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**Hilborn Ellis Grant LLP**  
**401 Bay Street, Suite 3100**  
**P.O. Box 49**  
**Toronto, Ontario**  
**M5H 2Y4**

**Telephone: (416) 364-1359**

**Fax: (416) 364-9503**

**Website:**  
**www.hilbornellisgrant.com**

# Facts & Tax

From Hilborn Ellis Grant LLP

**February 23, 2005 -- Federal Budget Review**

## Introduction

Finance Minister Ralph Goodale's second Budget, presented to Parliament on Wednesday, February 23, was the first to be tabled by a minority government in 25 years. As such it appeared to reflect the government's aim of pleasing almost everyone while offending as few as possible by combining increased program spending with tax cuts while forecasting balanced budgets over the next five years. In fact, the Budget was unique in that it contemplates a five-year framework rather than the traditional two years.

Major spending initiatives proposed in the Budget included \$13 billion of increased funding for the military and security, \$3.4 billion over five years in additional international assistance, \$5 billion over five years for early learning and child care initiatives, and a minimum of \$4 billion over five years for action on climate change, as well as a further \$1 billion for "other environmental priorities."

Other significant proposals included: an additional \$805 million over five years to deliver on the government's earlier commitments on health care; \$735 million over five years to strengthen aboriginal communities; an additional \$668 million for arts and culture; \$398 million over five years for immigration and settlement programs; an additional \$800 million for regional economic development; \$375 million in additional funding for federal research councils; and raising Sport Canada funding from \$70 million in 2004-05 to \$170 million in 2005-06.

Among other significant proposals, Guaranteed Income Supplement benefits for low-income seniors will be increased by \$2.7 billion over five years through increased monthly benefits of \$36 a month for singles and \$58 a month for couples by January 1, 2007. The government will also implement an earlier pledge to share \$5 billion in gasoline tax revenues with cities and communities.

## Personal Tax Changes

### Retirement Savings

#### Limits

The Budget proposes that the maximum annual contribution amounts for money purchase registered pension plans and registered retirement savings plans be as follows:

	RRSP _____\$	RPP _____\$
2005	16,500	18,000
2006	18,000	19,000
2007	19,000	20,000
2008	20,000	21,000
2009	21,000	22,000
2010	22,000	Indexed
2011	Indexed	Indexed

The maximum annual contribution to deferred profit sharing plans, which is 50% of the registered pension plan limit, will therefore change as well.

#### Plan Investments

Currently, the foreign content of deferred income plans, such as registered retirement savings plans, is restricted to a maximum of 30% of the cost of the plan's assets. If the 30% limit is exceeded, a penalty tax is exigible. The Budget proposes to repeal the foreign content restriction, effective January 1, 2005.

The Budget also proposes to allow registered retirement savings plans to invest in certain investment-grade gold and silver bullion coins and bars, and related certificates. This change is effective for investments made on or after February 23, 2005.

## Non-Refundable Tax Credits

The Budget proposes to increase certain non-refundable tax credits above the annual indexed amounts.

The indexed basic personal amount, to which all taxpayers are entitled, is \$8,148 for 2005. The Budget proposes that the indexed amount be supplemented by \$100 for 2006, \$100 for 2007, \$400 for 2008 and, for 2009, the greater of \$600 and the amount needed to bring this amount to \$10,000. Thus, for 2009, the basic personal amount will be a minimum of \$10,000.

The Budget proposes that the indexed amount for the spousal, common-law partner and wholly dependent relative credits be supplemented by \$85 for 2006, \$85 for 2007, \$340 for 2008 and, for 2009, the greater of \$510 and the amount needed to bring this amount to \$8,500. Thus, for 2009, these amounts will be a minimum of \$8,500. The Budget also proposes parallel changes to the income threshold amounts, above which the credits are reduced.

## Disabled Taxpayers

The Budget proposals include measures, which commence in 2005, to assist persons with disabilities including: several changes to the eligibility criteria for the disability tax credit; expansion of the list of expenses qualifying for the disability supports deduction; an increase in the maximum refundable medical expense supplement to \$750 from the current \$571; changes to RESPs which are intended to better meet the needs of students with disabilities; an increase in the maximum Child Disability Benefit Supplement to the Canada Child Tax Benefit to \$2,000 annually; an expansion of the list of expenses qualifying for the medical expense credit; proposals to tighten the rules for medical expense eligibility for home renovation expenses; and an increase in the maximum amount a caregiver may claim in respect of medical expenses for a dependent relative from \$5,000 to \$10,000.

## Adoption Expense Tax Credit

The Budget introduced a non-refundable adoption expense tax credit effective January 1, 2005. The credit will be 16% of eligible expenses to a maximum of \$10,000 of expenses. Eligible expenses include: adoption agency fees, court and legal costs, travel expenses and the like. The maximum of \$10,000 will be indexed after 2005.

## Corporate Tax Changes

### Corporate Surtax Elimination and Corporate Tax Rate Reduction

The Budget proposes to eliminate the corporate surtax in 2008 and reduce the general corporate income tax rate starting in 2008 in accordance with the following chart.

	<u>2005/7</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
General income tax rate (%)	21.0	20.5	20.0	19.0
Surtax rate (%)	1.12	—	—	—

The Federal small business rate of 12% is unchanged.

## Tax Amendments In Progress

### Interest Deductibility

The Department of Finance issued proposals regarding the deductibility of interest and other expenses in October, 2003, originally to be effective January 1, 2005. In addition, draft amendments dating back to 1991 appear to still be on hold. The October, 2003 proposals intended to legislate the requirement of a reasonable expectation of cumulative profit over the expected life of the business or property before interest and other expenses could be deducted. The government has indicated in this Budget that it has sought to develop a "more modest" legislative initiative that would respond to taxpayers' concerns while still achieving the intended objectives. However, it is not clear how these proposed changes will be integrated or on what dates they will be effective.

### Tax Treatment of Flow-Through Entities

The government will undertake consultations on tax issues related to business income trusts and other flow-through entities such as limited partnerships. The Budget indicates that future initiatives, if any, will be taken following these consultations and in full consideration of the costs and benefits.

### Cross-Border Share-for-Share Exchanges

The government's October, 2000 mini-budget announced that it 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 announced that a detailed proposal regarding cross-border share-for-share exchanges will be released for public comment in the "near future".

### Foreign Investment Entities (FIEs) and Non-Resident Trusts (NRTs)

Draft tax legislation affecting FIEs and NRTs was previously tabled with an effective date of January 1, 2003. However, these proposals have not yet been passed into law and further amendments are being considered. The Budget indicated that legislation to implement these proposals will be introduced "at a suitable time, consistent with other legislative priorities".

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