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Federal Budget – February 23, 2005

BUDGET HIGHLIGHTS

On February 23, 2005, Finance Minister Ralph Goodale delivered the 2005 federal budget (the “Budget”). The Budget proposes modest personal and corporate tax reductions, while increasing funding for the environment, health care, municipalities, national defense and others. In summary, the Budget proposes that:

- The federal general corporate tax rate be reduced from 21% to 19%, phased in from 2008 to 2010.
- The 1.12% corporate surtax be eliminated, effective 2008.
- The basic personal amount and the spousal amount be increased to \$10,000 and \$8,500, respectively, by 2009.
- The registered retirement savings plan (“RRSP”) limit be increased to \$22,000 by 2010.
- The elimination of the foreign property content rule for RRSP and other tax-deferred retirement savings plans, effective in 2005.
- The deposit insurance coverage limit be increased from \$60,000 to \$100,000.

The Budget also proposes changes to the medical expense tax credit and to various items affecting individuals with disabilities.

The highlights of the tax changes announced in the Budget are summarized below. In addition, this commentary highlights other items of interest.

BUSINESS TAX MEASURES

Corporate Income Tax Rate Reduction

The Budget proposes to reduce the federal general corporate income tax rate from 21% to 19% by 2010. The general corporate income tax rate will be reduced to 20.5% effective January 1, 2008, 20% effective January 1, 2009, and 19% effective January 1, 2010 (all prorated for taxation years that include those dates). The rate reductions will not apply to investment income of Canadian-controlled private corporations, nor to small business income that is subject to the low 12% federal corporate tax rate.

Corporate Surtax Elimination

The Budget proposes to eliminate the corporate surtax effective January 1, 2008, prorated for taxation years that include that date. Its elimination is equivalent to a 1.12% reduction in the corporate income tax rates.

The revised combined federal and Ontario corporate tax rates are reflected in the table on page 11.

Capital Cost Allowance (“CCA”) Rate Changes

The Budget proposes to change the CCA rates for the following assets acquired on or after February 23, 2005:

Asset Type	Current CCA Rate	Proposed CCA Rate
Hydrocarbon transmission pipelines	4%	8%
Petroleum pumping and natural gas compression equipment	20%	15%
Combustion turbines	8%	15%
Electricity transmission and distribution assets e.g. power lines, transformers and substation equipment	4%	8%
Wire and cable for telephone, telegraph or data communication (other than fibre-optic cable)	5%	12%
High-efficiency and renewable energy generation equipment, acquired before 2012	30%	50%

Distribution equipment of a district energy system and biogas production equipment will become class 43.1 assets, eligible for the 30% CCA rate. If acquired before 2012, the enhanced 50% CCA rate will be available.

The Budget also proposes to expand the types of energy related properties whose CCA claims will be restricted to the income derived therefrom, where such properties are acquired by passive investors.

Other Issues

Deductibility of Interest and Other Expenses

On October 31, 2003, the Department of Finance released for public comment, draft proposals regarding the deductibility of interest and other expenses for income tax purposes. The proposals provided that a taxpayer will be considered to have a loss from a business or property for a taxation year only if, in that year, it is reasonable to expect that the taxpayer will realize a cumulative profit from that business or property, during the time that the taxpayer has carried on or held, or can reasonably be expected to carry on or hold, the business or the property. Many parties expressed concern with the proposals; in particular, the proposals' codification of an objective "reasonable expectation of profit" test might inadvertently limit the deductibility of a wide variety of ordinary commercial expenses.

The Budget indicates that the Department will develop a more modest legislative initiative that would respond to those concerns, while still achieving the Department's objectives. The Department will, at an early opportunity, release that alternative proposal for public comment.

Income Trusts

The 2004 federal budget proposed to significantly reduce the ability of tax-exempt entities such as pension funds to invest in income trusts. As a result of concern expressed by stakeholders, the Department of Finance decided to suspend the implementation of these measures and to engage in further consultation.

PERSONAL TAX MEASURES

Basic Personal Amount

The Budget proposes to annually increase the basic personal amount from \$ 8,149 in 2005 to at least \$ 10,000 in 2009. Specifically, in addition to annual indexation, the Budget proposes to increase the basic personal amount by:

- \$100 in 2006
- \$100 in 2007
- \$400 in 2008
- \$600 (to at least \$ 10,000) in 2009.

Spouse or Common-law Partner Amount & Amount for an Eligible Dependent

The Budget proposes to annually increase these amounts from \$6,919 in 2005 to at least \$ 8,500 in 2009. Specifically, in addition to annual indexation, the Budget proposes to increase these amounts by:

- \$85 in 2006
- \$85 in 2007
- \$340 in 2008
- \$510 (to at least \$8,500) in 2009.

Registered Pension Plan (“RPP”) and RRSP Limits

The Budget proposes to increase the RPP and RRSP annual maximum contribution limits, subject to the existing restrictions based on earnings, as follows:

	2005	2006	2007	2008	2009	2010	2011
Money purchase RPP annual contribution limit	18,000*	19,000	20,000	21,000	22,000	Indexed	
Defined benefit RPP maximum pension benefit (per year of service)	2,000*	2,111	2,222	2,333	2,444	Indexed	
RRSP annual contribution limit	16,500*	18,000*	19,000	20,000	21,000	22,000	Indexed

* No change from the existing limit

The Deferred Profit-Sharing Plan (“DPSP”) limit will remain at one-half of the money purchase RPP limit.

Foreign Property Rule

Under the current foreign property rule, the foreign content limit of investments in pension funds, RRSPs and other tax-deferred retirement plans is 30% of the book value of the plan’s assets. The Budget proposes to entirely eliminate this limit for all tax-deferred retirement plans, effective 2005.

Qualified Investments

RRSPs, Registered Education Savings Plans (“RESPs”), Registered Retirement Income Funds (“RRIFs”) and DPSPs must invest only in “qualified investments,” as prescribed by the Income Tax Regulations. Effective February 23, 2005, the Budget proposes to include as qualified investments, investment-grade gold and silver bullion coins and bars, and certificates on such investments, provided that such investments are acquired either from the producer of the investment or from a regulated financial institution.

Medical Expense Tax Credit (“METC”)

The Budget proposes to expand the list of expenses eligible for the METC to include the following, effective for the 2005 and subsequent taxation years:

- i) Cost to purchase, operate, and maintain phototherapy equipment prescribed for the treatment of psoriasis or other skin disorders.
- ii) Expenses incurred to operate an oxygen concentrator, including the cost of electricity (the cost of purchasing an oxygen concentrator is currently an eligible expense).
- iii) Cost to purchase drugs and devices under the Special Access Programme (a program that allows the purchase of unapproved drugs under special circumstances), and medical marihuana, subject to certain limitations.
- iv) Items added to the list of expenses eligible for the disability supports deduction (except for job coaching services), where they were not incurred for educational or employment purposes.

Currently, expenses incurred for home renovations are eligible for the METC when they are undertaken to enable a disabled person to gain access to, or to be mobile or functional within, his/her home. Decisions from recent court cases have broadened the generosity of this measure beyond the policy intent of the METC. Therefore, in order to limit the eligibility of these expenses, the Budget proposes to allow home renovation costs for the METC, only where:

- i) The renovation is not typically expected to increase the value of the home; and
- ii) The renovation is of a type that would not typically be incurred by unimpaired persons.

Furthermore, the Income Tax Regulations will be amended to ensure that only devices exclusively designed for the purpose of assisting an individual in walking, where the individual has a mobility impairment, will be eligible for the METC. These changes will be effective for expenses incurred on or after February 23, 2005.

Medical Expenses Incurred for Dependent Relatives

Currently, taxpayers paying medical or disability-related expenses on behalf of a dependent relative (ie. the taxpayer’s child, grandchild, parent, grandparent, brother, sister, uncle, aunt, niece or nephew, who is 18 or older and dependent on the taxpayer for support) may claim those expenses under the METC, reduced by certain income thresholds, to a maximum of \$5,000 per dependent relative. The Budget

proposes to increase this maximum limit to \$10,000 per dependent relative for the 2005 and subsequent taxation years.

Adoption Expense Tax Credit

The Budget proposes a 16% non-refundable tax credit for eligible adoption expenses (to a maximum of \$ 10,000 in 2005, and indexed for future taxation years) incurred for adopting a child under age 18, effective for the 2005 and subsequent taxation years. Eligible adoption expenses include the following:

- i) Fees paid to a licensed adoption agency.
- ii) Court, legal and administrative expenses.
- iii) Reasonable travel and living expenses for the child and the adoptive parents.
- iv) Document translation fees.
- v) Mandatory fees paid to a foreign institution.
- vi) Any other reasonable expenses required by the government or the adoption agency.

This credit is claimed in the year the adoption is finalized but the taxpayer is permitted to include in the computation of the credit those eligible expenses incurred in prior taxation years, commencing from the earlier of the time the adoption file is opened and the time, if any, an adoption application is made to a Canadian court.

To be eligible for the credit, a parent must submit proof of the adoption. The credit may be split between two adoptive parents, but the combined expenses claimed for an adopted child cannot exceed the maximum amount.

Persons with Disabilities

The Budget proposes to implement a number of income tax changes that will benefit persons with disabilities and those who care for them, based on the report released in December 2004 by the Technical Advisory Committee on Tax Measures for Persons with Disabilities.

These measures, which will generally apply for the 2005 and subsequent taxation years, are summarized as follows:

- i) Currently, the disability tax credit (“DTC”) is available to individuals that have a “severe and prolonged mental or physical impairment”. The Budget proposes to amend the present wording with the wording “severe and prolonged impairment in physical or mental functions”. The intent of this measure is to clarify the existing legislation, and not to expand the eligibility for the DTC.
- ii) Individuals with severe impairments in mental functions are eligible for the DTC, if they have a marked restriction in “perceiving, thinking and remembering”. The Budget proposes to amend the present wording with the wording “mental functions for everyday life”. Mental functions will be defined as including memory, problem-solving, goal setting, judgement, and adaptive functioning. The intent of this measure is to clarify the existing legislation, and not to expand the eligibility for the DTC.

- iii) Currently, the DTC eligibility criteria require that an individual be unable or take an inordinate amount of time (i.e. a marked restriction) to perform at least one basic activity of daily living (e.g. feeding, dressing, walking, talking, etc.), all or substantially all of the time. The Budget proposes to extend eligibility for the DTC to include individuals who have significant restrictions in more than one basic activity of daily living, such that the cumulative effect of their restrictions is equivalent to having a single marked restriction in one basic activity of daily living, all or substantially all of the time.
- iv) Currently, individuals who require extensive therapy to sustain a vital function qualify for the DTC, provided that it is required to be administered at least three times each week for a total duration averaging not less than 14 hours per week, and it cannot reasonably be expected to be of significant benefit to persons who are not so impaired. The Budget proposes to better define the activities that will be considered therapy, and what will be included as time spent receiving therapy.
- v) The Budget proposes to allow physiotherapists to certify a marked restriction in walking for the purposes of determining eligibility for the DTC. Certification of eligibility for the DTC as a result of the cumulative effect of multiple restrictions must be made by a medical doctor, unless it pertains strictly to walking, feeding or dressing, in which case certification may also be made by an occupational therapist.
- vi) The Budget proposes to expand the list of expenses eligible for the disability supports deduction (“DSD”) which are incurred for employment or education purposes. These expenses will include amounts paid for job coaching services (but not job placement or career counseling services) for individuals who have a severe and prolonged impairment, reading services and software/devices facilitating the reading of print for individuals who are blind or who have a severe learning disability, deaf-blind intervening services for individuals who are both blind and deaf, bliss symbol boards used by individuals who have a speech impairment, braille note-takers, and page-turners to assist the turning of the pages of a book or other bound documents. The need for the above expenses, except for the deaf-blind intervening services, must be certified by a medical practitioner.
- vii) For 2005, the Budget proposes to increase the refundable METC from \$571 to \$750, and will be indexed for future taxation years.
- viii) Ordinarily, contributions to an RESP can only be made for 21 years following the year in which the plan is entered into, and it must be terminated by the end of the 25th year following the creation of the plan. The Budget proposes that where an RESP beneficiary qualifies for the DTC in the 21st year following the year in which the plan was entered into, then the period for making RESP contributions and the termination date for the RESP will be extended to 25 years and 30 years, respectively.

While this change applies only to single beneficiary RESPs, if an individual who qualifies for the DTC is a beneficiary under a family plan, that individual’s share of the family plan can be transferred into a single beneficiary RESP, in order to ensure access to these extended limits.

- ix) The Child Disability Benefit Supplement of the Canada Child Tax Benefit will be increased from \$1,681 to \$2,000 for the 2005-06 benefit year. The benefit will continue to be indexed for future years.
- x) The Canada Revenue Agency (“CRA”) intends to continue to enhance communication and improve the awareness and the administration of the various disability related tax measures. As well, a new technical advisory committee, comprised of community and professional representatives, will advise the CRA on the administration of tax measures for persons with disabilities.
- xi) The Department of Finance has indicated its intention to review the legislation to allow more flexibility in respect of a deceased’s RRSP or RRIF proceeds left to a financially dependent child or grandchild with a disability and, in particular, that the use of a discretionary trust be permitted in these circumstances. As well, a review of the METC and the Work Opportunity Tax Credit available in the United States will be undertaken.

SALES AND EXCISE TAX MEASURES

Excise Tax on Jewellery

The Budget proposes that the excise tax on jewellery be phased-out through a series of rate reductions over the next four years. The rate will be reduced from 10% to 8% effective February 24, 2005 and will be reduced by an additional 2% on March 1 for each of the next four years, until the tax is eliminated effective March 1, 2009.

Goods and Services Tax (“GST”) / Harmonized Sales Tax (“HST”) Health Care Rebate

The Budget proposes to increase from 50% to 83% the GST/HST rebate in respect of purchases made by eligible charities and non-profit organizations related to the provision of health care services similar to those traditionally performed in hospitals, effective January 1, 2005.

Director’s Liability for GST/HST Refunds

Under existing provisions in the Excise Tax Act, a director of a corporation can be held liable for the corporation’s unremitted net GST/HST, unless the director can prove that he/she exercised due diligence.

The Budget proposes to provide that a director of a corporation may be held liable not only for unremitted net GST/HST amounts, but also for GST/HST net tax refund amounts to which the corporation is not entitled. Similar to the liability for unremitted net GST/HST amounts, a director’s liability with respect to GST/HST net tax refunds would arise only where the director has not exercised due diligence.

The extension of the directors’ liability to GST/HST net tax refunds will apply in respect of net tax refund amounts received on or after Royal Assent.

GST/HST Web Registry

As part of their obligations under the GST/HST, registrants are required to ensure that input tax credits are claimed only where GST/HST has been paid to suppliers who are registered for GST/HST purposes. Currently, the sole means available to verify the validity of a supplier's registration is to contact the CRA.

In order to facilitate verification of a supplier's GST/HST registration, a publicly accessible web-based GST/HST registry is proposed. It is intended that this registry be operational within 12 months of Royal Assent.

OTHER ITEMS OF INTEREST

Workplace Safety and Insurance Board ("WSIB")

Most businesses in Ontario that employ workers (including family members and sub-contractors) must register with the WSIB within 10 days of hiring their first full or part-time worker. The Workplace Safety and Insurance Act imposes severe penalties for non-compliance under the Act.

Where a business is required to be registered with the WSIB, the business must generally insure all of its employees (except its executive officers). In addition, the business will also have to insure its contractors, unless (a) the contractor is not factually considered to be an employee of the business, and (b) the contractor provides a clearance certificate from the WSIB. The WSIB issues this certificate where the contractor itself is registered with the WSIB and its WSIB premiums are current. The clearance certificate is valid only for a specified period, so updated certificates will be required, and should be retained in the event of audit. If a contractor is not registered with the WSIB, and the contractor is an independent operator (a person who carries on a certain specified trade and who does not employ any worker for that purpose), the contractor may not have to be insured by your business. For this purpose, the contractor should provide you with a letter from the WSIB confirming its status as an independent operator. The WSIB will usually require the contractor to complete a questionnaire before issuing this letter.

Where a business is not required to be registered with the WSIB, it can still choose to insure its workers through the WSIB. A sole proprietor, partner of a partnership, or executive officer of a company is not required to be covered under the WSIB insurance plan, but can voluntarily choose to be covered by the WSIB.

The CRA and the WSIB have entered into an agreement to share business information to ensure that all Ontario employers required to register with the WSIB are, in fact, registered. The WSIB has identified employers that are currently registered with the CRA, but do not appear to be registered with the WSIB. The WSIB has piloted a registration campaign for 1,000 identified employers. A joint CRA-WSIB letter requests that employers confirm that they are registered, or else begin the registration process. Otherwise, the WSIB will register and assess premiums for these employers, based on the information available through the CRA records. It is anticipated that the scope of the campaign will be increased after the initial pilot project. Employers required to register will be assessed WSIB premiums from 2002 to date, plus penalties and interest.

If you are not sure whether or not your business is required to be registered with the WSIB and pay the premiums, please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP.

Inactive Ontario Corporations

Every corporation that is incorporated in Ontario must file an annual income tax return, including an inactive or trustee corporation. If a corporation fails to file an annual income tax return, the corporation and/or its officers or directors could be held liable for significant penalties (not less than \$200 per day of default). The Ontario Ministry of Finance (“MOF”) sends notices to corporations that have not filed one or more annual income tax returns. In a number of situations, the MOF has taken directors of the delinquent corporations to court. We are aware of several situations where the MOF made a settlement with the directors before the court hearing for an amount that was significantly lower than the amount provided in the legislation. Nonetheless, the MOF may impose the maximum penalty. Once the delinquent filings are made, if you no longer require the inactive/trustee corporation, you may wish to consider voluntarily dissolving the corporation.

Please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP if you wish assistance in handling the requests to file the delinquent corporate income tax returns.

Self-employed Individuals and the GST

The CRA has been contacting individuals with self-employment income e.g. business, professional, or commission income, who are not registered for the GST. Unless the individual is in the business of providing exempt goods and services (e.g. certain health care services), or zero-rated goods (such as basic groceries), or has annual revenue of less than \$30,000, the individual must collect and remit the GST.

If the GST should have been collected and remitted by the individual, he or she will be required to pay the GST, together with interest and penalties thereon. Moreover, the individual may lose his/her entitlement to certain input tax credits with respect to the GST paid by the individual.

Please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP, if you are ensure whether you need to register your self-employed business for GST purposes.

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To discuss the impact of the Budget on your business, please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP.

COMBINED FEDERAL AND ONTARIO CORPORATE TAX RATES

The following combined Federal and Ontario tax rates will apply to corporations subject to Ontario tax:

		2004	2005 to 2007	2008	2009	2010
Small business rate on active income up to \$250,000*	Federal	13.12%	13.12%	12.00%	12.00%	12.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		18.62%	18.62%	17.50%	17.50%	17.50%
Small business rate on active income from \$250,000 to 300,000*	Federal	22.12%	13.12%	12.00%	12.00%	12.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		27.62%	18.62%	17.50%	17.50%	17.50%
Small business rate on active income from \$300,000 to 320,000*	Federal	22.12%	22.12%	20.50%	20.00%	19.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		27.62%	27.62%	26.00%	25.50%	24.50%
Small business rate on active income from \$320,000 to 400,000*	Federal	22.12%	22.12%	20.50%	20.00%	19.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		27.62%	27.62%	26.00%	25.50%	24.50%
M & P rate	Federal	22.12%	22.12%	20.50%	20.00%	19.00%
	Ontario	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>
		34.12%	34.12%	32.50%	32.00%	31.00%
General rate (active income not eligible for the small business rate)	Federal	22.12%	22.12%	20.50%	20.00%	19.00%
	Ontario	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>
		36.12%	36.12%	34.50%	34.00%	33.00%
Investment income	Federal	35.79%	35.79%	34.67%	34.67%	34.67%
	Ontario	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>
		49.79%	49.79%	48.67%	48.67%	48.67%

* These rates do not take into account the effect of the clawback of the Ontario small business deduction. The clawback applies where taxable income of the corporation and those corporations associated with it, falls between \$400,000 and \$1,128,519. The Ontario clawback rate is 4.67%.

In addition, the table does not take into account that a corporation's business limit for Federal tax purposes is clawed back where the corporation, together with any associated corporations, had taxable capital, as computed for Federal Large Corporation Tax purposes, in excess of \$10 million in the preceding year.

The rates are presented on a calendar-year basis. Where a corporation's fiscal year straddles two calendar years, its corporate income tax rate will be pro-rated for the number of days in its fiscal year that falls into each calendar year.