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Explanatory Notes to Legislative Proposals Relating to Income Tax

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Preface

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act* and *Income Tax Regulations*. These notes describe proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

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Minister of Finance

These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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Amendments Related to the Income Tax Act

Clause 2

Income deferrals – livestock

ITA
80.3

Section 80.3 of the *Income Tax Act* (the "Act") provides for a tax deferral in respect of the proceeds of sales by farmers of breeding herds of grazing livestock due to drought conditions. It provides that the income of a taxpayer for a year that is deferred pursuant to that section is to be included in the taxpayer's income in the earlier of the taxation year in which the taxpayer dies or the taxation year following a drought year, or series of consecutive drought years, as the case may be.

Section 80.3 is amended to extend the existing rules in order to permit farmers, who dispose of such breeding livestock in a taxation year because of flood or excessive moisture conditions, to exclude a portion of the sale proceeds from their incomes until the following taxation year.

As with the existing rules applicable in respect of prescribed drought regions, the tax deferral will apply to unusually heavy sales and, therefore, the amount deferred will increase with increasing levels of sales. The deferral will apply to proceeds from sales of grazing livestock where such sales result in a reduction of 15 per cent or more of the number of animals in a farmer's breeding herd. For sales which result in a reduction of 15 per cent or more, but less than 30 per cent of the breeding herd, 30 per cent of the proceeds will be eligible for the deferral, while 90 per cent of the proceeds will be eligible for the deferral in respect of sales of 30 per cent or more of the animals in the herd.

Clause 3

Home Renovation Tax Credit

ITA
108(1.1)

Subsection 108(1) of the Act defines a testamentary trust as being a trust that arises on and as a consequence of the death of an individual, except where certain events occur that cause the trust to be re-characterized as an *inter-vivos* trust. One of these exceptions is where a contribution is made to an otherwise testamentary trust. New subsection 108(1.1) of the Act provides that a "qualifying expenditure" (as defined by new subsection 118.04(1) of the Act for the purposes of the Home Renovation Tax Credit), made by a beneficiary of a testamentary trust in respect of a home renovation will not be considered a contribution to the trust.

For more information about the definition "qualifying expenditure", please refer to the notes for new subsection 118.04(1).

This amendment applies to the 2009 and subsequent taxation years.

Clause 4

Home Renovation Tax Credit

ITA
118.04

New section 118.04 of the Act introduces the Home Renovation Tax Credit and provides for a non-refundable tax credit in respect of qualifying expenditures directly attributable to qualifying renovations made to an eligible dwelling by an individual. The credit is available for the 2009 taxation year.

Definitions

ITA
118.04(1)

New subsection 118.04(1) of the Act sets out definitions that apply for the purpose of the Home Renovation Tax Credit.

“eligible dwelling”

An “eligible dwelling” of an individual generally means a housing unit located in Canada where the individual owns, whether jointly with another person or otherwise,

(a) the housing unit; or

(b) a share of the capital stock of a co-operative housing corporation that was acquired for the sole purpose of acquiring the right to inhabit the housing unit, that is owned by the corporation.

A trust under which the individual is a beneficiary may also own the housing unit, or the share of the capital stock of a co-operative housing corporation, as the case may be.

To qualify for the Home Renovation Tax Credit, the housing unit must be ordinarily inhabited at any time during the “eligible period” by

- the individual,
- the individual’s spouse or common-law partner,
- the individual’s former spouse or common-law partner, or
- a child of the individual.

An eligible dwelling includes the land subjacent to the housing unit and up to 1/2 hectare of contiguous land (or such greater area of land that the individual establishes is necessary for the use and enjoyment of the housing unit as a residence).

“eligible period”

The “eligible period” means the period that begins on January 28, 2009 and that ends on January 31, 2010.

“individual”

For the purposes of the rules relating to the Home Renovation Tax Credit, an “individual” does not include a trust.

“qualifying expenditure”

A “qualifying expenditure” of an individual means an outlay or expense that is made or incurred during the eligible period by an individual, or by a qualifying relation in respect of the individual, that is directly attributable to a qualifying renovation of the individual. However, this does not include an outlay or expense made or incurred under the terms of an agreement entered into before January 28, 2009.

A qualifying expenditure includes the cost of permits required for the qualifying renovation, as well outlays or expenses for the rental of equipment used in the course of the qualifying renovation.

Certain expenditures do not qualify for the Home Renovation Tax Credit under this definition. These include expenditures

(a) for the acquisition of goods that have been previously used, or acquired for use or lease, for any purpose whatever by the individual or a qualifying relation in respect of the individual;

(b) to acquire a property that can be used independently of the qualifying renovation;

(c) for annual, recurring or routine repairs or maintenance;

(d) to acquire a household appliance or electronic home-entertainment device;

(e) that are financing costs;

(f) incurred for the purpose of gaining or producing income from a business or property; and

(g) for goods or services provided by a person not dealing at arm’s length with the individual, unless that person is registered for the purposes of the Goods and Services Tax.

In this regard, furnaces and other heating systems are not considered to be household appliances.

“qualifying relation”

A “qualifying relation” in respect of an individual means a person who is

- the individual’s spouse or common-law partner, or
- a child of the individual who has not attained the age of 18 years before the end of 2009 (other than a child who was, at any time during the eligible period, a married person, a person who is in a common-law partnership or a person who has a child).

“qualifying renovation”

A “qualifying renovation” of an individual means a renovation or alteration of an eligible dwelling of the individual or of a qualifying relation in respect of the individual. The renovation or alteration must be of an enduring nature and be integral to the eligible dwelling.

Rules of application

ITA
118.04(2)

New subsection 118.04(2) of the Act sets out certain rules that apply for the purpose of the Home Renovation Tax Credit.

New paragraph 118.04(2)(*a*) provides for cases where an eligible dwelling of an individual is owned by a co-operative housing corporation, a condominium corporation or a similar entity (the "corporation"), instead of being owned by the individual directly. In these circumstances, the individual's share of a qualifying expenditure of the corporation is considered to be a qualifying expenditure of the individual. The corporation must notify the individual, in writing, of the individual's share of the expenditure.

New paragraph 118.04(2)(b) provides for a similar rule with respect to trusts, where an eligible dwelling of an individual is owned by a trust instead of by the individual directly.

This paragraph ensures that an outlay or expense made or incurred by a trust may qualify as a qualifying expenditure of an individual, if the outlay or expense would have been a qualifying expenditure of the trust if the trust were a natural person. The trust must notify the individual, in writing, of the individual's share of the outlay or expense.

Home Renovation Tax Credit

ITA
118.04(3)

New subsection 118.04(3) of the Act provides for the calculation of a non-refundable Home Renovation Tax Credit for the 2009 taxation year. The credit is determined as 15% of the portion of qualifying expenditures in excess of a base amount of $1,000 to a cap of $10,000.

Interaction with the Medical Expense Tax Credit

ITA
118.04(4)

New subsection 118.04(4) of the Act provides that, notwithstanding paragraph 248(28)(*b*) of the Act, an outlay or expense made or incurred by an individual may qualify for both the Home Renovation Tax Credit, under section 118.04 of the Act, and for the Medical Expense Tax Credit, under section 118.2 of the Act, if that outlay or expense would otherwise qualify for the purposes of those credits.

Apportionment of credit

ITA
118.04(5)

New subsection 118.04(5) of the Act provides that, where more than one individual is entitled to the Home Renovation Tax Credit in respect of a qualifying expenditure of an individual, the total amounts claimed by those individuals cannot exceed the maximum amount that would be allowed if only one individual were claiming the Home Renovation Tax Credit. If the individuals cannot agree as to the amount each may claim, the Minister of National Revenue may fix the portions.

First-Time Home Buyers' Tax Credit

ITA
118.05

New section 118.05 of the Act provides to first-time home buyers a $750 non-refundable tax credit in respect of qualifying homes acquired after January 27, 2009. This credit is also available to individuals who purchase a home after that date for the benefit of a related individual who is eligible for the Disability Tax Credit. Generally, a home that qualifies for the Home Buyers' Plan under section 146.01 of the Act will also qualify for the purposes of the First-Time Home Buyers' Tax Credit.

These amendments apply to the 2009 and subsequent taxation years.

Definitions

ITA
118.05(1)

New subsection 118.05(1) of the Act sets out certain definitions that apply for the purpose of the First-Time Home Buyers' Tax Credit.

"qualifying home"

A "qualifying home" in respect of an individual is defined as a housing unit located in Canada that was acquired (whether jointly or otherwise) after January 27, 2009. It also includes a share of a capital stock of a cooperative housing corporation, where the holder of the share is entitled to possession of a housing unit located in Canada.

Paragraph (*a*) of the definition sets out the conditions for a home to be a "qualifying home" in respect of an individual, where the home is acquired for the benefit of that individual. In this regard, the home must be acquired by the individual or by the individual's spouse or common-law partner. The individual must intend to inhabit the home as a principal place of residence not later than one year after its acquisition. As well, the individual must be a first-time home buyer. An individual is considered to be a first-time home buyer for this purpose if, during the 4 calendar years preceding the year of acquisition, neither the individual, nor the individual's spouse or common-law partner, owned a home that was occupied, generally, by the individual or the individual's spouse or common-law partner.

Paragraph (*b*) of the definition, on the other hand, sets out the conditions for a home to be a "qualifying home" in respect of an individual, where the home is acquired by the individual for the benefit of a related individual who is eligible for the Disability Tax Credit. The home must be acquired by the individual for the benefit of a "specified person" in respect of the individual. The individual must also intend that the home be inhabited by the specified person as a principal place of residence not later than one year after its acquisition by the individual. The purpose of the acquisition of the home by the individual must be to enable the specified person to live in

- a home that is more accessible by specified person, or in which the specified person is more mobile or functional, or
- an environment better suited to the specified person's personal needs and care.

"specified person"

A "specified person" in respect of an individual is a person who is the individual (or who is related to the individual), where the person is entitled to the Disability Tax Credit under subsection 118.3(1) of the Act or would be so entitled if the restriction in that subsection with respect to attendant care were ignored.

Rules of application

ITA
118.05(2)

New subsection 118.05(2) of the Act sets out rules that apply for the purpose of the First-Time Home Buyers' Tax Credit. Subsection 118.05(2) provides that an individual is considered to have acquired a qualifying home only if the individual's interest in the home is registered in accordance with the land registration or other similar system applicable in the province where it is located.

First-Time Home Buyers' Tax Credit

ITA
118.05(3)

New subsection 118.05(3) of the Act provides for the calculation of the non-refundable First-Time Home Buyers' Tax Credit for the taxation year in which a qualifying home in respect of the individual is acquired. For the 2009, the credit is $750 (determined by applying the appropriate percentage for the taxation year to $5,000).

Apportionment of credit

ITA
118.05(4)

New subsection 118.05(4) of the Act provides that, where more than one individual is entitled to the First-Time Home Buyers' Tax Credit in respect of a particular qualifying home, the total amounts claimed by those individuals cannot exceed the maximum amount that would be allowed if only one individual were claiming the First-Time Home Buyers' Tax Credit. If the individuals cannot agree as to what amount each may claim, the Minister of National Revenue may fix the portions.

Clause 5

Dependant having impairment

ITA
118.3(2)

Subsection 118.3(2) of the Act provides criteria for determining the entitlement of a supporting individual of a disabled person to claim that person's unused disability tax credit. The French version of subsection 118.3(2) and the English version of paragraph 118.3(2)(*d*) are amended to include a reference to sections 118.01 to 118.05, consequential to the introduction of the Home Renovation Tax Credit and the First-Time Home Buyers' Tax Credit.

This amendment applies to the 2009 and subsequent taxation years.

Clause 6

Unused tuition, textbook and education tax credits

ITA
118.61(1) and (2)

Subsection 118.61(1) of the Act provides a formula for the calculation of a student's unused tuition and education tax credits that may be carried forward to future taxation years. Variable C of the formula requires that any unused tuition, textbook and education tax credits be claimed in advance of certain personal credits. Subsection 118.61(2) of the Act determines the amount of the carry-forward of unused tuition and education tax credits that can be claimed in the current year.

Variable C in subsection 118.61(1) and paragraph 118.61(2)(*b*) are amended consequential to the introduction of the Home Renovation Tax Credit and the First-Time Home Buyers' Tax Credit in sections 118.04 and 118.05 of the Act respectively.

These amendments apply to the 2009 and subsequent taxation years.

Clause 7

Transfer of unused credits to spouse or common-law partner

ITA
118.8

Subsection 118.8 of the Act provides a formula that governs the amount of certain unused personal income tax credits that can be transferred to a taxpayer from a spouse or common-law partner. Paragraphs (*a*) and (*b*) of the description of variable C are amended consequential to the introduction of the Home Renovation Tax Credit and the First-Time Home Buyers' Tax Credit. Paragraph (*a*) is also amended to add a reference to subsection 118(10), such that the availability of the Canada Employment Credit to the spouse or common-law partner does not reduce the amount of these unused personal income tax credits that may be transferred to the taxpayer.

These amendments apply to the 2009 and subsequent taxation years.

Clause 8

Tuition, textbook and education tax credits transferred

ITA
118.81

Section 118.81 of the Act provides for the calculation of the amount of tuition and education tax credits that may be transferred by a student to the student's spouse or common law partner or to a parent or grandparent. The description of B in paragraph 118.81(*a*) is amended consequential to the introduction of the Home Renovation Tax Credit and the First-Time Home Buyers' Tax Credit.

This amendment applies to the 2009 and subsequent taxation years.

Clause 9

Part-year residents

ITA
118.91

Section 118.91 of the Act provides rules with respect to non-refundable tax credits available to individuals who reside in Canada for a part only of a taxation year. Paragraph 118.91(*b*) is amended to add references to subsection 118(10) and to sections 118.01 to 118.05 and 118.3. This amendment is consequential to the introduction of various personal tax credits. The paragraph is also rewritten to improve clarity.

This amendment applies to the 2009 and subsequent taxation years.

Clause 10

Ordering of credits

ITA
118.92

Section 118.92 of the Act provides that the tax credits allowed in computing an individual's tax payable for a taxation year are to be applied in a specific order. This section is amended to add references to new sections 118.04 (the Home Renovation Tax Credit) and 118.05 (the First-Time Home Buyers' Tax Credit).

This amendment applies to the 2009 and subsequent taxation years.

Clause 11

Tax payable by non-residents (credits restricted)

ITA
118.94

Section 118.94 of the Act provides rules with respect to non-refundable tax credits available to individuals who did not reside in Canada at any time in a taxation year. Subject to a special rule in section 217, such individuals are allowed to claim certain non-refundable credits for a taxation year only where all or substantially all of their income for the taxation year is included in computing their taxable income in Canada. This section is amended to add references to new sections 118.04 (the Home Renovation Tax Credit) and 118.05 (the First-Time Home Buyers' Tax Credit).

This amendment applies to the 2009 and subsequent taxation years.

Clause 12

Credits in year of bankruptcy

ITA
118.95

Section 118.95 of the Act governs the rules applicable to credits in the year of bankruptcy. Paragraph 118.95(*a*) is amended to add references to new sections 118.04 (the Home Renovation Tax Credit) and 118.05 (the First-Time Home Buyers' Tax Credit). Paragraph 118.95(*b*) is amended to add a reference to subsection 118(10).

These amendments apply to the 2009 and subsequent taxation years.

Clause 13

Working Income Tax Benefit

ITA
122.7

Section 122.7 of the Act provides to low-income individuals and families, who have earnings from employment or business, the Working Income Tax Benefit ("WITB").

The amounts in the descriptions of A and B in subsection 122.7(2) are amended so that the WITB provides a refundable tax credit equal to 25% (up from 20%) of each dollar earned in excess of $3,000, to a maximum credit of $925 (up from the indexed amount for 2009 of $522) for single individuals and $1,680 (up from the indexed amount for 2009 of $1,044) for families. The WITB is reduced by 15% of net income in excess of $10,500 (up from the indexed amount for 2009 of $9,923) for single individuals and $14,500 (down from the indexed amount for 2009 of $15,145) for families.

The amounts in the description of C and D in subsection 122.7(3) are amended so that the WITB disability supplement provides a refundable credit equal to 25% (up from 20%) of each dollar earned in excess of $1,150 (down from the indexed amount for 2009 of $1,750), to a maximum credit of $426.50 (up from the indexed amount for 2009 of $261). The disability supplement is reduced by 15% of net income in excess of $16,667 (up from the indexed amount for 2009 of $13,404) for single individuals and $25,700 (up from the indexed amount for 2009 of $22,108) for families.

The WITB maximum benefit levels and thresholds continue to be indexed to inflation on an annual basis.

These amendments apply to the 2009 and subsequent taxation years.

Clause 14

Basic minimum tax credit determined

ITA
127.531(*a*)

Section 127.531 of the Act permits an individual to claim a deduction in computing the alternative minimum tax for most non-refundable personal tax credits. Paragraph 127.531(*a*) is amended to add references to new sections 118.04 (the Home Renovation Tax Credit) and 118.05 (the First-Time Home Buyers' Tax Credit).

This amendment applies to the 2009 and subsequent taxation years.

Clause 15

Where individual bankrupt

ITA
128(2)(*e*)(iii)(A)

Subsection 128(2) of the Act contains a number of special rules that apply in cases of personal bankruptcy. Clause 128(2)(*e*)(iii)(A) is amended to add references to new sections 118.04 (the Home Renovation Tax Credit) and 118.05 (the First-Time Home Buyers' Tax Credit).

This amendment applies to the 2009 and subsequent taxation years.

Income Tax Regulations

Clause 16

Income deferrals – livestock

ITR
7305

Section 80.3 of the Act permits farmers who dispose of breeding livestock because of drought conditions existing in a prescribed drought region in a year to exclude a portion of the sale proceeds from their taxable income until the first following year that is not a drought or flood or excessive moisture year. As a result, the full amount of the proceeds eligible for the deferral will be available to replenish their breeding livestock at that time.

Prescribed drought regions are those regions of Canada that are prescribed, on the advice of the Minister of Agriculture and Agri-Food and on the recommendation of the Minister of Finance, as suffering from drought conditions during a year. Section 7305 of the Regulations is amended by adding the prescribed regions that are eligible drought regions in 2007, 2008 and 2009.

Clause 17

Income deferrals – livestock

ITR
7305.02

Amended section 80.3 of the Act permits farmers who dispose of breeding livestock because of flood or excessive moisture conditions existing in a prescribed region in a year to exclude a portion of the sale proceeds from their taxable income until the first following year that is not a drought or flood or excessive moisture year. As a result, the full amount of the proceeds eligible for the deferral will be available to replenish their breeding livestock at that time.

Prescribed regions of flood or excessive moisture are those regions of Canada that are designated, on the advice of the Minister of Agriculture and Agri-Food and on the recommendation of the Minister of Finance, as suffering from flood or excessive moisture conditions during a year. The Regulations are amended by adding section 7305.02, which prescribes regions that are eligible regions of flood or excessive moisture in 2008 and 2009.