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## 2008 Federal Budget — What's the Outlook for Tax Changes?

Finance Minister Jim Flaherty has announced that he will deliver the Conservative government's third federal budget on February 26, 2008. The government's minority status and ongoing speculation about the timing of the next federal election are undoubtedly influencing this year's budget-making process.

Given the personal and corporate tax cuts announced in the October 30, 2007 mini-budget (see [TaxNewsFlash-Canada 2007-28](#)), it seems unlikely that any further broad-based tax cuts are in the works. Judging by recommendations of the House of Commons Standing Committee on Finance in its February 2008 pre-budget report, plenty of specific areas of taxation may be under review for budget action, such as enhanced R&D tax incentives and extension of the temporary accelerated capital cost allowance for manufacturing and processing equipment. The Conservatives could also fulfill their election campaign pledge to defer capital gains tax for individuals where the proceeds from an asset's sale are reinvested.

### ***Short-list of potential tax changes***

Highlights of possible tax changes that may be included in the 2008 federal budget are discussed below under the following headings:

- Finance Committee Reports — Signs of things to come?
- Federal-provincial tax harmonization
- Accelerated CCA for M&P machinery to be extended?
- Enhanced R&D tax incentives?
- Capital gains tax deferral?
- Income trust conversion guidelines to be clarified?
- Cap on defined benefit pension plan surpluses to rise?
- International tax changes?
- Other business tax changes?
- Personal tax bracket thresholds to increase?
- Other personal tax changes?

### ***Watch for KPMG's same-day budget release***

Whatever kind of tax changes are announced in this year's budget, your KPMG adviser can help you understand their effect on your personal finances or business affairs, and point out ways to ease their impact or take advantage of new opportunities. And watch for our special budget edition of *TaxNewsFlash-Canada* — it is expected to be available late in the afternoon on budget day from your KPMG adviser and on our website at [www.kpmg.ca](http://www.kpmg.ca).

### ***Finance Committee Reports — Signs of things to come?***

In previous years, the House of Commons Standing Committee on Finance (the "Finance Committee") has tabled a pre-budget report with recommendations for budget changes developed through the public pre-budget consultation process. Based on prior years' experiences with majority governments, these recommendations often form the basis for the government's budget proposals, if not in the next budget, then in a later year.

Titled *Taxing to Prosper: Canada's System of Taxes, Fees and Other Charges*, this year's report runs over 260 pages and offers 19 specific recommendations related to possible tax changes. The report also contains supplementary and dissenting opinions from the four major political parties. This is not surprising given the government's minority status and that no one party controls the 12-member committee (which consists of five Conservatives, four Liberals, two Bloc Québécois members and one NDP member).

The Conservatives say in their supplementary opinion that they largely support the recommendations in the Finance Committee's report, with certain exceptions.

### ***Federal-provincial tax harmonization***

Though the Finance Committee makes no specific recommendations on federal-provincial tax harmonization, it remains a priority for the Conservatives. In a presentation by the Finance Minister at a meeting of provincial and territorial finance ministers in December 2007, the Finance Minister said the federal government is seeking the collaboration of the provinces and territories to reach a 25% combined federal-provincial corporate tax rate to improve Canada's international competitiveness. With the federal corporate tax rate scheduled to drop to 15% by 2012, all provinces would need to reduce their corporate tax rates to 10% to reach this goal.

The Conservatives' supplementary opinion to the report says it will continue encouraging the provinces and territories to harmonize their sales taxes with the federal GST.

As a result, it is possible that the budget may contain incentives for the provinces to pursue the federal government's harmonization goals.

### ***Accelerated CCA for M&P machinery to be extended?***

The Finance Committee recommends extending the accelerated capital cost allowance (CCA) rate for manufacturing and processing (M&P) machinery for five years. The 2007 federal budget temporarily increased the CCA rate for M&P machinery and equipment included in Class 43 to a 50% straight-line rate (from 30%). The accelerated rate currently applies to eligible assets acquired on or after March 19, 2007 and before December 31, 2008.

### ***Enhanced R&D tax incentives?***

The Finance Committee recommends the government enhance Canada's tax incentives for scientific research and experimental development (R&D) by:

- Increasing the annual \$2 million expenditure limit for claiming R&D investment tax credits (ITC) at the enhanced 35% rate
- Increasing the \$15 million taxable capital threshold for claiming enhanced ITCs (eligibility for the enhanced ITC rate begins to be phased out for corporations with taxable capital of \$10 million)
- Removing the Canadian-controlled private corporation (CCPC) restriction for accessing the enhanced 35% ITC rate
- Making ITCs partially refundable for all claimants (currently available only to CCPCs, individuals and unincorporated businesses).

The federal government undertook extensive public consultations on improving the federal tax incentives for R&D in the fall of 2007. As a result, the government may use the opportunity of the 2008 federal budget to introduce changes to the R&D system such as the recommendations above and/or changes recommended in submissions to Finance by KPMG and others as part of the R&D consultation process.

### ***Capital gains tax deferral?***

A key commitment in the Conservatives' 2006 election campaign was a promise to defer capital gains tax for individuals on the sale of assets when the proceeds are reinvested within six months. A variation of this proposal was recently recommended in a joint submission to Finance by the Canadian Real Estate Association, the Canadian Federation of Apartment Associations and the Real Property Association of Canada (REALpac).

As the federal government has not yet implemented this election promise, it is possible that it will make its way into the 2008 federal budget. The Finance Committee makes no specific recommendations in this area.

### ***Income trust conversion guidelines to be clarified?***

The Finance Committee recommends that the government clarify the transitional rules for the conversion of income trusts to corporations on a tax-

deferred basis in light of the tax on distributions from income trusts and other specified investment flow-through (SIFT) entities. The tax was introduced on October 31, 2006, and it will apply to SIFTs that existed on that date in 2010 (see [TaxNewsFlash-Canada 2007-36](#) and 2006-36). Though the federal government said in December 2006 that it would allow such conversions to occur without tax consequences to investors, no details have been provided.

### ***Cap on defined benefit pension plan surpluses to rise?***

To help ensure defined benefit pension plans can be sufficiently funded to weather adverse economic conditions without compromising the benefits of plan members, the Finance Committee recommends increasing the maximum tax-deductible surplus allowed for such plans before plan sponsor contributions must be suspended. The increase would be proportionate to the plan's going concern liabilities.

### ***International tax changes?***

In November 2007, the federal government established an Advisory Panel on International Tax Issues, as promised in the 2007 federal budget. The panel's mandate is to provide recommendations for consideration by the government on how to improve Canada's current system of international taxation.

It seems unlikely that the federal government will announce any major changes in this area before the panel completes its work and issues its final report, which is due in December 2008. However, the government could still introduce targeted international tax measures to tighten the tax system in the 2008 federal budget.

### ***Other business tax changes?***

Other business tax changes recommended by the Finance Committee include:

- Developing a policy to assist the manufacturing and forestry sectors, which are struggling due to the rising Canadian dollar and other factors
- Adopting tax incentives to encourage truck owners and operators to reduce greenhouse gas emissions and to promote more purchases of environmentally friendly vehicles
- Developing a non-refundable training tax credit for employers
- Increasing the CCA rate that applies to rail rolling stock so that the rate is more in line with that in the U.S. and reflects the rolling stock's useful life
- Introducing a new non-refundable tax credit to encourage small and medium-sized businesses to undertake pandemic preparedness activities.

### ***Personal tax bracket thresholds to increase?***

The Finance Committee recommends increases to the income thresholds at which the graduated federal personal income tax rates apply. It appears this recommendation would apply to all marginal tax brackets, and not just to the highest income threshold as some witnesses suggested, or just to the bottom threshold, as suggested by others.

As noted, however, in light of the personal tax cuts set out in the October 2007 mini-budget, it appears unlikely that the government will adopt across-the-board personal tax cuts in the 2008 federal budget.

### ***Other personal tax changes?***

On the personal tax front, the Finance Committee also recommends:

- Allowing people arriving in Canada to make duty-free purchases at Canadian airports
- Increasing the \$20,000 maximum amount that can be withdrawn from registered retirement savings plans (RRSP) to buy or build a new home under the Home Buyers Plan
- Enhancing the ability to withdraw RRSP funds under the Lifelong Learning Plan to support lifelong learning
- Enhancing the tax incentives for charitable giving (though no specific measures are recommended)
- Making the disability tax credit refundable.

### ***Complete tax-sensitive transactions before budget day***

As with any budget, there's no telling what type of changes the government may have in store this year. Since federal budgets often contain measures that take effect on budget day, your best defence against adverse tax changes is to complete or close all tax-sensitive transactions before February 26, 2008.

Information is current to February 11, 2008. The information contained in this *TaxNewsFlash-Canada* is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation. For more information, contact KPMG's National Tax Centre at 416.777.8500.

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