GGFL FEDERAL BUDGET COMMENTARY

January 27, 2009

BUDGET OVERVIEW

As was widely expected, the Budget presents a wide-ranging package of provisions to stimulate the economy through dramatically increased, although mostly time-limited, spending on infrastructure and targeted programs. It also proposes a variety of tax measures aimed at increasing consumer spending and business investment, boosting employment and providing some relief to those most affected by the current downturn.

The Budget also signals the return of federal budget deficits. The Minister forecast deficits of almost $34 billion for fiscal year 2009-10 and almost $30 billion in 2010-11, although he also predicted a small budget surplus by 2013-14.

In aggregate, the Budget proposes a series of new programs and tax incentives totaling approximately $34.8 billion over two years, including $7 billion of new spending on infrastructure such as roads, bridges, public transport, college and university upgrades, social housing, broadband Internet access and renewable-energy projects. This is in addition to $33 billion already committed for longer-term projects under the Building Canada Plan. Other stimulus measures include $8 billion allocated for training and skills development, including a doubling of the Working Income Tax Benefit, and increased program spending of $160 million for culture, $302 million for heritage and tourism and $170 million for forestry programs, as well as incentives targeted at farming, media, entertainment and small businesses.

In addition, to help ease credit pressures a variety of measures including a new Extraordinary Financing Network will give individuals and businesses access to up to $200 billion in liquidity and financing. In total, spending on stimulus measures will amount to 1.9 percent of Canada's GDP for 2009-10. This approximates the recent recommendations of the International Monetary Fund and the G20 group of nations. However, it falls short of the 3-percent-of-GDP stimulus package proposed in the United States. In his Budget speech, Minister Flaherty said that despite the forecast budget deficits, by 2013 Canada's net debt as a share of the national economy will be the lowest of the G7 nations, "by a wide margin."

In summary, the 2009 Budget was clearly designed to persuade Canadians that the federal government is taking concrete action to meet the challenges of the current recession and the bleak near-term economic outlook. Whether or not it will “float” in Canada’s unsettled political waters remains to be seen.

PERSONAL

PERSONAL INCOME TAX RATES

The previously announced federal personal tax brackets for 2009, based on taxable income, were as follows:

- 15% on the first $38,832
- 22% between $38,832 and $77,664
- 26% between $77,664 and $126,264
- 29% over $126,264

This Budget proposes the following increased personal tax brackets for 2009:

- 15% on the first $40,726 (federal tax saving of $132)
- 22% between $40,726 and $81,452 (federal tax saving of $76)
- 26% between $81,452 and $126,264 (no tax saving)
- 29% over $126,264 (no tax saving)

These tax brackets will be indexed to account for inflation in 2010 and subsequent years.

BASIC PERSONAL AMOUNT

The basic personal amount, the spouse or common-law partner amount and the eligible dependant amount will be increased to $10,320 (from $10,100) for the 2009 taxation year and indexed to inflation for subsequent years. This will result in a federal tax savings of $33 in 2009 for each applicable credit.

AGE CREDIT

For 2009, effective January 1, the amount on which the age credit is based will be increased from $5,408 to $6,408 and indexed thereafter. This increase will provide up to an additional $150 of federal tax savings, depending upon the individual’s taxable income for the year. The income level at which this credit is fully phased out will increase from $68,365 to $75,032.

HOME RENOVATION TAX CREDIT (HRTC)

The Budget proposes a 15% non-refundable tax credit to individuals for eligible expenditures in excess of $1,000, but not more than $10,000, made in respect of eligible dwellings. This will result in a maximum federal credit of $1,350 ($9,000 x 15%).

Work must be performed or goods acquired between January 28, 2009 to January 31, 2010. However, the credit will not be available for expenditures pursuant to an agreement entered into prior to January 28, 2009. The credit may be claimed in the individual's 2009 personal tax return, even with respect to qualifying expenditures incurred in 2010.

The HRTC provides a single limit for each family. A family consists of an individual, a spouse or common-law partner and their children under age 18 throughout 2009. The HRTC may be claimed entirely by one member of the family or by any members of the family. Two or more families which share ownership of an eligible dwelling will each be eligible for the credit.

An eligible dwelling consists of a person's principal residence, or a principal residence of one or more of the other family members. For condominiums and co-operative housing corporations, eligible expenditures will include the individual's share of the cost of renovating common areas, in addition to costs to renovate the unit.

Where a home is used partly to earn business or rental income, qualifying expenditures in respect of the personal-use areas can be claimed in full. However, expenditures made in respect of common areas or that benefit the housing unit as a whole, such as re-shingling a roof, must be allocated between personal and income-earning use in order to determine the portion which qualifies for the credit.

A renovation or alteration of an eligible dwelling qualifies for the HRTC provided that it is of an enduring nature and is integral to the dwelling, including expenditures for the cost of labour and professional services, building materials, fixtures, equipment rentals and permits. However, the following expenditures will not qualify for the HRTC: the cost of routine repairs and maintenance normally performed on an annual or more frequent basis; expenditures for appliances and audio-visual electronics; and financing costs. Items such as furniture, draperies and other indirect expenditures for items that retain a value independent of the renovation, such as construction equipment and tools, will not qualify since they will not be considered integral to the dwelling.

The HRTC will not be reduced by other tax credits or grants under other government programs. For example, an eligible expenditure which qualifies for both the HRTC and the Medical Expense Tax Credit can be claimed under both programs.

Expenditures must be supported by receipts. Goods or services provided by a non-arm's length person will qualify only if that person is registered for GST/HST purposes.

HOME BUYERS' PLAN

The maximum eligible withdrawal permitted from an RRSP has been increased from $20,000 to $25,000 after January 27, 2009.

FIRST-TIME HOME BUYER'S TAX CREDIT

The Budget proposes a new non-refundable tax credit for first-time home buyers who acquire a qualifying home after January 27, 2009. The tax credit is 15% of $5,000 (or $750 for 2009) and is claimable in the year in which the home is acquired.

A person will qualify as a first-time home buyer if neither the individual nor his or her spouse or common-law partner owned and lived in another home in the year of the home purchase or in any of the previous four years. A qualifying home is one which the individual or the spouse or common-law partner intend to occupy as their principal residence within one year after acquisition. To be eligible for the credit, the home must be registered under the applicable land registration system.

The credit will be available for the acquisition of a home by, or for the benefit of, an individual who is eligible for the disability tax credit The home must be acquired to enable the individual to live in a more accessible dwelling or in an environment better suited to personal needs and care. The home must be intended to be the principal residence of that individual within one year after its acquisition.

Where a home is acquired jointly with a spouse or common-law partner, any unused portion of the credit may be claimed by the spouse or common-law partner. The total amount of the credit claimed for the year by these individuals cannot exceed the maximum amount available to any one of these individuals.

REGISTERED RETIREMENT SAVINGS PLANS (RRSP)

In the absence of a spousal or dependant rollover, the fair market value of investments held in an RRSP or Registered Retirement Income Fund (RRIF) at the time of an annuitant's death is included in the income of the deceased for the year of death.

The Budget proposes to allow a deduction for a decrease in value of the investments held in an RRSP or RRIF subsequent to the annuitant's death and upon the final distribution of the property. This deduction would be carried back and deducted against the year-of-death RRSP/RRIF income inclusion. This measure will apply where the final distribution from the RRSP or RRIF occurs after 2008.

MINERAL EXPLORATION TAX CREDIT (METC)

The METC provides an additional tax benefit of 15% of specified mineral exploration expenses renounced by corporations to individual investors on the issue of flow-through shares. The METC, which was to expire at the end of March 2009, has been extended until the end of 2011 for flow-through agreements entered into before April 1, 2010.

BUSINESS

SMALL BUSINESS DEDUCTION (SBD)

The SBD reduces the federal corporate income tax rate to 11% on the first $400,000 of qualifying active business income earned by a group of associated companies in a year. The Budget proposes to increase this limit to $500,000 for taxation years ending after December 31, 2008. For taxation years that straddle December 31, 2008 the $100,000 increase is prorated based on the number of days after December 31, 2008. There are a number of consequential changes as a result of this change.

Partnerships allocate their income eligible for the SBD to corporate partners based on the percentage of income allocated times the annual business limit. The Budget proposes to increase the business limit to $500,000 for partnership fiscal periods ending in 2009. The proration rules also apply.

SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT (SR&ED)

Corporations may earn enhanced investment tax credits (ITCs) equal to 35% of qualified current SR&ED expenditures and 40% of qualified capital SR&ED expenditures. The combined maximum amount of qualified SR&ED expenditures cannot exceed $3 million. The Budget proposes that for taxation years that end after 2009, this entitlement will be phased out when taxable income is between $500,000 (versus $400,000) and $800,000 (versus $700,000) in the preceding taxation year. The phase-out will be prorated for taxation years that straddle December 31, 2008. The existing rule to phase out the entitlement to the enhanced ITC for taxable capital between $10 and $50 million is unaffected.

These enhanced ITCs may be fully refundable if the corporation does not have sufficient taxable income to utilize them. Similar rules reduce refundability to the extent that a corporation's taxable income exceeds $500,000 (versus the current $400,000).

ACQUISITION OF CONTROL

Where there has been an acquisition of control of a corporation, subsection 256(9) deems the acquisition to have occurred at the commencement of the day unless the corporation elects that the acquisition be treated as having occurred at the time that it actually happened. A general lack of awareness of this provision has resulted in a number of unintended consequences.

For example, a Canadian resident individual would normally claim the $750,000 capital gains exemption (CGE) on the sale of "qualified small business corporation shares" (QSBC shares). However if the sale were to a non-resident, the CGE would not be available because the corporation would have ceased to be a "Canadian-controlled private corporation" (CCPC) at the commencement of the day. Therefore its shares would not be QSBC shares at the time of sale later in the day.

The Budget proposes that, for acquisitions of control ***after 2005***, subsection 256(9) will not apply for purposes of determining the status of a corporation as a small business corporation (SBC) or CCPC.

Taxpayers are, however, entitled to elect on or before their 2009 filing-due-date to have the existing rules apply. Furthermore, taxpayers will be deemed to have made this election if it is evident that they assumed that the corporation was an SBC or CCPC at the actual time of transfer of the shares.

CAPITAL COST ALLOWANCE (CCA)

Taxpayers acquiring new manufacturing equipment after March 19, 2007 and before 2010 were able to treat these assets as Class 29 assets (50% straight-line CCA rate, subject to the half-year rule). The Budget proposes to extend this treatment to qualifying assets acquired in 2010 and 2011.

Eligible computers and software acquired after January 27, 2009 and before February 2011 will be eligible for a 100% write-off in the first year the equipment is available for use.

COMPLIANCE

ELECTRONIC FILING OF CORPORATE INCOME TAX RETURNS

The Budget proposes that corporations with gross revenue exceeding $1 million (other than atypical situations, such as non-resident corporations and corporations reporting in a functional currency) must file their T2 corporate income tax returns electronically for taxation years ending after 2009. Failure to comply with these rules will make offending corporations liable for penalties depending on the corporation's year-end. The penalties will be $250 in 2011, $500 in 2012, and $1,000 in subsequent years. These penalties will also apply for filing returns in an incorrect format.

INFORMATION RETURNS

There will be a lower threshold requiring taxpayers to file information returns (such as T4s) electronically after 2009. The new threshold for T4s will be 50 (versus the current 500). Failure to comply with these new rules will make a taxpayer liable for a penalty, based on the number of information slips. Similarly, taxpayers may be liable for penalties for filing information returns in the incorrect format. The proposed penalties will be:

Number of Slips or Information Returns	Penalty
More than 50 but less than 251	$250
More than 250 but less than 501	$500
More than 500 but less than 2,501	$1,500
More than 2,500	$2,500

Where a taxpayer is required to file a number of similar returns, under the current rules it may be liable for late filing penalties with respect to each return. This can be very punitive. Subject to a minimum of $100, the proposed penalties will be based on the number of returns, and will be:

Number of Slips or Information Returns	Penalty per day
Less than 51	$10
More than 50 but less than 501	$15
More than 500 but less than 2,501	$25
More than 2,500 but less than 10,001	$50
More than 10,000	$75

The maximum penalty will be 100 days times the applicable rate.

These penalties will apply to information returns required to be filed after 2009.

INTERNATIONAL TAXATION

INTEREST DEDUCTIBILITY

When a Canadian corporation (Canco) borrows to invest in a foreign corporation in the group (Forco), it is common to structure the transaction so that Canco and Forco can each claim an interest deduction for the same borrowing. Section 18.2 was enacted, to be effective in 2012, to prevent taxpayers from claiming such “double dip” interest deductions. The Budget proposes to repeal section 18.2.

FOREIGN TRUSTS AND OTHER FOREIGN INVESTMENT VEHICLES — FURTHER DELAY IN IMPLEMENTATION

The 1999 federal budget introduced measures intended to curtail the use of foreign trusts and other vehicles to avoid Canadian tax. The latest implementation date was supposed to have been January 1, 2007. The Budget proposes to once again delay implementation, pending further review.

The Budget also proposes to defer the implementation of certain legislation announced in February 2004 in connection with the foreign affiliate rules.

DUTY AND GST/HST MEASURES

CUSTOMS TARIFF AMENDMENTS

The Budget proposes to eliminate Customs Tariffs on a wide range of machinery and equipment that currently does not qualify for duty-free entry. This measure will reduce costs for Canadian producers, particularly in the forestry, energy and food processing sectors. This expanded duty relief is expected to apply to $2 billion in annual machinery and equipment imports, providing $440 million in duty savings over the next five years.

The Budget also proposes to undertake a review of Customs Tariff rules as they relate to temporarily imported cargo containers in an effort to simplify compliance and facilitate their use.

SIMPLIFIED GST/HST TREATMENT FOR NETWORK SELLERS

Where a direct selling organization employs a network of sellers to arrange sales to consumers on a commission basis, a simplified GST accounting method will be available. This simplified method is only available where both the network seller and network sales representatives have jointly elected for its use and they also meet certain eligibility requirements. Certain supplies and commissions between a network seller and its sales representatives will not be subject to GST under the simplified GST accounting method. Sales to the final consumer will continue to be subject to GST under the normal rules

The simplified approach is available for fiscal years beginning after 2009.