



CHARTERED ACCOUNTANTS

MARCH 19, 2007

KNV TAX MEMO

FEDERAL BUDGET 2007

Budget 2007 was tabled today by federal finance minister Jim Flaherty. This budget reflects a continuing recent trend of targeting tax relief to specific groups such as low income taxpayers and taxpayers with disabilities. There were a few items of significance to small business owners however; the following is an outline of the most important changes that may affect KNV and its clients.

PERSONAL TAX CHANGES

WORKING INCOME TAX BENEFIT

A common concern for Canadians on social assistance is that they may be worse off by working, as a result of benefits being lost or reduced as a result of other sources of income. The Budget proposes to introduce a working income tax benefit ("WITB") which is an annual refundable tax credit of 20% of earned income (business and employment) in excess of \$3,000 to a maximum of \$500 (single) and \$1,000 (family). The credit is reduced by 15% of net family income in excess of \$9,500 (single) and \$14,500 (family). This benefit is to be available starting in 2007 and will apply to individuals resident in Canada throughout the year and at least 19 years old at the end of the year.

A supplement is to be provided for individuals who are eligible for the disability tax credit and earn at least \$1,750 of earned income. The supplement will be 20% of earned income over the \$1,750 threshold to a maximum of \$250, reduced by 15% of family net income in excess of \$12,833 (single) and \$21,167 (family).

Similar to the child tax benefit program, the WITB will be prepaid starting in 2008.

LIFETIME CAPITAL GAINS EXEMPTION

The lifetime capital gains exemption (which is currently available for disposals of small business shares or qualifying farm or fishing properties) is to be increased from \$500,000 to \$750,000 for qualifying disposals on or after March 19, 2007. It appears that individuals who may have previously fully utilized their capital gains exemption will be able to claim the additional exemption on new dispositions.

REGISTERED DISABILITY SAVINGS PLANS ("RDSP")

The budget proposes to introduce the RDSP to assist parents and others save for children with disabilities. The RDSP will be modelled after the existing Registered Education Savings Plan ("RESP" program) in that

- Contributions will not be deductible and will be tax free on withdrawal
- Investment earnings will be taxable when withdrawn
- Matching annual grants will be provided based on family net income - 300% of the first \$500 and 200% of the next \$1,000 will be paid to families with net incomes up to \$74,357. If family income exceeds that threshold, the grant will be 100% on the first \$1,000 contributed.

- Lifetime contributions will be limited to \$200,000 for each disabled person (no annual limit) up to age 59. The lifetime limit on grants will be \$70,000
- A further amount up to \$1,000 per year will be paid to affected families with incomes lower than \$37,178

SAVING FOR EDUCATION

Benefits available via the existing Registered Education Savings Plan (“RESP”) program are to be enhanced as follows:

- The annual RESP limit of \$4,000 per beneficiary is to be eliminated; the lifetime limit is to be increased from \$42,000 to \$50,000.
- The annual contribution qualifying for the 20% Canada Education Savings Grant is to be increased from \$2,000 to \$2,500, increasing the annual maximum grant from \$400 to \$500 per beneficiary.
- It will now be possible for part-time students to receive education assistance payments from RESP’s if they have coursework requiring at least 12 hours per month.

These changes will apply after 2006.

An unrelated change will fully tax exempt scholarships and bursaries received to attend elementary and secondary schools starting in 2007.

OTHER CHANGES

- Starting in 2007, the spousal and related credits will be increased to the same level as the basic personal tax credit.
- Also starting in 2007, the recently introduced tax credit for transit pass users will apply to weekly passes used on an ongoing basis and certain “electronic payment” cards.
- A new \$2,000 non-refundable child tax credit is to be introduced to provide tax relief up to \$310 for each child under age 18. This change also commences in 2007.
- The age for mandatory conversions of RRSP’s to RRIF’s is to be increased for 2007 and subsequent years to 71 from 69 years of age.
- The budget proposes to eliminate the tax on capital gains from the donation of publicly-traded securities to private foundations after March 18, 2007. This treatment will give private foundations the same treatment as is currently available for donations of publicly-traded securities to other types of charities.

BUSINESS TAX CHANGES

CAPITAL COST ALLOWANCE (“CCA”)

CCA rates for certain types of assets are to be increased as follows:

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| - General Non-Residential Buildings | - | from 4% to 6% per annum |
| - Buildings used in manufacturing or processing | - | from 4% to 10% per annum |
| - Computer Equipment | - | from 45% to 55% per annum |

These enhanced allowances will generally apply for acquisitions on or after March 19, 2007.

A temporary increase in the CCA rate for manufacturing and processing equipment from 30% (declining balance) to 50% (straight line) is to apply for acquisitions during the period March 19, 2007 to December 31, 2008.

TRUCK DRIVER MEAL EXPENSES

The budget proposes to allow long haul truck drivers to deduct 80% (instead of the normal 50%) of food and beverages consumed during periods of eligible travel. This increased limit will also apply to employers that pay or reimburse these costs incurred by their employees. This increase is to be phased in over a four-year period as follows:

- 60% limit – 2007 (after March 18)
- 65% limit – 2008
- 70% limit – 2009
- 75% limit – 2010
- 80% limit – after 2010

Generally, qualifying travel will be over 24 hours in duration and at least 160 km away.

INVESTMENT TAX CREDIT (“ITC”) – CHILD CARE SPACES

The budget proposes to allow an ITC to encourage businesses (other than child-care businesses) to create licensed child-care spaces for their employees. The credit will be 25% of eligible expenditures to a maximum of \$10,000 per space created, and will apply for taxation years ending on or after March 19, 2007.

CANADA-US INTEREST PAYMENTS

Currently, a 10% withholding tax applies on interest payments from the US to Canada and vice versa. The budget announces a proposal to eliminate this 10% tax for “arms length” interest payments once the appropriate changes to the Canada-US Tax Treaty are finalized. For non-arms-length payments, the withholding tax will be reduced from 10% to 7%, 4% and 0% over a three-year period.

This change should make the structuring of cross border financing arrangements significantly easier for KNV clients with cross border operations.

INTERNATIONAL TAX FAIRNESS INITIATIVE

Numerous technical changes are proposed in the international context. Amongst these changes is a proposal to eliminate the deductibility of interest incurred on debt to finance foreign affiliates. The new rules will apply to debts incurred on or after March 19, 2007.

Further details on the 2007 Federal Budget are available on the Department of Finance’s Website at <http://www.fin.gc.ca/fin-eng.html> or contact your KNV advisor.

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