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## **Federal Mini-Budget – November 14, 2005**

### **MINI-BUDGET HIGHLIGHTS**

On November 14, 2005, Finance Minister Goodale presented the Economic and Fiscal Update 2005 (the “Mini-Budget”). As the opposition politicians threatened to force an early January election, Minister Goodale announced higher than expected budget surpluses and unveiled \$30 billion in tax cuts over the next five years.

Given the likelihood of an imminent election call, there is greater than usual uncertainty as to whether the Mini-Budget measures will be enacted by Parliament as proposed.

The Mini-Budget proposes significant personal tax reductions and reinstates certain corporate tax reductions originally proposed in the February 2005 budget, while increasing funding for post-secondary education, workplace training, advancement of public infrastructure and international trade initiatives.

In summary, the Mini-Budget proposes:

- To reduce the federal general corporate tax rate from 21% to 19%, phased in from 2008 to 2010. This reduction was originally proposed in the February 2005 budget, but was later abandoned.
- To eliminate the 1.12% corporate surtax for all corporations, effective 2008. Again, this measure was originally proposed in the February 2005 budget to apply to all corporations, but was later amended to apply only to small and medium-sized corporations.

- To eliminate the federal Large Corporations Tax as of January 1, 2006.
- To increase the non-capital loss carry-forward period to 20 years, for post-2005 losses.
- To extend the investment tax credit (“ITC”) carry-forward period to 20 years, for post-2005 ITCs.
- To decrease by 1% the personal tax rate applicable to the first \$35,000 of taxable income, effective January 1, 2005.
- In 2010, to decrease by 1% the personal tax rates applicable to taxable income between \$35,000 and \$116,000.
- In 2010, to increase the taxable income threshold for the top tax bracket from \$116,000 to \$200,000.
- To accelerate the phase-in of the previously announced increases in the basic personal amount and the spousal/eligible dependant amount. The basic personal amount of \$8,148 will increase by \$500 for 2005, with accelerated annual increases to bring the basic personal amount to \$10,000 by 2009. The spousal/eligible dependant amount of \$6,919 will increase by \$425 for 2005, with accelerated annual increases to bring the amount to \$8,500 by 2009.

The Mini-Budget also proposes to increase the Child Disability Benefit and the refundable medical expense supplement.

The highlights of the tax changes announced in the Mini-Budget are summarized below.

## **BUSINESS TAX MEASURES**

### **Corporate Income Tax Rate Reduction**

The Mini-Budget proposes to reinstate the February 2005 budget proposal to reduce the federal general corporate income tax rate from 21% to 19% by 2010 (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 (“CCPC”), nor to small business income subject to the low 12% federal corporate tax rate.

### **Corporate Surtax Elimination**

The Mini-Budget proposes to reinstate the February 2005 budget proposal to eliminate the 1.12% corporate surtax for all corporations, effective January 1, 2008. The surtax elimination has already been enacted effective January 1, 2008 for small and medium-sized corporations (that is, corporations with taxable capital of \$50 million or less, with a reduced surtax for corporations with taxable capital between \$50 million and \$75 million).

The revised combined federal and Ontario corporate tax rates are reflected in the table on page 6.

### **Elimination of Federal Large Corporations Tax (“LCT”)**

The Mini-Budget proposes to eliminate the LCT as of January 1, 2006 - two years earlier than previously scheduled. Currently, the LCT rate is 0.175% on taxable capital in excess of \$50 million. The LCT elimination will be prorated for non-calendar taxation years.

The definition of a “large corporation” for the purpose of various other provisions of the Income Tax Act will be unaffected by the elimination of the LCT. For example, the small business deduction limit will continue to be reduced or eliminated for CCPCs with taxable capital in excess of \$10 million, regardless of whether such CCPCs are exempt from the LCT.

### **Carry-Forward Period for Non-Capital Losses and Investment Tax Credits**

The Mini-Budget proposes to extend the carry-forward period from 10 years to 20 years for non-capital losses incurred and investment tax credits earned in taxation years ending after 2005. The carry-forward period for non-capital losses is 7 years for taxation years that end prior to March 23, 2004.

### **Capital Cost Allowance (“CCA”) Rate Changes – Forestry Bioenergy Equipment**

The CCA rate for Class 43.1 renewable energy generation equipment acquired before 2012 was enhanced in the February 2005 budget from 30% to 50%. The Mini-Budget proposes that cogeneration systems that use a type of biomass used in the pulp and paper industry, referred to as “black liquor”, will become a Class 43.1 asset, eligible for the 30% CCA rate. If acquired before 2012, the enhanced 50% CCA rate will be available.

### **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. Shortly thereafter, the Department of Finance announced its decision to suspend the implementation of this measure and to engage in public consultation. On September 19, 2005, the Department of Finance announced that the Canada Revenue Agency would immediately cease to issue advance tax rulings on income trust structures, leading to significant uncertainty in the securities markets. Today, Minister Goodale stated that the Department is reviewing various proposals received through its ongoing consultations and will respond promptly with the results of the process.

## **PERSONAL TAX MEASURES**

### **Personal Income Tax Rate Reduction**

The Mini-Budget proposes to reduce the federal personal income tax rates as follows:

- The lowest 16% rate be reduced to 15%, effective January 1, 2005
- The 22% rate be reduced to 21%, effective January 1, 2010
- The 26% rate be reduced to 25%, effective January 1, 2010.

The taxable income threshold at which the top 29% rate begins to apply will be increased to \$200,000, effective January 1, 2010.

As a result of the above changes, the federal alternative minimum tax (“AMT”) rate and the federal rate that applies to most non-refundable tax credits will be reduced from 16% to 15%.

### **Combined Federal and Ontario Personal Tax Rates**

The following combined federal and Ontario personal income tax rates will apply from 2005 to 2010:

| Taxable Income Brackets <sup>(1)</sup> | Calendar Year |        |
|--|---------------|--------|
|  | 2005 to 2009  | 2010   |
| \$0 to \$34,009                        | 21.05%        | 21.05% |
| \$34,010 to \$35,595                   | 24.15%        | 24.15% |
| \$35,596 to \$59,881                   | 31.15%        | 30.15% |
| \$59,882 to \$68,020                   | 32.98%        | 31.98% |
| \$68,021 to \$70,558                   | 35.39%        | 34.39% |
| \$70,559 to \$71,190                   | 39.41%        | 38.41% |
| \$71,191 to \$115,739 <sup>(2)</sup>   | 43.41%        | 42.41% |
| Over \$115,739 <sup>(2)</sup>          | 46.41%        | 46.41% |

- (1) The income brackets shown above reflect all applicable taxes and surtaxes (except the Ontario Health Premium), and do not include any personal tax credits. This chart shows the 2005 tax brackets, which will be indexed for inflation after 2005.
- (2) The top tax bracket begins to apply at \$200,000 of taxable income in 2010.

### **Basic Personal Amount**

The Mini-Budget proposes to accelerate the scheduled annual increases in the basic personal amount, which is currently \$8,148, to at least \$10,000 in 2009. Specifically, in addition to annual indexation, the Mini-Budget proposes to increase the basic personal amount by:

- \$500 in 2005
- \$200 in 2006
- \$100 in 2007
- \$100 in 2008
- \$300 (to at least \$10,000) in 2009.

**Spouse or Common-Law Partner Amount & Amount for an Eligible Dependant**

The Mini-Budget proposes to accelerate the scheduled annual increases in the spousal/eligible dependant amount, which is currently \$6,919, to at least \$8,500 in 2009. Specifically, in addition to annual indexation, the Mini-Budget proposes to increase this amount by:

- \$425 in 2005
- \$170 in 2006
- \$85 in 2007
- \$85 in 2008
- \$255 (to at least \$8,500) in 2009.

**Increase in Child Disability Benefit (“CDB”)**

The Mini-Budget will increase the maximum CDB Supplement of the Canada Child Tax Benefit from \$2,000 to \$2,300, effective July 2006. The benefit will continue to be indexed for future years.

**Increase in Refundable Medical Expense Supplement (“RMES”)**

The Mini-Budget proposes to increase the maximum RMES from \$571 to \$750 for 2005, and to \$1,000 for 2006. The amount will be indexed for future taxation years.

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To discuss the impact of the Mini-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<br>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 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.