

# Douglas A. Boufford

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## Tax Highlights of the Federal Budget – February 23, 2005

Today the Liberal government delivered the first federal budget presented by a minority government in decades. The budget includes more than \$12 billion over a five year period in new spending for defense. It also includes \$5 billion over five years to establish a national Early Learning and Child Care initiative and more than \$800 million in direct federal support for health care. The budget also provides increased benefits for seniors, immigrants, aboriginal communities and the disabled. Personal and corporate tax breaks have also been proposed.

The following is a summary of the tax measures as proposed in the budget. Please note that these measures are not yet law and may undergo revisions prior to receiving Royal Assent.

### Business Measures

#### Elimination of the corporate surtax:

The budget proposes to eliminate the corporate surtax as of January 2008, pro-rated for taxation years that include that date. This measure will result in a 1.12% reduction in the corporate income tax rate. There will also be a reduction in the general corporate tax rate of two percentage points phased in over a three-year period. This rate reduction will apply to all types of corporate income except small business income eligible for the 12% rate; investment income of CCPCs; income of a credit unions eligible for the 16% tax credit; income of mutual fund corporations, mortgage investment corporations and investment corporations. These changes will be phased in as follows:

	2005	2006	2007	2008	2009	2010
On first \$300,00 of CCPC active business income	12%	12%	12%	12%	12%	12%
Surtax rate	1.12%	1.12%	1.12%	-	-	-
General income tax rate	21%	21%	21%	20.5%	20%	19%
Surtax rate	1.12%	1.12%	1.12%	-	-	-

#### Capital cost allowance modifications:

The budget proposes to adjust capital cost allowance (CCA) rates for the following types of assets, generally effective for assets acquired on or after February 23, 2005 that have not been used or acquired before that date:

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	<b>Current rate</b>	<b>Proposed Rate</b>
Electricity-generating combustion turbines	8%	15%
Electricity transmission and distribution assets	4%	8%
Oil and gas pipelines	4%	8%
Oil and gas pipelines – compression equipment	8% or 20%	15%
Certain energy generation equipment in Class 43.1	30%	50%
Telecommunications infrastructure cables	5%	12%

## Eligibility for R&D tax credits:

Eligibility for investment tax credits for scientific research and experimental development performed in Canada is extended to include R&D activities performed within “Canada’s Exclusive Economic Zone”, or in other words, within 200 nautical miles of Canada’s coastline.

## Agricultural cooperatives:

Patronage dividends paid in the form of shares, rather than cash, to members of eligible cooperatives will no longer be taxable nor subject to withholding in the year received, thereby deferring the taxation of these dividends until the year of disposition of the shares. However, there will be a limitation on the cooperative’s deduction for patronage dividends paid in the form of shares.

## Personal Measures

### Increase in the basic personal amount:

For 2004, the federal basic personal amount was \$8,012, which resulted in a non-refundable federal income tax credit of \$1,282 ( $\$8,012 \times 16\%$ ). The basic personal amount for 2005 is \$8,148 resulting in a credit of \$1,304. The budget proposes to increase the basic personal amount to \$10,000 by 2009. Increases are also proposed for the amount available for a spouse or common-law partner or a wholly dependent relative. Net income thresholds (the income level above which the amount of the credit is reduced) will also be enhanced. These increases will be in addition to the increases that take effect due to indexation of the tax system. The provinces have their own basic personal credit amounts and it remains to be seen if the provinces will follow suit by increasing their respective amounts.

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## Contribution limits raised for RRSPs and RPPs:

The budget proposes to increase the annual contribution limit for RRSPs and money purchase RPPs, as shown below:

	2005	2006	2007	2008	2009	2010	2011
Proposed RRSP contribution limit	\$16,500*	\$18,000	\$19,000	\$20,000	\$21,000	\$22,000	indexed
Proposed money purchase RPP contribution limit	\$18,000*	\$19,000	\$20,000	\$21,000	\$22,000	indexed	
* No change from existing limit							

## RRSP and RPP foreign content limit eliminated:

The budget proposes to eliminate the 30% limit on foreign property held by pension funds, RRSPs and other tax-deferred retirement plans, effective immediately.

## Deposit insurance coverage increased:

The budget increases the deposit insurance coverage limit to \$100,000 of insurable deposits (up from \$60,000), effective immediately.

## Enhanced benefits for seniors:

The Guaranteed Income Supplement monthly benefits for low-income seniors will rise by \$36 for singles and \$58 for couples by the year 2007.

## Assistance for persons with disabilities:

Eligible medical and disability related expenses incurred by a taxpayer on behalf of certain dependents may be claimed by that taxpayer to the extent they exceed the lesser of #% of the dependent relative's net income and \$1,844. The amount that could be claimed was capped at a maximum of \$5,000 per year per dependent. The budget proposes to increase this limit to \$10,000, effective for 2005 and subsequent years.

## Additional enhancements to the personal tax credit system:

Eligibility criteria for the disability tax credit is clarified and extended and several other changes enhancing the tax assistance for persons with disabilities were announced, based on advice from the government's Technical Advisory Committee on Tax Measures for Persons with Disabilities.

A new 16% non-refundable tax credit is introduced for up to a maximum of \$10,000 for eligible adoption expenses.

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## GST and Excise Tax Changes

The budget announced that as of January 1, 2005, the 83% GST rebate that is currently available to hospitals will be extended to eligible charities, public institutions and non-profit organizations performing services similar to those traditionally performed in hospitals. Formerly, these services were eligible for rebate at the rate of 50%.

The budget proposes to hold corporate directors liable not only for unremitted net GST/HST amounts, but also for net tax refund amounts to which the corporation is not entitled. This measure will take effect on or after the enabling legislation is enacted.

A web-based GST/HST registry will be established to verify that suppliers are registered.

The 10% excise tax on jewellery manufactured and sold in, or imported into, Canada will be phased out over the next four years and eliminated completely as of March 1, 2009.

## Air Travellers Security Charge

For tickets purchased on or after March 1, 2005, the budget proposes the following adjustments:

- ◆ For air travel within Canada, the charge will drop from \$6.00 to \$5.00 for one-way travel, and from \$12.00 to \$10.00 for round-trip travel.
- ◆ For transborder air travel, the charge will drop from \$10.00 to \$8.00.
- ◆ For other international air travel, the charge will drop from \$20.00 to \$17.00.

## Update on Outstanding tax Measures

### Interest Deductibility Proposals:

The Department of Finance issued proposals relating to the deductibility of interest and other expenses in October 2003. Among other things, these controversial proposals would ensure that you have a reasonable expectation of cumulative profit over the expected life of the business or property before you could deduct interest on the borrowed funds. In the 2005 budget, the government says that it will release an alternative proposal for comment "at an early opportunity" and that it "has sought to respond [to commentators' concerns] by developing a more modest legislative initiative that would respond to those concerns while still achieving the government's objectives".

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## Tax treatment of income trusts:

The budget says that the government will undertake consultations on tax issues related to business income trusts and other flow-through entities such as limited partnerships. The Department of Finance intends to release a paper for consultation shortly. The budget says that future initiatives, if any, will be taken following these consultations and in full consideration of the costs and benefits related to business income trusts and other flow-through entities.

## Cross-border share-for-share exchanges:

The government's October 2000 mini-budget announced that the government would undertake consultations on the merits and technical design of a tax deferral provision for Canadian resident shareholders who exchange shares of a domestic corporation for shares of a foreign corporation. The 2005 budget announces that a detailed proposal regarding cross-border share-for-share exchanges will be released for public comment in the "near future".

## Foreign investment entities and non-resident trusts/Technical amending bill:

In an update on the status of the tax proposals affecting foreign investment entities (FIE) and non-resident trusts, which were tabled in the detailed Notice of Ways and Means Motion on October 20, 2003, and on the status of the February 27, 2004 draft technical amendments, the 2005 budget says that it intends to "introduce legislation to implement these proposals at a suitable time, consistent with other legislative priorities".

### Disclaimer

The information provided is of a general nature and is not intended to construe an opinion. As each taxpayer's situation is unique, no one should act upon any of the above without first obtaining professional advice, from a Chartered Accountant, concerning the particular facts of their situation.