("CCTB") to reflect the introduction of the UCCB. Currently, the CCTB has 3 components: the CCTB base benefit, the National Child Benefit supplement, and the Child Disability Benefit. The CCTB base benefit is enhanced for children under the age of 7 years. With the introduction of the UCCB, the CCTB enhancement to the base benefit will be eliminated, generally as of July 1, 2006. However, in respect of children who attain the age of 6 years on or before June 30, 2007, the enhancement will remain in place for those months before July 2007 for which no UCCB is receivable.

### ***Mineral Exploration Tax Credit for Flow-Through Share Investors***

To promote exploration and help moderate the impact of the downturn on mining communities, a temporary mineral exploration tax credit for investors in flow-through shares was introduced effective October 2000. The temporary tax credit was a benefit available to individuals investing in flow-through shares, equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors. Under the existing rules, the credit expired for flow-through share agreements entered into after December 31, 2005. Under a special “look-back” rule, expenses in respect of flow-through share agreements entered into in 2005 can be incurred up to the end of 2006 and still be eligible for the credit for 2005.

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. Under the “look-back” rule, funds raised with the benefit of the credit in 2007, for example, can be spent on eligible exploration up to the end of 2008.

### ***Tradespeople’s Tool Expenses***

To provide tax recognition for tradespeople who must provide their own tools as a condition of employment, 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 the 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, and will apply to new tools acquired on or after May 2, 2006.

### ***Textbook Tax Credit***

The budget proposes to introduce a non-refundable textbook tax credit, which will be calculated by reference to the lowest personal income tax rate for the taxation year (i.e. 15.25% for 2006 and 15.5% for 2007 and subsequent taxation years). 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***

Currently, the first \$3,000 of scholarship, fellowship or bursary income received by a taxpayer in a taxation year with respect to post-secondary education or occupational training is not taxable. The budget proposes to fully exempt such 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.

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 16 years in an eligible program of physical activity.

Eligible expenses will include those for the operation and administration of the program, instruction, renting facilities, equipment used in common (eg. team jersey), referees, and judges.

To ensure that the same expenses are not claimed under both the children’s fitness tax credit and the child care expense deduction, an individual will not be allowed to make a claim for a children’s fitness tax credit in respect of amounts for which any person has made a claim under the child care expense deduction.

This 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.

### ***Pension Income Credit***

The budget proposes to increase to \$2,000 from \$1,000, the maximum amount of eligible pension income that can be used in calculating the pension income tax credit.

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

### ***Child's Disability Benefit***

The budget proposes two changes to the Child Disability Benefit ("CDB"). First, the budget proposes to increase the maximum annual CDB to \$2,300 from \$2,044, starting in July 2006. The benefit will be indexed for inflation thereafter.

Second, the budget proposes to extend the CDB to more families by reducing the rates at which the CDB is reduced as family income rises.

### ***Refundable Medical Expense Supplement ( for low and modest income earners)***

The budget proposes to increase the maximum amount of the refundable medical expense supplement ("RMES") to \$1,000 from \$767 for the 2006 taxation year. This amount will be indexed for inflation thereafter.

### ***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. The credit for a taxation year will be calculated by reference to the lowest personal income tax rate for the taxation year. It will be claimable by the individual 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. Public transit will include transit by local bus, streetcar, subway, commuter train, commuter bus and local ferry.

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***

Since 1997, donations of publicly-listed securities to charitable organizations and public foundations have been eligible for tax assistance as the capital gain that has accrued on the securities is included in income at only ½ the standard capital gains inclusion rate. Currently, the standard capital gains inclusion rate is 50%, and therefore the inclusion rate for charitable donations of publicly-listed securities is 25%. The budget proposes to reduce the capital gains inclusion rate for such donations to zero.

Since 2000, an individual who makes a qualifying donation of listed publicly-traded securities that were acquired with employee stock options has also been eligible for a special deduction that has the effect of taxing the associated employment benefit at the reduced capital gains inclusion rate. The budget also proposes to reduce the effective inclusion rate for such donations to zero.

These measures 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.

### ***Capital Gains of Fishers***

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 as well as extending the \$500,000 capital gains exemption to such property.

### **GST**

The budget proposes to reduce the GST from 7% to 6%, effective July 1, 2006.

### ***Transitional Rules***

If GST becomes payable, or is paid without having become payable, before July 1, 2006, the 7% rate will apply. If GST becomes payable on or after July 1, 2006, without having been paid before that day, the 6% rate will apply. If GST is paid on or after July 1, 2006, without having become payable before that day, the 6% rate will apply.

### ***Sales of Real Property***

The new 6% rate will apply to a 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 the property under the agreement, are transferred to the buyer on or after July 1, 2006.

The 7% rate will apply to a sale of real property if ownership of the property, or possession of the property under the agreement of purchase and sale, is transferred to the buyer before July 1, 2006. The 7% rate will apply to sales of houses, apartment buildings, and other residential complexes, made pursuant to a written agreement entered into on or before May 2, 2006, even if ownership and possession of the real property are both transferred on or after July 1, 2006.

### ***Imported Goods***

The 6% rate will apply to goods that are either imported on or after July 1, 2006, or released from Customs' control on or after July 1, 2006.

### ***Taxable Benefits; Passenger Vehicles; and Employee/Partner Rebates***

In certain circumstances, the GST to be remitted, the input tax credit, or the GST rebate is calculated in reference to a calendar year or a person's taxation year. In these cases, the GST to be remitted, the input tax credit, or the GST rebate is calculated by multiplying the amount determined for income tax purposes by a certain factor specified in the Excise Tax Act or a certain rate prescribed in the GST regulations. These factors and rates will be adjusted to reflect the July 1, 2006 GST rate reduction. For example, prior to the budget, the prescribed rate for calculating the GST on the automobile operating expense benefit was 5%, the budget proposes to reduce this rate to 4.5% for the 2006 taxation year, and to 4% thereafter.

### ***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% 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 percentage of 36%, and the lower and upper phase-out thresholds of \$350,000 and \$450,000 respectively, will not change. However the budget proposes to reduce the maximum dollar value of the rebate from \$8,750 to \$7,560 (\$350,000 multiplied by the new 6% GST rate multiplied by the rebate percentage of 36% is equal to \$7,560).

The maximum dollar amount will also be adjusted for other similarly structured housing rebate provisions in the Excise Tax Act, such as the New Residential Rental Property Rebate.

### ***Public Service Bodies***

The existing rebate percentages used to calculate rebates of the otherwise unrecoverable GST claimed by charities, qualifying non-profit organizations, and selected public service bodies (including municipalities, universities, public colleges, school, and hospitals) will not change.

***Quick Method of Accounting for GST***

The budget proposes to reduce the remittance rate for the Quick Method from 5% to 4.3%. The proposed 4.3% rate will apply to reporting periods that begin on or after July 1, 2006. For reporting period that straddle July 1, 2006, the 5% rate will apply to consideration that becomes due, or is paid without having become due, before July 1, 2006, and the 4.3% rate will apply to the remaining consideration.

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