



CHARTERED ACCOUNTANTS

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KNV TAX MEMO

FEDERAL BUDGET 2006

Stephen Harper's Conservative government today released its first budget, and as expected significant tax relief is being proposed. In addition to the expected 1% reduction to the GST tax rate, numerous other corporate and personal tax measures have been proposed, many of which will provide relief to overburdened Canadian taxpayers. The following is a summary of the more important personal, corporate and GST changes proposed in the 2006 federal budget.

GST REDUCTION

Effective July 1, 2006, the GST rate is to decrease by 1% to 6%. Numerous transitional rules are proposed that will determine the GST rate that will apply to transactions that straddle the July 1 implementation date. Certain anti-avoidance rules are also proposed to prevent inappropriate tax savings where non-arms length transactions are undertaken in order to benefit from the rate reduction and other than for commercial purposes.

PERSONAL INCOME TAX CHANGES

PERSONAL TAX RATES

The budget confirms the previously-announced reduction in the lowest personal federal tax bracket to 15% for 2005, with the rate increasing in 2006 to 15.25% and remaining at 15.5% for 2007 and subsequent years. These new rates will also apply for purposes of calculating the various personal federal tax credits.

BASIC PERSONAL AMOUNT

The basic personal amount, the amount that an individual can earn without paying federal personal income tax is confirmed at \$8,648 for 2005, \$8,839 for 2006 and is to increase thereafter until it reaches the \$10,000 level by 2009. Personal amounts for dependent spouses, common law partners or wholly-dependent relatives are also to be gradually increased, to \$7,505 for 2006 and rising to \$8,500 by 2009.

CANADA EMPLOYMENT CREDIT

In recognition of the fact that employees may incur expenses relating to the earning of their income from employment that are not currently deductible under the Income Tax Act, it is proposed to allow employees to obtain tax relief on the lesser of \$500 and the individual's employment income for the year. This credit would take effect July 1, 2006 so that the credit for 2006 will be applicable to employment income up to \$250, but the ceiling will rise to a maximum of \$1,000 in 2007 (at which time the value of the credit in terms of tax reduction will amount to a maximum of \$155 per taxpayer) and will be indexed to inflation thereafter.

UNIVERSAL CHILD CARE BENEFIT

The Conservative pledge to offer cash assistance for child care for children under 6 is contained in their proposal to institute a Universal Child Care Benefit of \$100 per month per child commencing July 2006.

These payments will be taxable to the lower income spouse but will not be considered in calculating other income tested benefits (such as the Canada Child Tax Benefit, which is to be modified to reflect the introduction of this new credit).

ASSISTANCE FOR STUDENTS

Currently the Income Tax Act exempts post secondary or occupational training scholarships and bursaries from tax, to a limit of \$3,000 per year. This budget proposes to eliminate this limit such that such income will be fully tax exempt for 2006 and subsequent years. Furthermore, a new tax credit for textbooks is introduced for 2007 and later years, calculated as \$65 for each month of fulltime studies and \$20 for each month of part-time studies.

CHILDREN'S FITNESS TAX CREDIT

The budget proposes that, commencing in 2007, parents will be eligible to claim a non-refundable tax credit (at the lowest personal tax bracket rate of 15.5%) in respect of up to \$500 of eligible fees for the enrollment of a child under age 16 in an eligible program of physical activity. Consultations are to be undertaken to determine the types of eligible activities that will qualify for the credit. Supporting tax receipts will be required, and any amounts claimed as child care expense deductions will not be eligible for the credit.

PENSION INCOME CREDIT

Starting in 2006 the amount of eligible income qualifying for the non-refundable pension tax credit is to be increased from \$1,000 per year to \$2,000 per year.

ENHANCED CHILD DISABILITY BENEFIT

Currently, lower income families receive financial assistance for disabled children through the Canada Child Tax Benefit program. Starting in July 2006 the maximum credit for a disabled child is to be increased from \$2,044 to \$2,300 and the benefit is to be extended to more families by significantly reducing the rates at which the benefit is reduced as family income rises.

TAX CREDIT FOR PUBLIC TRANSIT PASSES

Starting on July 1, 2006, purchasers of public transit passes (monthly or longer) will be eligible for a non-refundable tax credit for the cost of their passes. The credit will be calculated based on the lowest personal tax rate, so that in 2006 the value of this credit will be 15.25% of the cost of eligible transit passes purchased. The credit can be claimed for passes purchased by the individual, his or her spouse or common law partner or their dependent children under 19.

DONATIONS OF PUBLICLY TRADED SECURITIES TO PUBLIC CHARITIES

Currently, capital gains inclusion rates on gifts of publicly traded securities are 25% of the amount of the gain. To further encourage charitable giving, gains on such gifts will now be subject to a zero inclusion rate. The full amount of the donation will still give rise to applicable donation tax credits, making this a further significant

incentive to donate shares to charities. Likewise, gains on donations of ecologically sensitive lands donated to a conservation charity will also be subject to a zero inclusion rate.

PERSONAL TAXATION OF DIVIDENDS

The budget reaffirmed the government's intention to carry through the previous Liberal administration's intention to enhance the dividend gross up and tax credit applicable to dividends received from Canadian resident public corporations and non-Canadian Controlled Private Corporations (CCPC's) that are resident in Canada and subject to the general corporate tax rate. This special dividend mechanism will also apply to dividends paid by CCPC's to the extent that their income is subject to tax at the general corporate income tax rate.

Dividends paid under the new regime will be grossed up by 45%, and the federal dividend tax credit will be 19% of the grossed-up amount. It is expected that this will reduce the tax cost of such dividends received by a BC taxpayer in the top tax bracket from 31.6% to about 21%. BC's 2006 provincial budget previously confirmed that they intend to provide similar relief for BC tax purposes.

It is proposed that this measure will apply to dividends paid after 2005, however it is still unclear how the rules will be applied to dividends received from corporations where the corporation has had its retained earnings subject to corporate tax partially at the general corporate tax rate and partially at the small business tax rate. The manner in which the final legislation is drafted will have a significant impact on future remuneration strategies of owner-managed businesses in BC.

BUSINESS INCOME TAX CHANGES

CORPORATE TAX RATES

The general federal corporate tax rates are to be gradually reduced by 2% (to 19%) by 2010 and the existing corporate surtax is to be eliminated by January 1, 2008. Furthermore, the small business tax rate is to be reduced by 1% over the same time period and the amount of income eligible for that lower rate is to be increased to \$400,000 per annum (from its current \$300,000 level). Tax rates payable by a Canadian Controlled Private Corporation carrying on an active business in BC will now be as follows:

	Current	Proposed			
	Rate	2007	2008	2009	2010
Income up to \$300,000 (\$400,000 – after 2006)	17.62	17.62	16.0	15.5	15.5
Income in excess of \$300,000 (\$400,000 – after 2006)	34.12	34.12	32.5	32.0	31.0

FEDERAL CAPITAL TAX

The federal capital tax (already phased out for most KNV clients) which was originally slated to be repealed in 2008 is now to be eliminated effective January 1, 2006.

INVESTMENT TAX CREDIT AND NON-CAPITAL LOSS CARRYOVER PERIODS

The carryforward period for claiming unused investment tax credits and non-capital losses is to be extended to 20 years (from the current 10 years) for credits and losses arising in tax years ending after 2005.

APPRENTICESHIP JOB CREATION TAX CREDIT

Eligible employers who employ apprentices in eligible trades will be provided with a non-refundable tax credit equal to 10% of salaries and wages paid to a maximum of \$20,000 per year (i.e., a maximum \$2,000 per year credit per apprentice). Qualifying trades are to be prescribed but will include the 45 Red Seal trades currently recognized throughout Canada. Unused credits will have 3-year carryback and 20 year carryforward provisions and will be generated on wages paid to qualifying apprentices on or after May 2, 2006.

CAPITAL COST ALLOWANCE – TOOLS

Currently, tools, kitchen utensils, and medical and dental instruments that cost less than \$200 are eligible for a 100% capital cost allowance rate. Such assets costing in excess of that limit must be depreciated at a rate of 20% per year. This threshold is to be increased to \$500 for assets acquired on or after May 2, 2006.

CAPITAL GAINS TAXES FOR FISHERMEN

The budget proposes to provide tax relief for gains on sales or intergenerational transfers of assets used in a fishing business.

For transfers that occur on or after May 2, 2006, it will generally be permissible to transfer assets (land, depreciable property and eligible capital property) used in Canadian fishing businesses carried on by the individual (or spouse, parents or children of the individual) to a child or grandchild on a tax deferred basis. The transferee would generally inherit the transferors tax cost of the asset.

The budget also proposes that capital gains on dispositions of qualifying property (real estate, fishing vessels and eligible capital property) used principally in a fishing business carried on by the individual (or spouse, parent, child or grandchild of the individual) will be eligible for exemption under the individual's \$500,000 lifetime capital gains exemption. Also eligible for exemption will be gains on sales of shares of family fishing corporations and family fishing partnerships

Further details on the 2006 Federal Budget are available on the Department of Finance's Website at <http://www.fin.gc.ca/budtoce/2006/budliste.htm> or contact your KNV advisor.

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