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2009 Federal Budget



On January 27, 2009, the Minister of Finance Jim Flaherty tabled the government's first deficit budget in 11 years, the result of living in a challenging environment in a global economic recession with dwindling federal tax revenues. Much has been written in the press on the economic stimulus measures contained in the budget and time will tell what effect these fiscal initiatives will have on the slumping economy.

The key tax measures announced were:

Personal Tax

Non-refundable tax credits

- Retroactive to January 1, 2009, there is an increase to the basic personal amount, the spousal and common-law partner amount and the eligible dependant amount to \$10,320
- Retroactive to January 1, 2009 there is an increase to upper limits of the two lowest tax brackets by 7.5 per cent; upper limit for the lowest income bracket has been increased to \$40,726 (taxed at 15 per cent) and the second income tax bracket to \$81,452 (taxed at 22 per cent).
- The amount on which the Age Credit is based will be increased by \$1,000 to \$6,408 effective for 2009, with no change to the net income level at which the credit begins to be phased out.
- These amounts will be indexed for inflation in subsequent years.

Business Tax Measures

Capital Cost Allowance (CCA) Rate Changes

- A temporary 100 per cent CCA rate for investment in eligible computers and software acquired before February 2011. This 100 per cent CCA rate is not subject to the half-year rule.
- A two-year extension of the temporary 50 per cent straight-line accelerated CCA for investment in manufacturing and processing machinery, and equipment acquired prior to 2010. The half-year rule continues to apply.

Small Business Limit

The amount of income eligible for the small business tax rate was increased to \$500,000 from \$400,000 as of January 1, 2009.

International Tax

In a response to recommendations by the Advisory Panel on Canada's System of International Taxation, Section 18.2 of the Income Tax Act is to be repealed. The section limited the deductibility of interest where a Canadian corporation uses borrowed funds to finance a foreign affiliate, and was to come into force in 2012.

Mandatory Electronic Filing

- Corporations that have annual gross revenues in excess of \$1 million for a taxation year will be required to file their income tax returns in electronic format for taxation years that end after 2009.
- Taxpayers will be required to file electronic income tax information returns, such as T4, T5, T5013, when the number of these returns is 50 or more. This is a reduction from the current 500 returns.
- Although these requirements apply to returns filed after 2009, no penalties will be introduced for failing to comply until 2011.
- The penalty for not filing corporate income tax returns in electronic format will be set at \$250 for taxation years that end in 2011, \$500 for taxation years that end in 2012 and \$1,000 for subsequent tax years.
- Penalties for filing information returns late or in the incorrect format will be reduced from penalties currently charged up to \$2,500. The penalty for late-filed returns will be based on the number of late returns and the number of days late (maximum 100 days). The penalties range from \$10 per day to \$75 per day.

Customs Tariff Measures

- Tariffs on some machinery and equipment imported from outside North America have been permanently eliminated. Currently these tariffs vary from 2.5 per cent to 11 per cent.

Home Renovation Tax Credit (HRTC)

The HRTC is a 15 per cent non-refundable tax credit for eligible home renovation costs not exceeding \$10,000 incurred prior to February 1, 2010. The maximum credit of \$1,350 would be claimed on the 2009 tax return. Family members would be subject to a single limit, but the HRTC will not be reduced by other tax credits or grants.

The taxpayer's principal residence would be eligible. In the case of a condominium or cooperative housing, the individual's share of eligible expenditures on common areas would be included.

Examples of HRTC Eligible and Ineligible Expenditures

Eligible

- Renovating a kitchen, bathroom or basement.
- Putting down new carpet or hardwood floors.
- Building an addition, deck, fence or retaining wall.
- Installing a new furnace or water heater.
- Painting the interior or exterior of a house.
- Resurfacing a driveway.
- Laying new sod.

Ineligible

- Purchasing furniture and appliances (i.e. refrigerator, stove, or couch).
- Purchasing tools.
- Cleaning carpets.
- Maintenance contracts (furnace cleaning, snow removal, lawn care, pool cleaning, etc.)

First-Time Home Buyers' Tax Credit

First-time home buyers will be able to withdraw a maximum of \$25,000 from a Registered Retirement Savings Plan (RRSP) under the Home Buyers' Plan, an increase of \$5,000. Also, a non-refundable tax credit based on the amount of \$5,000 was introduced for those first-time home buyers who acquire a qualifying home after January 27, 2009. Individuals eligible for the Disability Tax Credit can claim this credit when a home that is purchased is more suited to their personal care needs. Also, the individual's spouse or common-law partner can claim any unused portion of the Credit.

RRSP/RRIF losses

Losses realized after death but before the proceeds are distributed to beneficiaries can be carried back and deducted against the year-of-death RRSP/RRIF income.

Mineral Exploration Tax Credit (METC)

Eligibility for the METC is extended by one year for flow-through share agreements entered into on or before March 31, 2010.



Northwest Territories' 2009-2010 Budget

On February 5, 2009, Finance Minister J. Michael Miltenberger presented the Government of the Northwest Territories' 2009-2010 Budget.

Noting that the Northwest Territories (NWT) has not escaped the effects of the global economic downturn, Minister Miltenberger called on NWT residents "to work together during these difficult times, to meet the many challenges and to seize the opportunities as they present themselves."

Fiscal stimulus was provided in the form of operating spending of over \$1.2 billion in addition to the record investment of \$246 million in capital infrastructure already approved in the fall. The Budget included some modest tax measures. In an effort to encourage healthy lifestyle choices, the finance minister announced increases in tobacco taxes and liquor mark-ups, to take effect April 1, 2009. To keep up with inflation, increases will also be implemented to some property and school tax rates.

British Columbia 2009 Budget

On February 17, 2009, BC's Minister of Finance Colin Hansen delivered the province's 2009/2010 budget under

uncertain economic times. Very few new tax measures were announced. Most notably, BC did not follow the federal government's lead in increasing the small business limit to \$500,000.

However some key tax measures were announced:

Dividend Tax Credit Rate Reduced

Effective January 1, 2010, the provincial personal income tax dividend tax credit rate applicable to ordinary dividends is reduced to 3.4 per cent from 4.2 per cent. This change maintains integration between the personal and corporate income taxes as a result of the December 1, 2008 reduction in the small business corporate income tax rate to 2.5 per cent from 3.5 per cent.

Income from Registered Disability Savings Plans (RDSP)

Effective January 1, 2009, income from an RDSP is excluded from income for purposes of determining eligibility for the BC Sales Tax Credit. This income will also be excluded for purposes of eligibility for the Medical Services Plan premium assistance.

BC Mining Flow-Through Share Tax Credit Extended

As announced on December 5, 2008, the BC Mining Flow-Through Share Tax Credit is extended to the end of 2009.

General Corporate Income Tax Rate Reduced

As proposed in the 2008 Revenue Neutral Carbon Tax Plan, the general corporate income tax rate will be reduced from 11 per cent to 10.5 percent effective January 1, 2010, and to 10 per cent effective January 1, 2011.

Film Tax Credits

Expiry dates for the film tax credits are removed.

Film Incentive BC Eligibility Expanded

As announced on December 18, 2008, the requirement that a corporation be BC-controlled to be eligible for the Film Incentive BC tax credit is removed for productions with principal photography starting on or after January 1, 2009. This will allow all Canadian-controlled eligible production corporations to qualify.

Fifth Protocol to Canada-US Treaty Enters Into Force

The Fifth Protocol updating the treaty between Canada and the United States with respect to taxes on income and on capital, entered into force in late 2008. This means that many of the provisions in the treaty are effective retroactive to January 1, 2008.

The specific rules contained in the Fifth Protocol completely eliminate withholding taxes on interest payments between unrelated persons, a rule which Canada adopted domestically with effect from January 1, 2008. For interest paid on debt obligations between related parties that were not otherwise exempt from withholding tax, the new

exemption is phased in to reduce withholding tax to 7% for 2008, 4% for 2009, and eliminated thereafter.

Prescribed Rate Loans Planning Opportunity

With the prescribed interest rates reduced to 2% for the first quarter 2009 and 1% for the second quarter on certain employee/shareholder taxable benefits and low or no interest loans, the time might be right for low rate loan planning.

Generally, income arising from an investment funded by a loan to a spouse, partner, minor child, grandchild, or a trust for their benefit, is attributed to the lender and taxed in his or her hands due to the attribution rules. These complex provisions of the Income Tax Act are designed to prevent income splitting, however there is an exception to these rules. Loans made at the CRA prescribed interest rate will generally not be subject to the attribution rules provided that interest on the loan is paid by January 30 of each year. Therefore, if a loan is extended by an individual in a high tax rate to an individual in a lower tax rate, provided that the loan is interest bearing and the interest is paid within 30 days of the end of each calendar year, there is an opportunity to invest the funds to earn a higher return with the income being taxed in the hands of the low tax rate individual.

If you are party to an existing prescribed rate loan with an interest rate higher than 1%, you could repay the loan and enter into a new loan in order to attract the lower interest rate.

U.S. Tax Penalties for Late or Unfiled U.S. Returns - \$10,000 per Form

Katri Ulmonen, our new partner who specializes in U.S. tax, advises that the Internal Revenue Service (IRS) has announced that effective January 2009 it is levying penalties on taxpayers who late file foreign reporting forms. The penalty is \$10,000 per form with limited ability to obtain a waiver from its application and the IRS intends to scrutinize any such request carefully.

It is important that U.S. citizens living in Canada who have not filed their U.S. returns, and the corporations overdue in filing their foreign reporting returns, become compliant as soon as possible.

The following are common foreign reporting forms and situations when they may be required:

- Form 926 (Return by a U.S. Transferor of Property to a Foreign Corporation) e.g. U.S. citizen/Canadian resident incorporates a Canadian company.
- Form 5471 (Information Return of a U.S. Persons with respect to Certain Foreign Corporations) e.g. U.S. citizen/Canadian resident subscribes for at least 10% of the shares of a Canadian company.
- Form 5472 (Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in U.S. Trade or Business) e.g. Canco with U.S. sub-transfer pricing information.

- Form 8858 (Information Return of U.S. Persons with respect to Disregarded Entities) e.g. U.S. citizen/Canadian resident invests in a Canadian ULC).
- Form 8865 (Return of U.S. Persons with respect to Certain Foreign Partnerships) e.g. U.S. citizen/Canadian resident invests in a Canadian Limited Partnership.
- Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts).
- Form 3520-A Annual Information Return of Foreign Trust with a U.S. Owner).

If you think you may be affected by these requirements, please contact your local MacKay LLP office or Katri Ulmonen at KatriUlmonen@van.mackay.ca

Are Individual Pension Plans (IPP) the Solution for Devastated RRSPs?

A personal defined benefit plan, known as an IPP, may be used to provide an owner of a private company with strong cash flow an excellent opportunity to overcome serious losses recently suffered by their RRSPs.

IPPs work best for persons aged 50 and over and can allow for tax deductible payments by corporations in the hundreds of thousands of dollars. This applies when the pension actuarial calculations require that the initial funding of such IPPs must be substantial enough to provide the level of benefits required. In addition, the annual tax deductible payments to the IPP by the employer corporation can be more than double the currently permitted level of RRSP deductions.

While rates of return in IPPs are limited in contrast with RRSPs, if your RRSP has taken a serious financial hit, establishing an IPP may be an excellent way to play catch up. For more information please see your local MacKay LLP office.

Canada Revenue Agency on the Warpath for Charities Involved in Tax Shelter Arrangements

The Canada Revenue Agency (CRA) has alerted taxpayers that they have denied over \$2.5 billion in tax shelter gifting arrangement donations and plan to aggressively go after participants in such cases. The arrangements typically promise donors tax receipts worth more than the actual donation amount. To date, over 65,000 taxpayers who participated in these schemes have been audited.

Many high profile charities and associations, such as the Pinnacle Foundation, a Vancouver-area charity, and the Choson Kallah Fund of Toronto have had their charitable status revoked. In these cases, CRA has taken the position that the primary activity of the charities was issuing tax receipts in support of the donation arrangement and in amounts supplied by the donation arrangement promoters.

CRA cautions that they are reviewing all tax shelter-related donation arrangements, and it plans to audit every participating charity, promoter, and investor.

Lipson Case Confirms Interest Deductibility on Mortgage Financing

The long awaited Supreme Court of Canada decision on Lipson was released January 8, 2009. In a 4 to 3 decision of the majority (with two separate dissents), the court held that it was acceptable to convert what would have been non-deductible mortgage interest expenses to tax deductible interest. This was achieved by borrowing to acquire shares in the family owned company. The proceeds were used to buy a home, which ultimately formed the security for the loan. A greater concern for tax planners is that the court held that the general anti-avoidance rule (GAAR) would prevent the use of the attribution rules to attribute the wife's losses in respect of the share acquisition borrowings.

See your local MacKay LLP office for ideas to convert non-deductible interest to tax-deductible interest.

2009 Automobile Deduction Limits

The minister of finance announced that the automobile expense deduction limits and prescribed rates for the

automobile operating expense benefit that applied in 2008 will apply in 2009.

Specifically:

- The ceiling on the capital cost of passenger vehicles for capital cost allowance (CCA) purposes will remain at \$30,000 (plus applicable sales taxes).
- The limit on deductible leasing costs will remain at \$800 per month (plus applicable sales taxes).
- The maximum allowable interest deduction will remain at \$300 per month for loans related to vehicles acquired after 2008.
- The limit on the deduction of tax-exempt allowances paid by employers to employees using their personal vehicle for business purposes remains at 52 cents per kilometre for the first 5,000 kilometres driven and 46 cents for each additional kilometre.
- For the Yukon Territory, Northwest Territories and Nunavut, the tax-exempt allowance will remain at 56 cents for the first 5,000 kilometres driven and 50 cents for each additional kilometre.



Announcing our New Partners



Bill Gill, CA



Katri Ulmonen,
CA, M.S.
(U.S) Tax



Gillian Lee, CA

The partners of MacKay LLP are pleased to announce that Mr. Bill Gill of the Surrey office, Ms. Katri Ulmonen of the Vancouver office, and Ms. Gillian Lee of the Yellowknife office have accepted our invitation to join the partnership as of January 1, 2009.

Bill joined the firm in 1998 after graduating Simon Fraser University with a Bachelor of Business Administration (BBA) and obtained his CA designation in 2001. Bill has been involved in all areas of public practice. He enjoys providing accounting and tax services, including personal and corporate tax planning, for owner-managed businesses.

Katri's specialty is providing U.S. tax consulting and cross-border tax services for Canadian and US individuals and companies. Katri joined the firm in 2006. She obtained her CA designation in 1994 and a Master's Degree in U.S. Taxation with Honours in 2006.

Gillian assists clients in many areas including audit, accounting, personal and corporate tax and other special consulting engagements. She has worked on several large and complex clients in the Northwest Territories and Nunavut and has significant experience dealing with co-operatives and owner managed businesses. Gillian is active in her community and serves as the secretary of the Institute of Chartered Accountants of the Northwest Territories and Nunavut.

Prepared by the Taxation Services Section of MacKay LLP Chartered Accountants for review by our clients and other interested parties

Vancouver	(604) 687-4511
Surrey	(604) 591-6181
Kelowna	(250) 763-5021
Whitehorse	(867) 667-7651
Yellowknife	(867) 920-4404
Edmonton	(780) 420-0626
Calgary (Southcentre)	(403) 640-2227
Calgary (Downtown)	(403) 294-9292

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MacKay LLP is a Canadian firm of Chartered Accountants based in western and northern Canada and represented by offices in Alberta, British Columbia, Yukon and Northwest Territories. The firm currently has 35 partners and principals, approximately 250 staff, and offers a full range of accounting, auditing, taxation, insolvency, valuation, computer, and management consulting services to all clients.

In other areas of Canada and internationally, the firm is represented by other locally managed independent accounting firms.

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