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The 2007 Federal Budget:

A Summary of the Key Personal Tax Measures Contained in the Budget and How These Changes Impact You

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The March 19, 2007 federal budget delivered by Finance Minister Jim Flaherty is the Conservative government's second budget.

Highlights of the budget include: an increase to the lifetime capital gains exemption to $750,000 from $500,000; an increase to the age at which Retirement Savings Plans (RSPs) must be matured to 71 from 69; the elimination of non-resident withholding tax on interest income; a new tax credit for families with children under the age of 18; and enhancements to Registered Education Savings Plans (RESPs).

***Please note**: There is an element of risk in proceeding with a tax planning strategy that is based on legislation that is proposed, but has not yet been enacted. If proposed legislation is not passed, it is possible that Canada Revenue Agency (CRA) may assess your tax return based on existing legislation.*

While it has been the longstanding practice of CRA to ask taxpayers to file on the basis of proposed legislation, where such proposals result in a significant amount of rebate or refund being at stake, CRA's past practice has been to wait until the proposed legislation is enacted. It is recommended that you consult a professional tax advisor if you have any questions regarding this.

Personal Tax and Related Measures

<u>Income Splitting Measures Announced in the October 31, 2006 Tax Fairness Plan</u>

The government confirmed their intention to move forward with implementing the proposed pension income splitting measures announced in the Tax Fairness Plan on October 31, 2006. These measures will enable certain forms of retirement income to be split with a spouse which could result in significant tax savings for your family. Full details of these measures are covered in our Bulletin article titled *"Proposed Changes to Income Trusts and Other Tax Measures Announced October 31, 2006"*, a copy of which is available from your advisor.

<u>Increase in the Lifetime Capital Gains Exemption to $750,000 from $500,000</u>

The budget proposes to increase the lifetime capital gains exemption to $750,000 from $500,000 on capital gains realized on the disposition of qualified farm and fishing property or qualified small business corporation shares.

This measure will apply to dispositions of qualifying property that occur on or after March 19, 2007. As a transitional measure for 2007, your capital gains exemption will be capped at $625,000 for dispositions occurring on or after March 19, 2007 through December 31, 2007.

If you are in the highest federal tax bracket this would result in additional federal tax savings of approximately $18,000 in 2007 and $36,000 in 2008 and subsequent years. Your tax savings would be significantly more if the provinces harmonize with the federal proposal.

Increase in Age Limit Conversion for Maturing RSPs

The budget proposes to increase, for 2007 and subsequent years, the conversion age for Retirement Savings Plans (RSPs), Registered Pension Plans (RPPs) and Deferred Profit Sharing Plans (DPSPs) to 71 years of age from 69 years of age.

Transitional measures exist for individuals who turn 69, 70 and 71 years of age in 2007 and 71 years of age in 2008 and include provisions to allow a Retirement Income Fund (RIF) to be converted back to an RSP if you are 71 years of age or younger at the end of 2007.

Provided contribution room is available, RSP contributions will be permitted until the end of the year in which you turn 71 years of age.

You may benefit from this proposal if you are between the ages of 69 and 71 and any of the following apply to you: you have sufficient other sources of income and do not require the income from your RIF; you continue to work and accumulate RSP contribution room; or you have unused RSP deduction carryforward room.

Elimination of Non-resident Withholding Tax on Interest Income

Canada and the U.S. have agreed in principle to amend the Canada-U.S. Income Tax Treaty to reduce non-resident withholding tax on interest payments (that are not already exempt from withholding) to nil. This will mean that when interest income is earned from an investment issued in the other country, you will no longer have any tax withheld at source, resulting in increased cash flow. Also, tax return preparation with respect to foreign tax credits may be simplified.

The elimination of non-resident withholding tax for interest payments between unrelated (arm's length) parties will take effect as of the first calendar year following entry into force of the updated tax treaty, which is expected to be January 1, 2008. The elimination of non-resident withholding tax for interest payments between related parties (non-arm's length) will be phased in over a three-year period.

After the above-mentioned proposals take effect, the budget also proposes to eliminate Canadian non-resident withholding tax on interest paid to all unrelated parties, regardless of their country of residence.

New $2,000 Child Tax Credit

The budget proposes to introduce a non-refundable child tax credit of $2,000 per child for children less than 18 years of age at the end of a taxation year. The credit will be effective in 2007. The $2,000 credit (indexed in the future) is applied at the lowest marginal tax rate of 15.5% in 2007 to generate a tax saving of $310 per child.

If the child resides with both parents throughout the year, then either parent may claim the credit. In other cases, the parent entitled to claim the eligible dependant credit for the year for the child would also be able to claim the new child tax credit.

Enhancements to RESPs and the Canada Education Savings Grant (CESG) Program

The budget proposes measures to provide more flexibility to families that want to save money for education using an RESP. This will be achieved by eliminating the annual $4,000 RESP contribution limit, and increasing the lifetime contribution limit to $50,000 from $42,000. The maximum annual CESG grant is proposed to increase to $500 from $400. The lifetime CESG available per beneficiary will remain at $7,200.

Elimination of Capital Gains Tax on Donated Securities to Private Foundations

The 2006 budget eliminated the capital gains tax on donations of publicly-listed securities to public charities. At that time the government promised to review whether they would extend this rule to donations to private foundations. The same favourable tax treatment has now been extended to gifts made to private foundations on or after March 19, 2007.

This means that you may donate publicly-listed securities to either a private or public charity and pay no tax on the resulting capital gain on the disposition of the security. In addition, you will receive a donation tax receipt equal to the fair market value of the security at the time of the gift.

New Registered Disability Savings Plan (RDSP)

The budget proposes to create a savings plan to help disabled individuals that qualify for the disability tax credit. The plan is expected to become available sometime in 2008.

The RDSP will be based generally on the existing RESP design. Non-tax deductible contributions will be allowed up to a lifetime maximum of $200,000. Funds in the plan will grow on a tax sheltered basis. There will be a grant at varying rates depending on family net income and the amount contributed. Withdrawals of amounts other than original contributions are taxed in the hands of the beneficiary. Contributions can be paid to the beneficiary or returned to the contributor tax-free.

It is proposed that the RDSP will have an additional feature called the Canada Disability Savings Bond (CDSB) that will pay an additional $1,000 annually into the RDSP whether or not a contribution is made in the year. Only low and modest income families will qualify. There will be a $20,000 lifetime limit and eligibility for the bond will cease at age 49.

Extension of Mineral Exploration Tax Credit

The budget proposes to extend the eligibility for the mineral exploration tax credit to flow-through share investors, which was set to expire at the end of March 2007. Certain mineral exploration entities commonly known as “super” flow-throughs will continue to qualify for the enhanced investment tax credit for agreements entered into on or before March 31, 2008.

Increase to the Spousal Amount

The budget proposes to increase the non-refundable spousal credit to $8,929 for 2007 to match the basic personal exemption. In 2006 it was possible for a lower income spouse to earn $751 of income without affecting their spouse’s ability to claim this credit. Going forward, every dollar earned by the lower income spouse will reduce the available spousal credit.

The proposed changes will provide a tax savings of up to $209 where the maximum credit is claimed.

New Phased Retirement – Partial Pensions

Effective beginning 2008, the budget proposes a phased retirement measure for employees who are at least 55 years of age and who are eligible to receive an unreduced defined benefit pension. This new measure will allow employers to offer a partial pension of up to 60 percent, including bridging benefits, to the employee while they continue to work and contribute to the employer's pension plan on a current service basis. Until now, the *Income Tax Act* did not allow employees to accrue pension benefits if they also received a pension from the employer or a related employer.

List of Qualified Investments for Registered Plans Expanded

Qualified investments for RSPs and other registered plans will be expanded to include a greater variety of debt obligations.

Other Personal Tax Measures

- Elementary and Secondary School Scholarship – Scholarships and bursaries for elementary and secondary schools will be fully exempt from tax beginning in 2007.
- Public Transit Tax Credit – The public transit tax credit will be enhanced by extending eligibility to the cost of certain electronic payment cards and weekly passes (when at least four consecutive weekly passes are purchased).
- Working Income Tax Benefit (WITB) – The WITB will provide a refundable tax credit to low-income individuals and families. The maximum allowable credit for single individuals is $500, and for couples and single parents the maximum is $1,000.
- Increasing Personal Income Tax Instalment Threshold to $3,000 – Effective for 2008, if your final tax balance owing is less than $3,000 ($1,800 for Quebec residents) you will not be required to make income tax instalment payments.

If you have any questions or require clarification of any of the issues discussed in this document, do not hesitate to discuss these with your advisor.

Note: The above information is based on the current and proposed tax law in effect as of the date of this article. The article is for information purposes only and should not be construed as offering tax advice. Individuals should consult with a qualified tax and legal advisor before taking any action based upon the information contained in this article.