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KNV TAX MEMO

FEDERAL BUDGET 2008

The 2008 Federal Budget was a respite from the myriad of significant tax changes proposed in the last several budgets. Most of the proposed tax changes are merely refinements of existing rules. Some of the more significant changes are discussed below.

PERSONAL TAX CHANGES

TAX-FREE SAVINGS ACCOUNT

The budget proposes that starting in 2009, all Canadian residents 18 years of age and older will be able to save up to \$5,000 per year in a Tax Free Savings Account ("TFSA"). Contributions to a TFSA are not deductible. However, the investment income earned within the account will be tax-free. Withdrawals will also be tax free and unused contribution room can be carried forward to future years. A penalty tax will apply to overcontributions.

Funds withdrawn from a TFSA can be withdrawn at any time, for any purpose, and can be recontributed to the TFSA at a later date without the loss of contribution room. In other words, the TFSA is designed to be a flexible savings account to allow taxpayers to save for significant cash commitments such as weddings and home renovations.

Contributions to a spouse's TFSA will be allowed and TFSA assets will be transferable to a spouse upon death. Income within the TFSA will not affect eligibility for federal income-tested benefits and credits. Certain restrictions on the investments that may be held within a TFSA will apply.

SAVING FOR EDUCATION

For 2008 and subsequent tax years, Budget 2008 proposes to extend both the contribution periods allowed in respect of RESPs and the maximum lifespan of a RESP by an additional 10 years to increase the flexibility of the program.

Furthermore, under the proposed rules, student beneficiaries of RESPs may receive educational assistance payments for an additional six month grace period subsequent to ceasing to be enrolled in a qualifying post-secondary program.

DIVIDEND TAX CREDITS

The dividend gross-up factor and the dividend tax credit will be adjusted slightly to reflect the recent changes in corporate income tax rates and thus maintain the equilibrium between personal, corporate, and dividend tax rates. The effective personal tax rate after the dividend gross-up and tax credit mechanism will rise slightly to offset the previously announced decreases in corporate tax rates.

OTHER CHANGES

- Medical expenses eligible for the Medical Expense Tax Credit will be broadened slightly to include expenses incurred after February 26, 2008 in respect of certain new technologies such as altered auditory feedback devices and electrotherapy devices.
- The Northern Residents Deduction will be increased 10% to \$16.50 per day (or \$8.25 per day for residents of the Intermediate zone) for the 2008 and subsequent taxation years
- Slight changes to the rules governing Registered Disability Savings Plans (RDSPs) will ensure that mandatory collapses of RDSPs will only occur in situations where the beneficiary's condition has improved to the point where the beneficiary no longer qualifies for the Disability Tax Credit. This measure will be effective for the 2008 and subsequent taxation years.
- Budget 2008 proposes to extend by one year the eligibility for the Mineral Exploration Tax Credit to flow-through share agreements entered into before April 1, 2009.

BUSINESS TAX CHANGES**TAX COMPLIANCE**

The budget proposes to make permanent a graduated penalty system for late payroll remittances ranging from 3% to 10%, depending on the lateness of the remittance of source deductions due after February 25, 2008. Further, after February 25, 2008, a remittance that is received by the Canada Revenue Agency ("CRA") at least one full day before the due date will be considered in compliance with a requirement that it be remitted to a financial institution. Finally, legislation will be developed to broaden the scope of the sharing of business number (BN) related information.

CAPITAL COST ALLOWANCE ("CCA")

The budget proposes to extend the accelerated CCA treatment for manufacturing and processing equipment for three additional years. Eligible assets acquired in 2009 will use a 50% straight-line rate. Eligible assets acquired in 2010 will be eligible for a 50% declining balance rate in the first year, 40% the following year, and 30% thereafter. Eligible assets acquired in 2011 will be eligible for a 40% declining balance rate in the first year and 30% thereafter. The half-year CCA rule will apply.

INVESTMENT TAX CREDIT ("ITC")

The budget proposed to increase the expenditure limit for the enhanced ITC rate of 35% on qualified scientific research and experimental development ("SR&ED") expenditures to \$3 million. As well, the upper limits of the taxable income and capital phase-out ranges will be increased to \$700,000 and \$50 million respectively. The proposed increases will apply for taxation years that end on or after February 26, 2008, prorated based on the number of days in the taxation year after February 25, 2008.

The budget also proposes that permissible salary and wages in respect of Canadian-resident employees carrying on qualified SR&ED activities outside Canada to support SR&ED carried on in Canada will generally qualify for ITCs to a maximum of 10% of the total salary and wages directly attributable to SR&ED carried on in Canada during the year. This measure is proposed to apply to salary or wages incurred after February 25, 2008, with the 10% limit prorated based on the number of days in the taxation year after February 25, 2008.

Finally, the budget proposes that the CRA will conduct a review of its SR&ED policies and procedures to ensure that they are aligned with current business practices and applied consistently. The CRA will also introduce a new claim form, guide, and eligibility self-assessment tool.

NON RESIDENT DISPOSITION OF TAXABLE CANADIAN PROPERTY (“TCP”)

The budget proposes to simplify the rules that apply to non-resident dispositions of TCP, beginning in 2009. Specifically, treaty-protected property will be exempt from withholding requirements and non-residents will be exempt from filing Canadian income tax returns where the following conditions are met:

- no tax is payable for the year;
- the non-resident has no outstanding balances (other than amounts for which appropriate security has been posted); and
- either the TCP disposed of is “excluded property” (which includes treaty-protected property) or a 116 certificate has been received.

GST CHANGES

Budget 2008 proposes to make the following changes in respect of the Goods and Services Tax:

- Drugs prescribed by health professionals who are not medical practitioners, such as nurses and midwives, will be zero-rated to the final consumer (i.e. subject to 0% GST) after February 26, 2008.
- The exemptions for basic health and education services will be expanded to include training that is specially designed to assist individuals to cope with a disability or disorder (subject to certain conditions). This will, for example, allow children with autism spectrum disorder to receive a broader range of behavioural and social training free of GST. These expanded exemptions will apply for training subsequent to February 26, 2008.
- The services of health professionals provided after February 26, 2008 will be exempt from GST regardless of whether the services are provided directly or through a corporation.
- The list of medical and assistive devices that are zero-rated will be expanded.

Further details on the 2008 Federal Budget are available on the Department of Finance’s Website at <http://www.budget.gc.ca/2008/home-accueil-eng.htm> or contact your KNV advisor.

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