

Overview

Budget 2008 Forestalls Forced Election

A new personal financial vehicle, limited stimulus for the beleaguered manufacturing sector, and a renewed commitment to holding down spending formed the core of the Conservative minority administration's third budget. "Inflation is low and stable, interest rates are low, and unemployment is the lowest it has been in 33 years", Finance Minister Jim Flaherty told the House of Commons. However, he added, the economic downturn in the United States and the concomitant volatility in global financial markets mean that some segments of the Canadian economy are floundering — so much so that domestic growth will be slower than anticipated.

Both Mr. Flaherty and Prime Minister Stephen Harper have said repeatedly, in the weeks leading up to the Budget, that there was little, if any, opportunity for additional tax cuts or spending. The suggestion was that the Conservatives had exhausted their options in their 2006 and 2007 Budgets and in last October's Economic Statement. However, Mr. Flaherty indicated the day before his latest offering, that there likely would be a few "surprises" in store.

"We have come to a fork in the road", the Finance Minister said in his budget speech, taking aim at the Opposition parties and other critics, "some would have us go down the path to higher spending, higher interest payments and higher taxes, perhaps even an increase in the GST, but that approach is misguided . . . our government is taking the path that requires focus, prudence and discipline."

Much of his speech focused on the legacy from his two previous budget addresses, citing accelerated capital cost allowances, industrial support, and corporate and personal income tax cuts. The result this year alone, he said, was \$21 billion worth of stimulus which was "significantly greater" than the stimulus package offered by the U.S. government. "To date, our government has taken actions that will provide nearly \$200 billion in tax relief over this and the next five years, \$140 billion of which will be for individuals, and . . . as we pay down the federal debt, interest savings are being returned to Canadians in personal income tax relief"

Faced with the prospect of a vote of no-confidence in the Budget (on this, Liberal Leader Stéphane Dion immediately, but grudgingly, said he would not vote against the package and force an election), Mr. Flaherty unveiled "the single most important personal savings vehicle" since the introduction of Registered Retirement Savings Plans in 1957. This new Tax-Free Savings Account would enable Canadians to shelter up to \$5,000 annually, carrying forward unused room. Earned income, including capital gains, would be tax-exempt when withdrawn, and neither earnings nor withdrawals would affect eligibility for federal income-tested benefits such as the Guaranteed Income Supplement (GIS).

Following from earlier initiatives such as pension-income splitting, Mr. Flaherty announced that the GIS maximum exemption would be increased to \$3,500 from \$500, targeting seniors who opt to continue working. Another tax measure would increase the daily Northern Residents Reduction by 10% to \$16.50, boosting the maximum annual write-off to \$6,022.50. This would be the first acknowledgement of higher living costs in the North since 1986. "We are also . . . extending the Targeted Initiative for Older

Workers through to 2012. This is a new \$90-million investment in capable, experienced workers aged 55 to 64. It will allow them to remain productive participants in the workforce and help alleviate labour shortages.”

Having abolished the federal capital tax and implemented a phased reduction of the federal corporate income tax to 15% by 2012 — which Flaherty said would give Canada the lowest statutory tax rate among the G7 Economic Summit countries — the Conservatives renewed their call for the provinces to do likewise. Their goal of a combined 25% tax rate would not only boost “traditional” sectors, but also become a “powerful” competitive advantage internationally. Also with an eye on the global economy, Mr. Flaherty noted that only a few days earlier, he had appointed an expert panel to advise him and his provincial and territorial counterparts on the politically vexing issue of securities regulation. Its report, due by the end of 2008, is expected to include a recommendation for common securities legislation.

In an attempt to prop up the flagging manufacturing sector, which has been hit hard by the strength of the Canadian dollar on global markets as well as by relocation of capacity to developing countries, the government announced that it would extend temporary accelerated capital cost allowance (CCA) treatment by three years, on a declining basis. Mr. Flaherty estimated that this would amount to an additional \$1 billion in tax relief.

Given the automotive sector’s role as a major economic driver, he also announced a \$250 million “innovation fund” to leverage development of more fuel-efficient vehicles. A further \$440 million would be appropriated over three years to support not only the automotive sector, but also manufacturing, fisheries, and forestry, as well as university-based research. As well, two two-year funding initiatives would be undertaken, designed to curb vehicle emissions: \$10 million for biofuels emissions research and \$3 million for a demonstration of 85% ethanol-blended gasoline infrastructure.

Also on the environment front, from \$250 million announced by Mr. Flaherty for carbon capture and storage (CCS) development, \$240 million would go toward a full-scale commercial CCS demonstration in Saskatchewan’s coal-fired electrical generating sector. CCS would be critical to Canada reducing emissions of greenhouse gases (GHG) by at least 60% from 1990 levels by 2050, as promised by the Conservatives last year. While the Saskatchewan government and a private-sector partner also would be involved, officials in a budget background briefing session declined to go into detail, saying only that discussions were ongoing. The other \$10 million would be divided evenly between CCS research in Nova Scotia and at the University of Calgary.

A related measure would modify the tax write-down of carbon dioxide pipelines, which are expected to be the main means of transporting gas from industrial facilities to geologic storage. The CCA rate, currently 4% across the board, would be doubled to 8% for pipelines for at least the next two years, and nearly quadrupled to 15% for associated pumping and compression equipment. The role of nuclear power in the Canadian energy mix was addressed by investing \$300 million in the 2008–2009 fiscal year to support Atomic Energy of Canada Limited’s development of its next generation of CANDU reactor, as well as current operations at its Chalk River facility in Ontario.

Following up on last year’s extension to 2014 of the transfer of a portion of gasoline taxes to municipalities for infrastructure renewal, the Conservatives announced that this

program would be made “permanent”. The Minister projected that it would be worth \$2 billion annually by 2009–2010. “Municipalities large and small, from coast to coast, will be able to plan and finance their infrastructure needs with this additional funding . . . forever.”

Communities large enough to support public transit systems are to be eligible in 2007–2008 for an additional \$500 million in federal funding apportioned provincially on a *per capita* basis. However, they would have had to committed to specific projects by March 31, the end of the current fiscal year, to qualify. “Investing in modern public transit is about preserving our environment”, Mr. Flaherty said. “It’s about creating a seamless, modern, safe and secure transportation system for the benefit of all.”

The Employment Insurance program, a long-standing irritant for many employers because of the way surplus revenues (more than \$800 million in the first three-quarters of 2007–2008 alone) have been used to effectively augment general government revenues, is to be overhauled. Beginning in 2009, an independent Canada Employment Insurance Financing Board will develop a new premium-setting program which would hold the cash reserve in the program at \$2 billion. “EI will be managed on a truly break-even basis”, Mr. Flaherty said.

Although education is constitutionally a provincial responsibility, the federal government plans to augment what the Minister called its “historic role” by investing in a new consolidated post-secondary Canada Student Grant Program “that fully respects provincial jurisdiction”. As the Canada Millennium Scholarship Foundation is wound down, \$350 million would be allocated for the replacement program in 2009–2010, growing to \$430 million in 2012–2013. It is expected to increase participation by more than 100,000 low- and middle-income students, to some 245,000.

The government also plans to implement a new class of doctoral scholarships named for Georges Vanier, who was Governor-General from 1959 to 1967, and who had a reputation for promoting excellence. An initial \$100 million over five years, beginning in 2008–2009, would be used to attract post-graduate students from Canada and elsewhere. A further \$21 million would be used to establish “global excellence” research chairs in the environment, natural resources, and energy, health, and information and communications technologies.

Mr. Flaherty also underscored the importance of doing “a better job of bringing aboriginal Canadians into the skilled workforce”. To that end, he promised \$70 million over two years to a new initiative designed to match aboriginal people’s skills to labour market needs. In addition, over that same period, \$22 million would be used to tailor the immigration process to the labour market.

One of the few clearly-identifiable spending increases set out in the Budget, as the government focused on its “core responsibilities”, was for the Department of National Defence. It would receive annual increases of 2% beginning in 2011–2012, coupled with an additional \$282 million over the next two years for veteran’s survivors.

Overall, the 2008 Budget measures total \$2.7 billion in the current fiscal year, \$1.5 billion in 2008–2009, and \$1.7 billion in the following year. Combined with the measures set out in the last Economic Statement, the total would amount to \$29.4 billion over that period, with more than 80% dedicated to tax relief. Budget revenues for 2007–2008 now are forecast at \$244.5 billion, rising to \$241.9 billion in 2008–2009, and

to \$252 billion in 2009–2010. Program expenses, including the cost of servicing the accumulated public debt, are projected at \$234.3 billion, \$239.6 billion, and \$250.7 billion, respectively. This would yield surpluses of \$10.2 billion, \$2.3 billion, and \$1.3 billion, respectively, which the government said would be applied against debt.

In keeping with recent practice, the government focused on a two-year horizon on which its forecasts can “reasonably be held to account”. However, in light of global uncertainties, it updated the five-year fiscal projections, compiled from private-sector forecasts, set out in the Economic Statement. Nominal growth in gross domestic product this year is given as 3.5%, a significant deceleration from 5.7% in 2007. The outlook for 2009 is 4.3% and the 2010–2012 average would be 4.4%.

That essentially tallies with the last assessment of Canada by the International Monetary Fund. Issued by the Washington-based IMF the day before the Budget, and based on consultations with Canadian authorities up to February 6, it expected economic growth to decelerate in Canada this year, mainly due to global financial strains and the sliding U.S. economy. However, the IMF also expects Canadian growth to pick up again in 2009, thanks to impetus from the Economic Statement and the government’s focus on debt and tax reduction, and a more focused approach to spending.

Mr. Flaherty said the report highlights Canada’s economic flexibility. “Our government is taking steps to ensure continued growth in the face of uncertainty”, he said in a prepared statement. “The actions we and all Canadians take today will determine where we end up tomorrow. The question all of us face . . . is how to secure our future prosperity in these challenging economic times.”

Editorial Comment on Notice of Ways and Means Motion Resolutions and Supplementary Budget Information

Notice of Ways and Means Motion to Amend the Income Tax Act

That it is expedient to amend the *Income Tax Act* to provide among other things:

Resolution 1: Tax-Free Savings Accounts

(1) For the introduction of Tax-Free Savings Accounts, in accordance with proposals described in the budget documents tabled by the Minister of Finance in the House of Commons on February 26, 2008.

CCH Editorial Comment: Resolution 1 introduces the Tax-Free Savings Account (TFSA), effective for 2009. The TFSA will allow Canadian resident individuals to earn investment income, including interest, dividends and capital gains, on a tax-free basis. Contributions to the TFSA will not be deductible, but the income in the account will not be subject to tax, either while in the account or upon withdrawal. In this respect, the TFSA is similar to a “tax-paid RRS” or a US-style “Roth IRA”, in that the contributions are made on an after-tax basis, but the income is then permanently exempt from taxation. As discussed in the Budget papers, the permanent exemption from taxation effectively means that an investment in a TFSA will provide identical economic returns to that of the same investment in an RRSP (assuming equal tax rates upon contribution and withdrawal).

The Conservative government’s introduction of the TFSA is presumably the follow-up to its 2006 election campaign promise that would have provided relief from capital gains taxation for investments if the proceeds were reinvested within a specified period of time. The TFSA concept is narrower than that campaign proposal in that it has a relatively low annual contribution limit (see below), but in other ways it is broader in that it exempts from taxation all investment income (and not just capital gains) on a permanent basis.

The annual contribution limit for a TFSA will be \$5,000, and will be increased annually to inflation, and rounded to the nearest \$500. Unused TFSA room can be carried forward indefinitely. Withdrawals from the account will free up more TFSA room. Excess contributions will be subject to a 1% tax per month.

Qualified investments for a TFSA will be similar to those of an RRSP. However, a TFSA will be prohibited from holding investments in any entities with which the individual account holder does not deal at arm’s length, and any entities of which the individual is a specified shareholder or in which the individual has an analogous interest (generally, a 10% or greater interest together with non-arm’s length persons).

Interest on borrowed money used to invest in a TFSA will not be deductible, as is currently the case for borrowings used to invest in other tax-sheltered accounts, such as an RRSP. However, the assets in the TFSA can be used as collateral for a loan of the individual.

One of the relative advantages of the TFSA (especially compared to an RRSP) is that withdrawals from the TFSA will not be included in income for the purpose of determining eligibility for various income-based credits and benefits, including the Age Credit and OAS benefits. In other words, unlike withdrawals from an RRSP or RRIF, which can effectively create an additional “tax” by reducing the individual’s Age Credit or by clawing back OAS

benefits (and certain other credits and benefits), withdrawals from the TFSA will have no effect on such credits or benefits.

Furthermore, unlike an RRSP, there is no time limit at which the TFSA must be wound up or converted into another investment vehicle. Thus, the TFSA can be used to fund pre-retirement years or post-retirement years, and there are no limits on withdrawals or the use of the withdrawn funds.

The attribution rules will not apply to income earned in a TFSA. Therefore, one spouse can contribute to another spouse's TFSA and the investment income remains tax exempt and not subject to attribution.

Upon death, the value of the TFSA is not included in income (unlike an RRSP or RRIF), although any income that accrues after death will be subject to tax. To retain the tax-free status of the account, it may pass to the deceased's spouse or common-law partner, or the assets of the account can be transferred to a TFSA of the spouse or common-law partner.

The TFSA is a significant measure in terms of exempting investment income from taxation. When it is combined with other vehicles and measures that partially or fully exempt investment income from taxation, including RRSPs and other deferred income plans, the \$750,000 capital exemption, the exemption for capital gains on donated securities, the rollover for investments in eligible small business corporations, and of course, the preferential one-half rate of taxation for other capital gains, our tax system continues to tax investment income more favourably than employment income.

Resolutions 2 and 3: Registered Education Savings Plans

(2) That, for the 2008 and subsequent taxation years,

(a) paragraphs (b) and (c) of the definition "specified plan" in subsection 146.1(1) of the Act be replaced by the following:

(b) under which the beneficiary is an individual in respect of whom paragraphs 118.3(1)(a) to (b) apply for the beneficiary's taxation year that ends in the 31st year following the year in which the plan was entered into, and

(c) that provides that, at all times after the end of the 35th year following the year in which the plan was entered into, no other individual may be designated as a beneficiary under the plan;

(b) subparagraphs 146.1(2)(h)(i) and (ii) of the Act be replaced by the following:

(i) in the case of a specified plan, the 35th year following the year in which the plan was entered into, and

(ii) in any other case, the 31st year following the year in which the plan was entered into;

(c) subparagraphs 146.1(2)(j)(i) and (ii) of the Act be replaced by the following:

(i) in the case of a specified plan, the 40th year following the year in which the plan was entered into, and

(ii) in any other case, the 35th year following the year in which the plan was entered into;

(d) clause 146.1(2)(j)(ii)(A) of the Act be replaced by the following:

(A) the beneficiary had not attained 31 years of age before the time of the contribution, or

(3) That section 146.1 of the Act be amended, in respect of cessations of enrolment that occur after 2007, by adding the following after subsection (2.2):

Extension for making educational assistance payments

(2.21) Notwithstanding paragraph (2)(g.1), an education savings plan may allow for the payment of an educational assistance payment to or for an individual at any time in the six-month period immediately following the particular time at which the individual ceases to be enrolled as a student in a qualifying educational program or a specified educational program, as the case may be, if the payment would have complied with the requirements of paragraph (2)(g.1) had the payment been made immediately before the particular time.

Timing of payment

(2.22) An educational assistance payment that is made at any time in accordance with subsection (2.21) but not in accordance with paragraph (2) (g.1) is deemed, for the purposes of applying that paragraph at and after that time, to have been made immediately before the particular time referred to in subsection (2.21).

CCH Editorial Comment: Section 146.1 of the *Income Tax Act* governs registered education savings plans (RESPs), which are tax-assisted savings vehicles designed to help families accumulate savings for the post-secondary education of their children. Generally, the RESP regime provides a government grant computed with reference to contributions made to an RESP and the tax-free accumulation of income earned on such contributions and grants.

Currently, contributions to an RESP can be made for 21 years following the year in which the plan is entered into. In the case of an RESP where the beneficiary qualifies for the Disability Tax Credit (DTC) under Section 118.3, contributions can be made for 25 years. These contributions are not deductible for tax purposes and are not taxed upon withdrawal. Any investment income withdrawn from the RESP is generally included in the income of the beneficiary at that time and will be subject to tax. An RESP must be terminated by the end of the year that includes the 25th anniversary of the opening of the plan (or the 30th anniversary for DTC beneficiary plans). In the event the RESP is a “family plan” (i.e., a plan where more than one family member is a beneficiary), contributions cannot be made in respect of a beneficiary who is 21 years or older. For each beneficiary of an RESP, there is a lifetime contribution limit of \$50,000, but no annual limit on contributions.

Resolution 2 of the Budget proposes to increase each of these time limits by an additional 10 years, such that:

- contributions can be made to a RESP for up to 31 years after the plan has been entered into, as opposed to the current 21 years (35 years for DTC beneficiary plans, as opposed to the current 25 years);
- plans must terminate within the year that includes the 35th anniversary for the plan, as opposed to the current 25th anniversary (40th anniversary for DTC beneficiary plans, as opposed to the current 30th anniversary), and
- contributions to a family plan can be made until a beneficiary attains the age of 31 years, as opposed to the current 21 years. These amendments will apply to the 2008 and subsequent taxation years.

Currently, a beneficiary of an RESP is eligible to receive Educational Assistance Payments (EAPs) from the plan if he or she is enrolled as a student in a qualifying post-secondary program at the time of the payment. Resolution 3 proposes to allow a beneficiary of an RESP

to be eligible to receive EAPs for up to six months after ceasing to be enrolled in a qualifying post-secondary program (provided that the payment would have otherwise qualified under the rules for EAPs). This amendment will apply to beneficiaries who cease to be enrolled in a qualifying program after 2007.

Resolution 4: Excess Corporate Holdings by Private Foundations

(4) That the provisions of the Act relating to the ownership of shares of corporations by private foundations be modified in accordance with proposals described in the budget documents tabled by the Minister of Finance in the House of Commons on February 26, 2008.

CCH Editorial Comment: The 2007 Federal Budget extended the elimination of tax on capital gains realized on donations of publicly-listed securities to private foundations (see also resolution 9 below). At the same time, a new “excess corporate holdings regime” was introduced to apply to private foundations in order to monitor and prevent self-dealing concerns.

Generally speaking, under the excess holdings regime in sections 149.1 and 149.2, a private foundation can hold up to 2% of any class of shares of a corporation without consequence. If the combined shareholdings of the foundation and any relevant person (generally, a non-arm’s length person) exceeds 20% of the shares of any class, the foundation is required to either divest its shareholdings so as to reduce the combined holdings to 20% or less or to divest so as to come within the 2% safe harbour threshold for its own shares. The timeframe for a divestiture will depend upon the circumstances that resulted in the 20% threshold being exceeded, with a maximum timeframe of 5 years, although transitional rules allow foundations to divest, over a period of 5 to 20 years, excess business holdings that were present on March 18, 2007 (the day before the 2007 Budget day).

Currently exempt from the divestiture requirement are certain “entrusted shares”, which are shares donated before March 19, 2007 (the 2007 Budget day) and that are subject to a condition that they be retained by the foundation. Although such shares need not be divested, they are taken into account in determining whether other shares of the same class are subject to the excess holdings regime.

The 2008 Budget proposes to also exclude from the divestiture requirement shares that are not listed on a designated stock exchange (“unlisted shares”) that were held by the foundation on March 18, 2007 (referred to as “exempt shares”). Similar to entrusted shares, exempt shares will not have to be divested in accordance with the excess holdings regime, although they will be taken into account in determining whether other shares of the same class are subject to the regime.

Specifically excluded from the concept of “exempt share” is a share:

- that provides the foundation with an indirect interest in listed shares of a class of another corporation (e.g. the foundation owns an unlisted share of a corporation that holds listed shares in another corporation);
- the indirect interest is held through a controlled corporation, which is generally a corporation controlled by the foundation, a relevant person, a group of relevant persons, or a relevant person or group together with the foundation;
- if the foundation and the relevant persons had instead owned the listed shares, they would hold more than 20% of the listed shares; and
- the foundation, together with all controlled corporations, holds more than 2% of the listed shares.

If a share ceases to be an exempt share, the change in status does not affect the foundation’s divestment obligation in prior years. However, the share will be treated as if it had

not been exempt on March 18, 2007, and therefore be subject to the existing transitional rules (summarized above) for taxation years after the time that the share ceased to be exempt.

The 2008 Budget also proposes new “look-through” rules for trusts in which a private foundation has an interest, where the trust owned shares on March 18, 2007 — namely for the purposes of the transitional rules and the exemptions for entrusted and exempt shares. In general terms, a foundation will be deemed to own shares held by a trust on March 18, 2007, in proportion to the value of the foundation’s interest in the trust (presumably relative to all interests in the trust), where the foundation is the sole trustee of the trust, or if the foundation is a majority interest beneficiary of the trust and a majority of the trustees consist of the foundation and relevant persons. Assuming the shares of the trust would otherwise qualify as entrusted or exempt shares, that status will generally be retained and flow through to the foundation.

In addition, the Budget proposes that substituted shares be treated the same as the shares for which they were exchanged for the purposes of the excess corporate holdings regime. For example, shares acquired under the rollover provisions of section 51, 85.1, 86 or 87 of the Act could qualify for this treatment.

As well, the Budget proposes to fix an anomaly where a foundation owns entrusted shares that it cannot divest itself of, if the 20% threshold is exceeded (seemingly implying that a relevant person would have to divest itself of shares so as to get under the 20% threshold). The Budget Papers indicate that this situation will be addressed and the rules clarified to ensure that the entrusted shares will not have to be divested in these circumstances.

In addition, anti-avoidance provisions will be extended to trusts, in particular when it can reasonably be considered that one of the purposes of the trust is to hold or acquire shares or other rights in corporations that would, if they were held by the foundation or a relevant person, result in a divestment obligation, by deeming the foundation or relevant person to hold directly the shares in the corporation which reflect the value of their indirect interest.

Resolution 5: Dividend Tax Credit

(5) That, for the 2009 and subsequent taxation years,

(a) subparagraph 82(1)(b)(ii) of the Act be replaced by the following:

- (ii) the product of the amount determined under paragraph (a.1) in respect of the taxpayer for the taxation year multiplied by
 - (A) for the 2009 taxation year, 45%
 - (B) for the 2010 taxation year, 44%,
 - (C) for the 2011 taxation year, 41%, and
 - (D) for taxation years after 2011, 38%;

(b) paragraph 121(b) of the Act be replaced by the following:

- (b) the product of the amount, if any, that is required by subparagraph 82(1)(b)(ii) to be included in computing the individual’s income for the year multiplied by
 - (i) for the 2009 taxation year, $\frac{11}{18}$,
 - (ii) for the 2010 taxation year, $\frac{10}{17}$,
 - (iii) for the 2011 taxation year, $\frac{13}{23}$, and
 - (iv) for taxation years after 2011, $\frac{6}{11}$.

CCH Editorial Comment: The dividend tax credit (“DTC”) is provided to Canadian resident individuals receiving taxable dividends from Canadian corporations. There are two variations of the credit for federal tax purposes. Generally speaking, one DTC mechanism applies to dividends received out of so-called small business income of a CCPC and the other mechanism applies to dividends received out of business income of a public corporation or income of a CCPC in excess of the amount eligible for the lower rate of tax generally available on its first \$400,000 of Canadian business income (“eligible dividends”).

The DTC mechanism involves a gross-up of the dividend and a credit against the resulting tax. The gross-up is added to the dividend and is meant to approximate the before-tax earnings of the corporation. The DTC itself, which the individual shareholder claims, is meant to approximate the tax paid by the corporation on those earnings. Where the mechanism works perfectly, it achieves “full integration” between the personal and corporate tax systems.

The current federal gross-up for eligible dividends in subparagraph 82(1)(b)(ii) is 45% of the dividend and the current DTC in paragraph 121(b) is 11/18 of the gross-up amount. However, owing to reductions in the general corporate tax rate, which will see that rate reduced to 15% by 2012, the DTC mechanism is being amended to more closely resemble full integration.

In particular, it is proposed that subparagraph 82(1)(b)(ii) be amended so that the gross-up for eligible dividends will be reduced from 45% to 44% beginning in 2010, and then to 41% in 2011 and 38% in 2012 and subsequent years. It is proposed that paragraph 121(1) be amended so that the DTC will change on the same schedule, with the 11/18 amount being replaced by 10/17 in 2010, 13/23 in 2011, and 6/11 in 2012 and subsequent years.

Resolution 6: Medical Expense Tax Credit

(6) That, for the 2008 and subsequent taxation years, the portion of paragraph 118.2(2)(l) of the Act before subparagraph (i) be replaced by the following:

- (l) on behalf of the patient who is blind or profoundly deaf or has severe autism or severe epilepsy or has a severe and prolonged impairment that markedly restricts the use of the patient’s arms or legs,

CCH Editorial Comment: Resolution 6 proposes to expand the list of expenses eligible for the Medical Expense Tax Credit (section 118.2). Specifically, it is proposed that paragraph 118.2(2)(l) be amended to include, beginning in the 2008 taxation year, payments made with respect to service animals specifically trained to guide or assist a person who has severe autism or severe epilepsy. Such expenses are already recognized in relation to expenses incurred for service animals specially trained to assist individuals who are blind, deaf, or who have a severe impairment markedly restricting the use of the arms or legs.

Resolution 7: Medical Expense Tax Credit

(7) That, for expenses incurred after February 25, 2008, paragraph 118.2(2)(n) of the Act be replaced by the following:

- (n) for drugs, medicaments or other preparations or substances (other than those described in paragraph (k))
 - (i) that are manufactured, sold or represented for use in the diagnosis, treatment or prevention of a disease, disorder or abnormal physical state, or its symptoms, or in restoring, correcting or modifying an organic function,
 - (ii) that can lawfully be acquired for use by the patient only if prescribed by a medical practitioner or dentist, and

- (iii) the purchase of which is recorded by a pharmacist;

CCH Editorial Comment: Resolution 7 provides a clarification with respect to drugs, medications and other prescriptions that are eligible for the Medical Expense Tax Credit. This clarification comes about as a result of recent court decisions that have interpreted this measure to include the costs of vitamins, supplements, and drugs that could otherwise be purchased without a prescription (see *Breger v. R*, 2007 DTC 1156 (T.C.C.)). As such, in order to ensure that this measure only applies to the costs of substances that are not generally available to the public and that are required for medical reasons, the wording of paragraph 118.2(2)(n) will be changed to ensure that drugs and medications purchased without a prescription are ineligible for this credit.

Resolution 8: Registered Disability Savings Plan

(8) That, for the 2008 and subsequent taxation years,

(a) subparagraph 146.4(4)(p)(ii) of the Act be replaced by the following:

- (ii) the first calendar year throughout which the beneficiary has no severe and prolonged impairments with the effects described in paragraph 118.3(1)(a.1).

(b) paragraph 146.4(12)(d) of the Act be replaced by the following:

- (d) if the failure consists of the plan not being terminated by the time set out in paragraph (4)(p) and the failure was due to the issuer being unaware of, or there being some uncertainty as to, the existence of circumstances requiring that the plan be terminated,
- (i) the Minister may specify a later time by which the plan is to be terminated (but no later than is reasonably necessary for the plan to be terminated in an orderly manner), and
- (ii) paragraph (4)(p) and the plan terms are, for the purposes of paragraphs (11)(a) and (b), to be read as though they required the plan to be terminated by the time so specified.

CCH Editorial Comment: The registered disability savings plan (RDSP) was introduced in last year's budget. Under section 146.4, a RDSP can be established for the purpose of earning investment income, which is ultimately to be distributed tax-free to the disabled beneficiary, who must generally be eligible for the disability tax credit (DTC) under section 118.3. Currently, if the beneficiary ceases to be eligible for the DTC in a taxation year, the plan must be terminated by the end of the next year. Apparently, there has been some concern that a beneficiary could meet the DTC criteria but could rescind his or her DTC certification, in which case the RDSP would have to be terminated. Resolution 8 proposes to amend section 146.4 to address this concern by providing that plan termination is required only if the beneficiary's condition has factually improved to the extent that he or she no longer qualifies for the DTC. This measure will be effective for 2008 and subsequent years.

Resolution 9: Donations of Securities (exchangeable shares)

(9) That the provisions of the Act relating to taxable capital gains arising on the donation of publicly-traded securities be modified in accordance with proposals described in the budget documents tabled by the Minister of Finance in the House of Commons on February 26, 2008.

CCH Editorial Comment: Under paragraph 38(a.1), if a taxpayer donates certain publicly-traded securities to a registered charity or other qualified donee, any capital gain arising on the donation is deemed to be nil, even though the fair market value of the security is eligible for the charitable tax credit (individual) or deduction (corporation). In last year's budget, the government extended the tax-free capital gain rule to donations of such securities to private foundations, effective for donations on or after March 19, 2007.

Resolution 9 of Budget 2008 proposes to eliminate tax on capital gains realized on the exchange of unlisted shares and partnership interests for publicly-traded securities, if the publicly-traded securities are then donated to a qualified donee within 30 days of the exchange (in which case, any further capital gain on the donation would also be nil). The unlisted securities must include, at the time they are issued, a condition allowing the holder to exchange them for publicly-traded securities, and the publicly-traded securities must be the only consideration received on the exchange. This new measure will apply to donations made on or after February 26, 2008.

The Budget states that special rules will apply where the exchanged securities are partnership interests, in order to ensure that only capital gains that reflect economic appreciation of the partnership interests will be exempt, and not gains that arise solely because of the various statutory reductions to the adjusted cost base of partnership interests.

Resolution 10: Northern Residents Deduction — Residency Amount

(10) That for the 2008 and subsequent taxation years, clauses 110.7(1)(b)(ii)(A) and (B) of the Act be replaced by the following:

- (A) \$8.25 multiplied by the number of days in the year included in the qualifying period in which the taxpayer resided in the particular area, and
- (B) \$8.25 multiplied by the number of days in the year included in that portion of the qualifying period throughout which the taxpayer maintained and resided in a self-contained domestic establishment in the particular area (except any day included in computing a deduction claimed under this paragraph by another person who resided on that day in the establishment).

CCH Editorial Comment: To qualify for the northern residents deduction, an individual must reside, for a period (the “qualifying period”) of not less than 6 consecutive months beginning or ending in a taxation year, in one or more particular areas each of which is a prescribed northern zone or prescribed intermediate zone for the year. Currently, the northern residents deduction provides individuals with, among other deductions, a basic residency deduction in paragraph 110.7(1)(b) equal to the lesser of: (a) 20% of the individual’s income for the year, and (b) a specified percentage (100% for a prescribed northern zone and 50% for a prescribed intermediate zone) multiplied by \$7.50 for each day in the year in the qualifying period of residence in the particular area and, where the taxpayer maintained and resided in a “self-contained domestic establishment” as defined in subsection 248(1) (and no other person residing in the same establishment claimed this basic residency deduction for that day under this paragraph), by an additional \$7.50 per day. Resolution 10 of the 2008 Budget proposes to increase this residency deduction by 10 per cent, from \$7.50 per day to \$8.25 per day. This amendment will apply to the 2008 and subsequent taxation years.

Resolution 11: Mineral Exploration Tax Credit

(11) That, for expenses renounced under a flow through share agreement made after March 2008,

(a) paragraph (a) of the definition “flow-through mining expenditure” in subsection 127(9) of the Act be replaced by the following:

- (a) that is a Canadian exploration expense incurred by a corporation after March 2008 and before 2010 (including, for greater certainty, an expense that is deemed by subsection 66(12.66) to be incurred before 2010) in conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence, location, extent or quality of a mineral resource described in paragraph (a) or (d) of the definition “mineral resource” in subsection 248(1),

(b) paragraphs (c) and (d) of the definition “flow-through mining expenditure” in subsection 127(9) of the Act be replaced by the following:

- (c) an amount in respect of which is renounced in accordance with subsection 66(12.6) by the corporation to the taxpayer (or a partnership of which the taxpayer is a member) under an agreement described in that subsection and made after March 2008 and before April 2009, and
- (d) that is not an expense that was renounced under subsection 66(12.6) to the corporation (or a partnership of which the corporation is a member), unless that renunciation was under an agreement described in that subsection and made after March 2008 and before April 2009;

CCH Editorial Comment: The flow-through share regime allows Canadian corporations to enter into agreements with investors to renounce certain qualifying expenses to the investors. The definition of “flow-through mining expenditures” in subsection 127(9) describes certain types of mineral exploration expenses incurred by a corporation and renounced to individuals that qualify for the 15% investment tax credit. This credit applies to qualifying expenses incurred prior to 2009, including expenses deemed to have been incurred prior to 2009 by virtue of the “look-back” rule in subsection 66(12.66). The definition of flow-through mining expenditures currently requires the agreement to be entered into before April 1, 2008. Resolution 11 of the 2008 Budget proposes to extend the investment tax credit for flow-through mining expenditures by amending the definition to include qualifying expenses incurred before 2010, pursuant to agreements entered into before April 1, 2009. Qualifying expenses will include expenses incurred in 2010 and expenses deemed to be incurred before 2010 by virtue of the look-back rule.

Resolutions 12, 13, 14, 15 and 16: Scientific Research and Experimental Development

(12) That, subject to subsection (14), in respect of expenditures made on or after February 26, 2008, section 37 of the Act be amended by adding the following after subsection (1.3):

Salary or wages for SR&ED outside Canada

- (1.4) For the purposes of this section, section 127 and Part XXIX of the Income Tax Regulations, the amount of a taxpayer’s expenditure for a taxation year determined under subsection (1.5) is deemed to be made in the taxation year in respect of scientific research and experimental development carried on in Canada by the taxpayer.

Salary or wages outside Canada — limit determined

- (1.5) The amount of a taxpayer’s expenditure for a taxation year determined under this subsection is the lesser of
 - (a) the amount that is the total of all expenditures made by the taxpayer in the taxation year, each of which is an expenditure made in respect of an expense incurred in the taxation year
 - (i) for salary or wages paid to an employee who was resident in Canada at the time the expense was incurred,
 - (ii) in respect of scientific research and experimental development that
 - (A) was carried on outside Canada,
 - (B) was directly undertaken by the taxpayer,

- (C) related to a business of the taxpayer, and
 - (D) was solely in support of scientific research and experimental development carried on in Canada by the taxpayer; and
- (b) the amount that is 10 per cent of the total of all expenditures, made by the taxpayer in the year, each of which would, if this Act were read without reference to subsection (1.4), be an expenditure made in respect of an expense incurred in the year for salary or wages paid to an employee in respect of scientific research and experimental development that was carried on in Canada, that was directly undertaken by the taxpayer and that related to a business of the taxpayer.

(13) That, in respect of taxation years that end on or after February 26, 2008,

(a) paragraph 37(2)(a) of the Act be replaced by the following:

- (a) on scientific research and experimental development carried on outside Canada, directly undertaken by or on behalf of the taxpayer, and related to the business (except to the extent that subsection (1.4) deems the expenditures to have been made in Canada); or

(b) subsection 37(9) of the Act be replaced by the following:

Salary or wages

- (9) An expenditure of a taxpayer
 - (a) does not include, for the purposes of clauses (8)(a)(ii)(A) and (B), remuneration based on profits or a bonus, where the remuneration or bonus, as the case may be, is in respect of a specified employee of the taxpayer; and
 - (b) includes, for the purpose of paragraph (1.5)(a), an amount paid in respect of an expense incurred in the year for salary or wages paid to an employee only if the taxpayer reasonably believes that the salary or wages is not subject to an income or profits tax imposed, because of the employee's presence or activity in a country other than Canada, by the government of that other country.

(14) That, for taxation years that include February 26, 2008 the reference in paragraph 37(1.5)(b) of the Act, as proposed by subsection (12), to "10 per cent" be read as a reference to the percentage determined by the formula

$$10\% \times A/B$$

where

- A is the number of days in the taxation year that are after February 25, 2008; and**
- B is the total number of days in the taxation year.**

(15) That, subject to subsection (16), for taxation years that end on or after February 26, 2008, subsection 127(10.2) of the Act be replaced by the following:

Expenditure limit determined

- (10.2) For the purpose of subsection (10.1), a particular corporation's expenditure limit for a particular taxation year is the amount determined by the formula

$$(\$7 \text{ million} - 10A) \times (\$40 \text{ million} - B)/\$40 \text{ million}$$

where

A is the greater of

- (a) \$400,000, and
- (b) the amount that is
 - (i) if the particular corporation is not associated with any other corporation in the particular taxation year, the particular corporation's taxable income for its immediately preceding taxation year (determined before taking into consideration the specified future tax consequences for that preceding year), or
 - (ii) if the particular corporation is associated with one or more other corporations in the particular taxation year, the total of all amounts each of which is the taxable income of the particular corporation for its, or of one of the other corporations for its, last taxation year that ended in the last calendar year that ended before the end of the particular taxation year (determined before taking into consideration the specified future tax consequences for that last taxation year); and

B is

- (a) nil, if the following amount is less than or equal to \$10 million:
 - (i) where the particular corporation is not associated with any other corporation in the particular taxation year, the amount that is its taxable capital employed in Canada (within the meaning assigned by section 181.2) for its immediately preceding taxation year, or
 - (ii) where the particular corporation is associated with one or more other corporations in the particular taxation year, the amount that is the total of all amounts, each of which is the taxable capital employed in Canada (within the meaning assigned by section 181.2) of the particular corporation for its, or of one of the other corporations for its, last taxation year that ended in the last calendar year that ended before the end of the particular taxation year; or
- (b) in any other case, the lesser of \$40 million and the amount by which the amount determined under subparagraph (a)(i) or (ii), as the case may be, exceeds \$10 million.

(16) That, for taxation years that include February 26, 2008, the expenditure limit of a corporation for the taxation year in subsection 127(10.2) of the Act be determined by the formula

$$A + [(B - A) \times (C/D)]$$

where

A is the expenditure limit of the corporation for the taxation year determined in accordance with the formula in subsection 127(10.2) as that subsection read in its application to a taxation year that ended immediately before February 26, 2008;

B is the expenditure limit of the corporation for the taxation year determined in accordance with the formula in subsection 127(10.2) as that subsection is proposed to be enacted by subsection (15);

C is the number of days in the taxation year that are after February 25, 2008; and

D is the total number of days in the taxation year.

CCH Editorial Comment: The 2008 Budget proposes a number of changes to update the tax incentive program for Scientific Research and Experimental Development ("SR&ED").

The existing program allows for full deductibility of certain current and capital expenditures and also provides for investment tax credits (“ITCs”) in respect of such expenditures. ITCs fall into two categories: general ITCs (at the rate of 20%) and enhanced ITCs (at the rate of 35%). The enhanced ITCs are only available to taxpayers that qualify as Canadian-controlled private corporations (“CCPCs”) in respect of an annual limit of \$2 million of qualified SR&ED expenditures. To the extent a CCPC cannot fully apply such enhanced ITCs to reduce its tax payable in a given year, the unused portion is fully refundable. For a CCPC, this can generate a maximum annual tax refund of \$700,000 (35% of \$2.0 million). Currently, the \$2 million limit is phased out for CCPCs that reach certain thresholds of taxable income (\$400,000 to \$600,000) or taxable capital employed in Canada (\$10 million to \$15 million).

Resolution 15 provides a proposed amendment to subsection 127(10.2) which increases the expenditure limit for enhanced ITCs to \$3 million. The proposed increase is applicable for taxation years that end after February 26, 2008, and is pro-rated based on the number of days in the taxation year that are after February 25, 2008. The effect of this amendment increases the maximum amount of fully refundable ITCs to \$1.05 million from \$700,000 (i.e. 35% of \$3.0 million).

Resolution 15 also increases the maximum levels of taxable income and capital before the refundable ITCs are fully phased out. The ranges of taxable income and capital for a CCPC (together with associated corporations) are proposed to be \$400,000 to \$700,000 and \$10 million to \$50 million, respectively. The phase out in a particular year is based on the levels of taxable income and capital for the immediately preceding taxation year. The limits will be applicable for taxation years that end after February 26, 2008 and will be pro-rated based on the number of days in that taxation year that are after February 25, 2008.

Currently, one of the requirements to qualify for ITCs is that the relevant expenditures had to be related to SR&ED carried on in Canada by the taxpayer. Resolution 12 contains proposed subsections 37(1.4) and (1.5) which will deem certain expenditures incurred outside of Canada (on or after February 26, 2008) to be deemed to be made in the taxation year in respect of SR&ED carried on in Canada. The Budget Papers refer to the salary and wages paid to Canadian employees who are required to test their research in tropical or desert climates, as an example of these types of expenditures. These provisions will likely be welcomed by the R&D community, but they appear to have very narrow application. To qualify, the expenditures must relate to salary or wages paid to Canadian resident employees of the taxpayer who are undertaking the taxpayer’s SR&ED outside of Canada solely in support of SR&ED carried on in Canada related to the business of the taxpayer. In addition, there is a cap applicable to these types of eligible expenditures equal to 10% of the total salary and wages directly attributable to SR&ED carried on in Canada by the taxpayer during the taxation year. For the first taxation year ending on or after February 26, 2008, this 10% cap will be pro-rated based on the number of days in the taxation year after February 25, 2008.

Resolution 13 contains further limiting provisions which clarify that bonuses and profit sharing paid to employees are not included in the computations of eligible salary and wages. Also excluded are salary and wages paid to an employee undertaking SR&ED in a foreign country that are subject to income or profits taxes imposed by such country because of the presence or activities of the employee.

Resolution 17: Graduated Penalties and Remittance of Source Deductions

(17) That, in respect of remittances by a prescribed person that are first due on or after February 26, 2008, section 153 of the Act be amended to add after subsection (1.3) the following:

Exception — remittance to designated financial institution

(1.4) For the purpose of subsection (1), a prescribed person referred to in that subsection is deemed to have remitted an amount to the account of the Receiver General at a designated financial institution if the prescribed person has remitted the amount to the Receiver General at least one day before the day upon which the amount is due.

CCH Editorial Comment: Subsection 153(1) of the *Income Tax Act* requires large employers (as described in Regulation 110) to remit source deductions to designated financial institutions. This is to ensure that the payments are immediately credited to the Government of Canada. A failure to so remit could result in penalties to the large employer under Subsection 227(9) of the Act. This was the situation in *Pontiac Buick Cadillac Ltd. v. Canada (Customs and Revenue Agency)*, 2007 DTC 5014 (T.C.C.), in which the Tax Court ordered the Canada Revenue Agency to reconsider its decision to impose penalties on a large employer that had made its remittance directly to the Tax Services Office on the due date.

Resolution 17 provides that a remittance received directly by the CRA at least one full day before the due date will be considered to be in compliance with the requirement that it be remitted to a designated financial institution. This measure will apply to remittances that are first due on or after February 26, 2008.

The graduated penalty regime described in Resolution 18 applies to late remittances under this rule.

Resolution 18: Graduated Penalties and Remittance of Source Deductions

(18) That, in respect of payments and remittances that are required to be made on or after February 26, 2008, paragraph 227(9)(a) of the Act be replaced by the following:

- (a) subject to paragraph (b), if
- (i) the Receiver General receives that amount on or before the day it was due, but that amount is not paid in the manner required, 3% of that amount,
 - (ii) the Receiver General receives that amount
 - (A) one to three days after it was due, 3% of that amount,
 - (B) four or five days after it was due, 5% of that amount,
 - (C) six or seven days after it was due, 7% of that amount, or
 - (iii) that amount is not paid or remitted on or before the seventh day after it was due, 10% of that amount; or

CCH Editorial Comment: Currently, every person who fails to remit or pay on time an amount that has been deducted or withheld under the *Income Tax Act* or the Regulations is liable for a penalty of 10% of that amount.

Resolution 18 proposes to replace the current 10% fixed penalty with a graduated penalty regime. Under this graduated regime, the applicable penalty ranges from 3% to 10% of the amount required to be remitted, depending on the lateness of the remittance, as follows:

- one to three days late — 3%;
- four to five days late — 5%;
- six to seven days late — 7%; and

- more than 7 days late — 10%.

This measure will be effective for remittances due on or after February 26, 2008.

Resolution 19: Enhancing Canada’s Cross-Border Business and Investment Environment

(19) That, in respect of dispositions of property that take place after 2008,

(a) subsection 116(5) of the Act be amended by deleting the word “or” at the end of paragraph (a) and by adding the following after that paragraph:

(a.1) subsection (5.01) applies to the acquisition, or

(b) section 116 of the Act be amended by adding the following after subsection (5):

Treaty-protected property

(5.01) This subsection applies to the acquisition of a property by a person (referred to in this subsection as the “purchaser”) from a non-resident person if

(a) the purchaser concludes after reasonable inquiry that the non-resident person is, under a tax treaty that Canada has with a particular country, resident in the particular country;

(b) the property would be treaty-protected property of the non-resident person if the non-resident person were, under the tax treaty referred to in paragraph (a), resident in the particular country; and

(c) the purchaser provides notice under subsection (5.02) in respect of the acquisition.

Notice by purchaser in respect of an acquisition of property

(5.02) A person (referred to in this subsection as the “purchaser”) who acquires property from a non-resident person provides notice under this subsection in respect of the acquisition if the purchaser sends to the Minister, on or before the day that is 30 days after the date of the acquisition, a notice setting out

(a) the date of the acquisition;

(b) the name and address of the non-resident person;

(c) a description of the property sufficient to identify it;

(d) the amount paid or payable, as the case may be, by the purchaser for the property; and

(e) the name of the particular country.

(c) subsection 116(6) of the Act be amended by deleting the word “and” at the end of paragraph (g), by adding the word “and” at the end of paragraph (h) and by adding the following after paragraph (h):

(i) a property that is, at the time of its disposition, a treaty-exempt property of the person;

(d) section 116 of the Act be amended by adding the following after subsection (6):

Treaty-exempt property

(6.1) For the purpose of subsection (6), a property is a treaty-exempt property of a non-resident person, at the time of the non-resident person's disposition of the property to another person (referred to in this subsection as the "purchaser"), if

- (a) it is, at that time, a treaty-protected property of the non-resident person; and
- (b) where the purchaser and the non-resident person are related at that time, the purchaser provides notice under subsection (5.02) in respect of the disposition.

(e) clauses 150(1)(a)(i)(C) and (D) of the Act be replaced by the following

- (C) has a taxable capital gain (otherwise than from an excluded disposition), or
- (D) disposes of a taxable Canadian property (otherwise than in an excluded disposition), or

(f) subparagraph 150(1)(a)(ii) of the Act be replaced by the following:

- (ii) tax under this Part
 - (A) is payable by the corporation for the year, or
 - (B) would be, but for a tax treaty, payable by the corporation for the year (otherwise than in respect of a disposition of taxable Canadian property that is treaty-protected property of the corporation);

(g) subparagraph 150(1.1)(b)(iii) of the Act be replaced by the following:

- (iii) where the individual is non-resident throughout the year, the individual has a taxable capital gain (otherwise than from an excluded disposition) or disposes of a taxable Canadian property (otherwise than in an excluded disposition) in the year, or

(h) section 150 of the Act be amended by adding the following after subsection (4):**Definition of "excluded disposition"**

(5) For the purposes of this section, a disposition of a property by a taxpayer at any time in a taxation year is an excluded disposition if

- (a) the taxpayer is non-resident at that time;
- (b) no tax is payable under this Part by the taxpayer for the taxation year;
- (c) the taxpayer is, at that time, not liable to pay any amount under this Act in respect of any previous taxation year (other than an amount for which the Minister has accepted, and holds, adequate security under section 116 or 220); and
- (d) each taxable Canadian property disposed of by the taxpayer in the taxation year is
 - (i) excluded property within the meaning assigned by subsection 116(6), or
 - (ii) a property in respect of the disposition of which the Minister has issued to the taxpayer a certificate under subsection 116(2), (4) or (5.2).

CCH Editorial Comment: Under the existing provisions of the Act, where a non-resident person disposes of taxable Canadian property ("TCP") (other than certain excluded property), the non-resident is required, either before disposing of the property or within 10 days of the date on which the disposition took place, to send a notice to the Canada Revenue Agency with the name and address of the purchaser, a description of the property,

the proceeds of disposition of the property, and the adjusted cost base (“ACB”) to the non-resident immediately before the disposition.

Where no exemption or deferral with regards to the Canadian tax is available in respect of the disposition, the notice is accompanied by a payment on account of the tax payable. The Act requires that the amount of the payment be equal to 25% (assuming the TCP is not depreciable property and certain other types of property) of the amount, if any, by which the proceeds of disposition of the property exceeds its ACB immediately before the disposition. When the CRA is satisfied that it has received an amount equal to the tax on any gain, or appropriate security for such tax, the CRA issues a clearance certificate to the vendor (commonly known as a “section 116 certificate”) with a copy of the certificate delivered to the purchaser.

Where no tax is payable by the non-resident vendor by virtue of the application of a rollover provision in the Act (such as subsection 85(1)) or an exemption under an applicable income tax treaty or convention, the CRA allows vendors to claim such exemptions at the time they file the notification of disposition.

Subsection 116(5) provides that where a purchaser has acquired from a non-resident person any TCP (other than certain excluded property), the purchaser is liable to pay and shall remit to the Receiver General, 25% of the cost to the purchaser of the property acquired, unless (a) after reasonable inquiry, the purchaser had no reason to believe the vendor was a non-resident of Canada, or (b) an appropriate section 116 certificate has been provided to the purchaser. The purchaser is entitled to deduct or withhold this amount from the purchase price payable to the non-resident vendor in order to make such remittance within 30 days after the end of the month in which the property was acquired by the purchaser (the “Remittance Date”).

Thus, while the vendor of the TCP may not be subject to any Canadian taxes on the disposition, the purchaser of the TCP is nonetheless obliged to withhold 25% of the purchase price until such time as the purchaser receives a section 116 certificate from the CRA.

Currently, it takes several months to obtain a section 116 certificate, even where an exemption or rollover applies and no Canadian income taxes are payable. In recent years, the CRA has been unable to keep up with the growing number of requests for section 116 certificates. Because the purchaser is required to pay the withheld amount before the Remittance Date, a vendor who was unable to obtain a section 116 certificate before that time would have to wait until the beginning of the next taxation year to file its tax return and apply for a refund of the withheld amount. To prevent this delay, the CRA began issuing “comfort letters” advising the purchaser that it need not remit the withheld funds before the Remittance Date, but rather could continue to hold these amounts until the purchaser received a section 116 certificate or further notice from the CRA to remit the amount to it. Interestingly, the CRA’s comfort letters are not provided for in the Act.

This procedure has had a negative effect on foreign investment in Canada. Firstly, 25% of the proceeds from the sale of TCP is held by the purchaser for months waiting for the CRA to issue a section 116 certificate. Non-resident sellers of TCP are prejudiced by these waiting periods as they cannot reinvest or otherwise spend their money while they wait for the CRA to get through the backlog. Secondly, the costs to the parties of (i) providing for the complex section 116 procedures in the sale agreement; (ii) preparing the section 116 notice form (T2062) and accompanying documentation; (iii) obtaining the necessary comfort letter to avoid remittance; and (iv) responding to the inevitable enquiries from the CRA during the processing of the application, are continually growing.

In response to these concerns, Resolution 19 eases the compliance burden for certain non-residents investing in shares of private Canadian corporations and other TCP. These

provisions will apply to dispositions that occur after 2008. The primary relieving amendment contained in the Notice of Ways & Means is the amendment to the definition of “excluded property” which is expanded to include property that is, at the time of the disposition, a “treaty-exempt property”. A property is a “treaty-exempt property” of a non-resident person for this purpose if it is a “treaty-protected property” (as currently defined under Subsection 248(i) and, where the purchaser and the non-resident are related at that time, the purchaser provides notice under new subsection 116(5.02) in respect of the disposition. “Treaty-protected property” of a taxpayer as currently defined under subsection 248(1) means property any income or gain from the disposition of which by the taxpayer at that time would, because of a tax treaty with another country, be exempt from tax under Part I of the Act. As a result of this proposed amendment to the Act, non-resident vendors of TCP will not be required to apply for a section 116 certificate provided they are resident in a jurisdiction with which Canada has a tax treaty and the gains from the disposition of the TCP are exempt from Part I tax by virtue of such treaty. This change will significantly reduce the tax compliance costs associated with the disposition of TCP by non-residents.

Non-residents disposing of TCP may also avoid the negative consequences associated with the withholding against the payment of the purchase price required of the purchaser. The Budget introduces amendments to subsection 116(5) and proposed subsections 116(5.01) and 116(5.02) which provide a “safe harbour” for purchasers acquiring treaty-protected property from a person resident in a country that has a tax treaty with Canada. In order to avoid the requirement to withhold 25%, (i) the purchaser must conclude after reasonable inquiry that the non-resident disposing of the TCP is resident in a treaty country; (ii) the property would be treaty-protected property if the non-resident were a resident of such country; and (iii) the purchaser must provide notice under proposed subsection 116(5.02).

The second of these three requirements appears to be quite problematic to the successful implementation of a true “safe harbour”. The first requirement allows for the purchaser to reach a conclusion about the residency of the non-resident vendor based on a reasonable inquiry but the second requirement is that the property must be “treaty-protected property” of the vendor. The second requirement does not provide for the same “reasonable inquiry” defence. Therefore, if the purchaser incorrectly concludes that the TCP being acquired is “treaty-protected property”, the purchaser will not fall within this safe harbour and will be liable for failing to withhold amounts against the purchase price as required under section 116; even where such conclusion was based on a reasonable inquiry. There may be circumstances where TCP is not “treaty-protected property” by virtue of certain characteristics of the vendor or how the property was used or held by the vendor. For example, Article XIII of the Canada–U.S. Income Tax Convention provides that Canada may impose tax on the sale of property if the U.S. resident vendor has (or had) a permanent establishment in Canada and the property formed part of the business property of the permanent establishment. Similarly, under Article XIII, former residents of Canada may be subject to Canadian income tax on the disposition of property that would otherwise be treaty exempt.

Therefore, where an arm’s length purchaser is not able to confirm that the TCP being acquired is treaty-protected property, such purchasers will likely be reluctant to rely on this safe harbour and, in many cases, will continue to withhold the required amounts from the purchase price. In circumstances, where the purchaser is willing to accept this risk or to rely on an indemnity from the vendor, the purchaser of TCP may not withhold. Presumably, this safe harbour risk will be more acceptable when the non-resident vendor and purchaser are related.

Proposed new subsection 116(5.02) provides for the creation of a new compliance requirement for the purchaser arising from the acquisition of TCP. This provision requires the purchaser to provide notice to the Minister in respect of such acquisition on or before the day that is 30 days after the date of the acquisition. The information required to be contained in

such notice is largely the same as the information required in the notices provided for in subsection 116(1) by vendors of TCP.

Another important proposed change contained in the Budget relates to the requirement by a non-resident to file a Canadian tax return for the taxation year in which the non-resident disposes of TCP. Resolution 19 contains amendments to section 150 that will eliminate the requirement for non-resident corporations and individuals to file a Canadian tax return in respect of an “excluded disposition”. This term is defined in new subsection 150(5) and will relieve the non-resident from the requirement to file a tax return where there is a disposition of TCP that is excluded property (including tax-exempt property under new subsection 116(6.1)) or where a section 116 certificate was issued to the non-resident and no tax is payable under Part I by the non-resident for the taxation year. To fall within this definition of “excluded disposition”, the non-resident must also not be liable to pay any amount under the Act in respect of any previous taxation year (unless the Minister holds adequate security for such amount under section 116 or 220).

It is unfortunate that these changes will only apply to dispositions occurring after 2008. This means that the existing backlog and delay will continue to cause frustration and expense for the coming months.

Resolution 20: Donation of Medicines for the Developing World

(20) That, in respect of gifts of medicine that are made on or after July 1, 2008,

(a) paragraphs 110.1(8)(b) and (c) of the Act be replaced by the following:

- (b) the property that is the subject of the gift is a medicine that is available to be used by the donee at least six months prior to the expiration date, within the meaning of the *Food and Drug Regulations*, of the medicine;
- (c) the medicine qualifies as a drug, within the meaning of the *Food and Drugs Act*, and the drug
 - (i) meets the requirements of that Act, or would meet those requirements if that Act were read without reference to its subsection 37(1), and
 - (ii) is not a food, cosmetic or device (as those terms are defined in that Act), a natural health product (as defined in the *Natural Health Products Regulations*) or a veterinary drug;

(b) paragraph 110.1(8)(e) of the Act be replaced by the following:

- (e) the donee is a registered charity that, in the opinion of the Minister of International Cooperation (or, if there is no such Minister, the Minister responsible for the Canadian International Development Agency) meets conditions prescribed by regulation.

CCH Editorial Comment: Generally, donations by corporations of property held in inventory to Canadian registered charities and other qualified donees are eligible for a deduction equal to the fair market value of the gifted property. However, this charitable tax donation is generally fully offset by the income inclusion from the disposition of the product, resulting in a net deduction to the corporation equal to the cost of the property.

To encourage the donation of excess inventories of medicine, Budget 2007 introduced measures to allow corporations, that make donations from their inventory, to claim a special additional deduction equal to the lesser of; (i) 50% of the difference between the value of the donated medicine and its cost, and (ii) the cost of the medicine. In order to qualify for this additional donation, the donation must be made to a Canadian registered charity that

receives funding from the CIDA (Canadian International Development Agency) and be specified for use outside of Canada.

Resolution 20 of the 2008 Budget proposes to change the definition of an eligible charity to a registered charity that, in the opinion of the Minister of International Cooperation (or, if there is no such Minister, the Minister responsible for CIDA) meets conditions prescribed by regulation. The main purpose of these conditions will be to ensure that eligible charities; (a) act in a manner consistent with the principles and objectives of the World Health Organization Guidelines for Drug Donations, (b) have expertise in delivering medical donations to the developing world; and (c) implement appropriate policies and practices with respect to the delivery of international development assistance.

Currently, the additional deduction is available for medicines that meet the requirement of the *Food and Drugs Act* even if the expiry date of those medicines is imminent. Resolution 20 of the 2008 Budget proposes that eligible gifts of medicine must be donated at least six months prior to the expiration date of the medicines.

These changes will apply to eligible donations of medicines made on or after July 1, 2008.

Resolution 21: Provincial Component of SIFT Tax

(21) That, for the 2009 and subsequent taxation years,

(a) the description of D in subsection 122(1) of the Act be replaced by the following:

D is the provincial SIFT tax rate of the SIFT trust for the taxation year, and

(b) the description of C in the definition “taxable SIFT trust distributions” in subsection 122(3) of the Act be replaced by the following:

C is the provincial SIFT tax rate of the SIFT trust for the taxation year.

(c) the description of C in subsection 197(2) of the Act be replaced by the following:

C is the provincial SIFT tax rate of the SIFT partnership for the taxation year.

(d) the definition “provincial SIFT tax factor” in subsection 248(1) of the Act be replaced by the following:

“provincial SIFT tax rate”

«*taux d'imposition provinciale des EIPD*»

“provincial SIFT tax rate” of a SIFT trust or SIFT partnership for a taxation year means the prescribed amount determined in respect of the SIFT trust or SIFT partnership for the taxation year;

CCH Editorial Comment: On October 31, 2006, the Minister of Finance of Canada announced a tax fairness plan which dealt with taxing certain “flow-through” trusts and partnerships. Legislation to implement the proposed changes was contained in Bill C-52 which received Royal Assent on June 22, 2007 (“The SIFT Rules”). The SIFT Rules apply a tax on certain income earned by a specified investment flow-through trust and partnership (“SIFT”). In general terms, a SIFT is subject to tax on its non-portfolio earnings as defined in the *Tax Act*.

The SIFT Rules generally do not apply until the 2011 taxation year for SIFTs entities, the units of which were publicly traded prior to November 1, 2006 so long as the SIFT complies with the normal Growth Guidelines issued by the Department of Finance of Canada on December 15, 2006.

The government has announced that it would introduce measures which would facilitate the conversion of pre November 1, 2006 SIFTs to corporations. Although, these measures

were not included in this Budget, the Budget confirms the Government's intention to introduce such measures. As well, the Budget has confirmed that the Government will proceed with technical modifications to the SIFT Rules announced on December 20, 2007.

Currently, the provincial component of the SIFT tax is set at a rate of 13%, which is intended to approximate the average provincial corporate income tax rate. Resolution 21 proposes that, beginning in the 2009 taxation year, the provincial component of the SIFT tax will be based on the general provincial corporate income tax rate of each province in which the SIFT has a permanent establishment.

To determine the tax rate, the taxable distributions of a particular SIFT will be notionally allocated to provinces according to the general corporate taxable income allocation formula. Specifically, a SIFT's taxable distributions will be allocated to a province by a formula based on the gross revenue and salaries and wages paid to employees in that province. The relevant provincial tax rate will then be applied, generating a dollar amount that provides an average rate of provincial tax that will in turn be the provincial component of the SIFT tax rate of the particular SIFT for the taxation year.

Taxable distributions not allocated to a province will be subject to a 10% rate for the provincial component.

The provincial component applied to Quebec will be deemed to be nil to take into account the SIFT tax which is to be imposed in that province as set out in the Quebec Ministry of Finance Bulletin 2007-5 issued on June 26, 2007 and which is to be based on the Quebec corporate tax rate.

Update on Measures Not in the ITA Notice of Ways and Means Motion

Selected Regulations

Manufacturing and Processing: Accelerated CCA

The 2007 Budget provided that machinery and equipment used in manufacturing or processing that would otherwise be included in Class 43 (and eligible for CCA on a 30% declining balance basis) would, if acquired before 2009, be included in Class 29 (and eligible for a 50% straight-line CCA rate).

The 2008 Budget extends the inclusion in Class 29 for assets acquired in 2009.

Assets acquired in 2010 will be placed in a separate Class 43, and CCA in respect of such assets may be claimed at a 50% declining-balance rate in the year of acquisition; a 40% declining-balance rate in the year after acquisition; and the regular 30% declining-balance rate thereafter.

For assets acquired in 2011, CCA may be claimed at the 40% declining-balance rate in the year of acquisition and at the 30% declining-rate balance thereafter.

The additional CCA being claimed on Class 43 assets will be subject to the half-year rule.

CCA for Buildings

The 2007 Budget promised additional CCA for buildings used for manufacturing and processing and other non-residential purposes. Before the changes, the CCA rate in respect of all buildings was generally 4%. The proposed amendment to the Regulation provides that if at least 90% of the floor space of a building is used for manufacturing or processing in Canada of goods for sale or lease, then an election may be made for the property to be in a separate class for which an additional 6% CCA may be claimed on a declining-balance basis.

An additional 2% CCA may be claimed for other non-residential buildings.

Additions or alterations to a building will be deemed to be a separate building for the purposes of claiming the additional CCA. Also, if a building was under constructions on March 19, 2007, the capital cost of the building incurred before March 19, 2007 is deemed to have been incurred by the taxpayer on March 19, 2007.

Class 50

A new CCA class — Class 50 — is to be introduced. It provides for a 55% CCA rate on a declining-balance basis for general-purpose electronic data processing equipment and system software for that equipment.

Previously Announced Measures

In the Budget, the government noted that it intends to proceed with the following previously announced measures, with some revisions, as a result of consultations and discussion since they were originally released:

- Taxation of foreign affiliates, originally released as draft legislation on February 27, 2004;
- Proposed improvements to the application of the GST/HST to the financial services sector announced on January 26, 2007;
- Proposals for the taxation of financial institutions to align the tax rules more closely with accounting standards, released as draft legislation on November 7, 2007;
- Technical modifications announced on December 20, 2007 to the income tax rules that apply to “specified investment flow-through” (“SIFT”) trusts and partnerships, along with measures to facilitate the conversion of SIFTs to corporations;
- The proposed extension from 10 to 20 years of the carryforward period for unused investment tax credits for Canadian businesses, announced on January 29, 2008;
- The increase in the automobile expense figures for 2008, announced on December 24, 2007.

Interestingly, there is no mention of the Government’s intention to introduce legislation relating to the deductibility, for income tax purposes, of interest and other expenses. Draft legislation in this regard was released in October 2003 and there was extended public consultation on the proposals which ended in August 2004. At that time, the Department of Finance announced that new proposals would be released for discussion, but, to date, the Department has failed to do so.

One other proposal which is not mentioned in the Budget is cross-border share-for-share exchanges. In October 2000, it was announced that a provision would be added to the *Income Tax Act* to permit Canadians to sell shares of a Canadian corporation to a non-resident corporation for the non-residents stock on a “rollover” basis. This proposal seems to have died.

Sales and Excise Tax Measures

CCH Editorial Comments: Notice of Ways and Means Motion to Amend the Excise Tax Act re: GST/HST

The 2008 Budget included a Notice of Ways and Means Motion to Amend the *Excise Tax Act*. This included a number of GST/HST initiatives. Key measures are discussed below.

Health Measures

Part II of Schedule V to the *Excise Tax Act* (the “Act”) provides for the exemption from GST/HST of various health care services. Parts I and II of Schedule VI, respectively, zero-rate many prescription drugs and medical and assistive devices. Budget 2008 proposes to expand both the exemptions and zero-rating available on a variety of health-related services. The proposed measures are generally intended to take effect for supplies made after February 26, 2008. The following paragraphs provide information on these measures.

Training for Individuals with Autism

It was noted that in some cases, inconsistent GST/HST treatment resulted from the exemption of certain types of assistance or training but not others. Consequently, the Budget proposes to add new section 14 to Part II of Schedule V. This section would add a new exemption for certain training services provided to individuals with autism or other disabilities. In order to qualify, the training must be specially designed to assist such individuals in coping with the disorder or disability or to alleviate or eliminate effects of the disorder. In addition:

- a specified health care practitioner must, in the course of a professional-client relationship, have identified the training as an appropriate means to assist the individual in either of the ways mentioned above;
- a prescribed person must have certified in writing that the training is similarly appropriate; or
- the training must be supplied by a government, *or* be fully or partially reimbursed by a government or designated organization, *or* the supplier must have received satisfactory evidence that the individual received (or will receive) an amount by a government or designated organization in order to acquire the training.

Training that would have normally been given to individuals who do not have a disorder or disability, and training for those not providing care or supervision to an individual with the disorder or disability, are excluded from the exemption.

Nursing Services

The Budget proposes to exempt a wider range of nursing services than those previously exempt. This is intended to take into account changes in nursing services over the past many years. Section 6 of Part II of Schedule V will be amended to widen the net of

exempt nursing services so that services rendered to individuals by registered nurses, registered nursing assistants, licensed or registered practical nurses, or registered psychiatric nurses will be exempt, provided that the services are rendered within a nurse-patient relationship. The location where the services were performed would no longer be relevant; to use the Department of Finance's example, a vaccination provided by a registered nurse would be exempt whether it was administered in a hospital or in a private practice office.

In addition, an amendment is proposed to section 10 of Part II of Schedule V to expand the exemption for diagnostic services, such as X-rays or blood tests.

Prescription Drugs

The Budget proposes to expand the zero-rating of drugs. Paragraph 3(b) of Part I of Schedule VI is amended so all drugs prescribed by health professionals authorized to prescribe them under provincial or territorial legislation will be zero-rated. The amendment would apply to supplies made after February 26, 2008, and to ones made on or before that date if no amount had yet been charged, collected or remitted as on account of GST/HST.

Paragraph 3(b) makes reference to an "authorized individual"; this term is newly defined in section 1 of Part I of Schedule VI. The definition of "prescription" in section 1 of Part I of Schedule VI is also amended to refer to an "authorized individual".

Two clarifying amendments are made to paragraphs 2(b) and 2(d) of Part I of Schedule VI.

Medical and Assistive Devices

A number of changes were proposed to Part II of Schedule VI, which provides for zero-rating of stipulated medical and assistive devices. The changes include the following:

- the addition of chest wall oscillation systems for airway clearance therapy (section 6);
- the addition of a general provision exempting chairs specially designed for use by an individual with a disability, where supplied on written order of a medical practitioner (new section 14.1; note also that existing section 14 is now restricted to chairs designed for locomotion, and that commode chairs are now dealt with in section 20);
- former sections 33 and 33.1 were replaced with new section 33, which is expanded to include not only guide dogs for use of blind individuals or individuals with hearing impairments, but supplies of service animals in general (or services of training individuals to use the animals), as long as the animals are specially trained to assist individuals with disabilities or impairments with a problem arising from such disabilities or impairments, and the supplies are made to or by an organization operated for that purpose; and
- a new provision is added to exempt supplies of devices specially designed for neuromuscular stimulation therapy or standing therapy, if supplied pursuant to a

medical practitioner's written order for use by a consumer with paralysis or a severe mobility impairment (section 41).

Exempt Health Services Supplied Through a Corporation

Amendments are proposed to provide that services of certain health professionals will be exempt regardless of whether they are provided directly by those individuals or through a corporation.

Real Property Measures

Long-Term Residential Care Facilities

In recent years, the GST/HST treatment of long-term residential care facilities has received significant attention. The Budget proposes several changes affecting such facilities. These are discussed very briefly in the following paragraphs.

In the recent Federal Court of Appeal decision in *North Shore Health Region v. The Queen*, 2008 GTC 1162, neutral citation: 2008 FCA 2, the Court held that the owner/operator of a health care facility was not required to self-assess GST on substantial completion of the facility. The Court held that the occupants of the facility did not have "possession", as mentioned in subparagraph 191(3)(b)(i) of the Act, of rooms in the facility. Consequently, the facility was not obliged to self-assess GST on substantial completion, and the appeal was allowed.

The 2008 Budget proposes to amend various provisions in the Act, including subparagraph 191(3)(b)(i) and other portions of section 191, to include the words "or use" after the reference to possession and make related amendments. See also amendments relating to the residential real property rebate provisions and to "head leases", and the proposed additions of section 236.4 of the Act and section 6.11 of Part I of Schedule V.

For the specific timing rules for these amendments, refer to sections 16 through 22 of the Notice of Ways and Means Motion.

Treatment of Property Leases for Wind and Solar Power Equipment

Supplies of rights to explore for, or to exploit, various kinds of resources (mineral deposits, peat deposits, or forestry, water, or fishing resources), are deemed not to be a supply for GST/HST purposes, and payments made for those rights are not treated as "consideration". The 2008 Budget proposes to expand this treatment to supplies of rights to enter or use land to generate, or evaluate the feasibility of generating, solar or wind power. Supplies made directly to consumers or non-GST/HST registrants are not granted this tax relief: this is also consistent with the treatment of other exploration rights.

This measure is to be applicable for supplies made on or after February 26, 2008, and to supplies made before this date, but only in respect of that consideration paid or payable on or after this date.

Previously Announced Measures

Financial Institutions

The 2008 Budget also confirmed the government's intention to proceed with the proposed amendments relating to GST/HST and financial institutions that were announced on January 26, 2007.

CCH Editorial Comment: Notice of Ways and Means Motion to Amend the *Excise Act, 2001, Excise Act, and Customs Tariff*

Tobacco-Related Measures

Changes proposed in the 2008 Budget relating to tobacco taxation include:

- a proposal that would limit possession and importation of tobacco manufacturing equipment to persons with a licence;
- increased authority for the Minister to refuse to issue, or to cancel, a tobacco licence;
- a new excise duty rate on manufactured tobacco of \$2.8925 per 50 grams or fraction thereof, effective July 1, 2008, to discourage the sale of small-sized packages and to simplify the CRA's administrative practices;
- an increased rate of duty on tobacco sticks, to equal the rate applicable to cigarettes; and
- a new refund mechanism for imported stamped tobacco products.

Spirits-Related Measures

Budget 2008 proposes to treat imitation spirits as it treats spirits, rather than like beer. Brewed products with an alcohol concentration of over 11.9% alcohol by volume will qualify as spirits and be subject to excise duty accordingly. Producers or importers of such spirits will accordingly need to acquire a licence to produce spirits. Such producers or importers have until 30 days after this measure receives Royal Assent to obtain the new licence. Until that time, the existing licence to produce or import beer will be treated as a spirits licence.

CCH Editorial Comment: Other

Aboriginal Tax Policy

The federal government reiterated its "willingness to discuss and put into effect direct taxation arrangements with interested Aboriginal governments". Currently, there are 30 sales tax arrangements involving *Indian Act* bands or self-governing Aboriginal groups.