

TAXTICS

March 23, 2004

2004 Federal Budget

inside

Minister of Finance Ralph Goodale presented his first Budget to Parliament on March 23, 2004 and placed an emphasis on “financial responsibility and integrity”. This was also the first Budget under Paul Martin as Prime Minister and it is widely expected that the Budget will be followed in short order by a federal election. Several of the initiatives described in the Budget (including the aid package aimed at cattle farmers, the planned assistance to municipalities and the additional health care funding for the provinces) had been announced before the Budget. Aside from the measures already announced, there is very little in the way of new spending measures and promises of future tax relief that would normally be found in a pre-election Budget. Balanced or better budgets are forecast for 2003-04, 2004-05 and 2005-06 and the use of contingency reserves is restored. The Minister of Finance introduced his Budget speech as follows:

“Today, I am presenting a focused budget plan with two clear objectives:



first, to demonstrate unequivocally the principles of financial responsibility and integrity; and second, to begin to give tangible shape to the goals presented in the Speech from the Throne. We are making the initial payments that we can afford to make, now. In future budgets and future years, we will build on the steps being taken today.”

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Business Tax Incentives in a Nutshell

Increased Small Business Deduction Threshold

The federal small business deduction threshold will increase to \$300,000 beginning on January 1, 2005 from the existing \$250,000 level. It was originally scheduled to increase to \$275,000 in 2005 and to \$300,000 in 2006. This will provide small businesses with a greater opportunity to reinvest in their businesses by deferring the personal tax burden.

Operating Losses Have a Longer Life

The carry-forward period for operating losses incurred in taxation years ending after March 22, 2004 is being extended from 7 years to 10 years. The 3-year loss carry-back remains in place. The change is applicable to all corporations, although the change is designed to assist those new businesses that incur losses for a number of years before they become profitable.

Rapidly Depreciating Equipment = Rapid Write-Off

The rate of write-off for computer equipment acquired after March 22, 2004 is being increased from 30% to 45%. The government intends on removing the separate class election available for computer equipment beginning in 2005 as it feels that this provision is no longer necessary given the higher write-off rates. The government feels that these new rates better reflect the true useful lives of the equipment.

For the same reasons, data network infrastructure equipment, otherwise included in schedule 8, acquired after March 22, 2004 can be written off at a 30% rate.

Non-Deductibility of Fines and Penalties

Before the current budget was tabled fines and penalties, other than those levied under the Income Tax Act, were deductible if they were incurred in the ordinary course of business. The budget proposes to

deny a deduction for any fines and penalties incurred after March 22, 2004. In their opinion, the effectiveness of such penalties is diminished if a deduction is allowed for tax purposes. Keep in mind that such comments would not extend to penalties levied under the GST portions of the Excise Tax Act and interest charges levied outside of the Income Tax Act.

Income Trusts Structure Unscathed, For Now

The government decided not to change the tax rules that make an income trust so appealing to the individual investor. For now, a corporation whose shares are held by an income trust will continue to avoid most, if not all, of the tax otherwise payable at the corporate level. Individual investors will continue to retain a larger amount of after-tax cash in their hands when compared to the alternative of investing directly in a profitable corporation. This will be especially true in cases where the trust units are held inside of registered accounts where no personal tax will be payable until the registered plan is liquidated.

In order to slow down the proliferation of income trust vehicles into the market, the government has restricted the amount of business income trust investments that a pension fund can hold. Effective January 1, 2005, they may only allocate 1% of their assets to these vehicles and they can not hold more than a 5% interest in any particular trust. This restriction will help combat the growing interest in income trusts which is expected to expand when provincial governments remove the liability concern hanging over the holders of income trust units.

Personal Tax

Taxpayer-Requested Adjustments

Effective January 1, 2005, individuals and testamentary trusts can no longer request the Canada Revenue Agency to revise a return for a taxation year dating back to 1985. In order to avoid administrative problems with such outdated taxation years, the new rule proposes to limit the look back period to 10 years.

For corporations, no adjustments can be requested and no reassessments can be made (except for instances of gross negligence) beyond the normal 3 to 4 year reassessment period.

Is School More Affordable?

Beginning in 2004, the education tax credit will be extended to employees who take post-secondary education courses to improve their employment related skills provided the costs are not paid for by their employer.

To enhance access to education for low to middle income families, the Canada Education Savings Grant has been enhanced, a new Canada Learning Bond has been created and the availability of post-secondary education grants has increased.

Tax Relief for Canadian Forces

Beginning in 2004, a member of the Canadian Forces or a Canadian police force deployed to an international high-risk operational mission is able to exclude from their income for tax purposes any employment income earned while on such a mission. The tax relief is intended to be in recognition of the contribution that these individuals have made to their country.

Tax Fairness for Persons with Disabilities

The government proposes to replace the attendant care deduction with a broader disability supports deduction which is extended to cover expenses incurred for education or employment purposes in addition to attendant care expenses. Under the new deduction no tax will be paid on income used to pay for disability related expenses. This may increase eligibility for income-tested benefits.

Caregiver Related Medical Expenses

Under the proposal effective 2004, a caregiver would now be able to claim a greater amount of qualifying medical and disability-related expenses incurred on behalf of a dependent relative (in excess of the lesser of \$1,813 or 3% of the dependant's net income), to a maximum of \$5,000.

Municipalities, No More GST!

As previously announced, effective February 1, 2004, municipalities will be able to recover 100%, as opposed to only 57.14%, of the Goods and Service Tax they pay.

Registered Charities – Give and Take

In order to better reflect long-term rates of return expected by a charity and to better meet its donor's wishes, the disbursement quota with respect to capital assets not being used directly in charitable activities is being reduced from 4.5% to 3.5%.

The government proposes to add a variety of penalties to combat non-compliance effective for taxation years beginning after March 22, 2004. These penalties include a \$500 penalty for late filing of the annual information return, a penalty of 5% of the donation for issuing an incomplete donation receipt and suspension of tax-receipting privileges for failing to comply with certain verification and enforcement sections of the Act. The charity has the option of transferring an amount equivalent to the penalty to a qualified donee in lieu of paying the penalty.

Readers are urged to consult their professional advisors prior to acting on the basis of material in this newsletter.

If you have any questions regarding the content of this newsletter, please contact Crawford, Smith & Swallow.

Complete copies of the 2004 Budget Plan in PDF format are available on our website as well as the Department of Finance website listed below:

<http://www.crawfordsmithandswallow.com/newsletter.html>

<http://www.fin.gc.ca/budget04/pdf/bp2004e.pdf>

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