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TAXING TIMES

AND OTHER ISSUES

BUDGET 2003

NOTICE TO READER

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Readers are cautioned that this commentary is informational only and that any issues specific to the reader's needs be addressed with the appropriate tax professional.

BUDGET SUMMARY

In his first budget, Finance Minister John Manley has managed to create the impression that the government is about to provide some tax breaks for Canadians. When in fact we review the details we will see that very little is new and what is new is likely not material to most Canadians. The best news is that as our economy continues to out-perform the rest of the G7 countries, we continue to see the dividends in the form of continued and projected future budget surpluses, some of which we hope will be used to reduce the national debt.

FAMILIES

Low- and middle-income families will benefit from increases in the Canada Child Tax Benefit (CCTB) and supplement payments beginning in July. The total maximum increase will be $192 for the first child, $189 for the second child and $191 for each subsequent child. These amounts are also slated to increase annually based on indexing.

Also the income thresholds will increase so the CCTB phase-out will begin at $33,487 as opposed to $32,960. The supplement phase-out will be complete at the same amounts.

A new addition to the CCTB will be a Child Disability Benefit (CDB) for families of special-needs children. The benefit in 2003 will be $1,600 for families with net income up to $33,487 and will phase-out at $46,602 for a family with one disabled child. Slightly higher phase-outs will apply for families with more than one disabled child. The first payment will be issued in March, 2004 and will include a retroactive payment for the period from July, 2003.

In order to be eligible for this benefit the child must meet the eligibility criteria for the disability tax credit. Families receiving the CDB will still be eligible to claim both the disability tax credit and the related supplement.

In another move to ease the burden for infirm children, the budget proposes to increase the level of income used to determine the financial dependence of an infirm child or grandchild from $7,634 to $13,814 effective for 2003. The purpose of this change is to expand the availability of the tax-free transfer of RRSP and RRIF funds as the result of the death of the supporting parent or grandparent.

DISABILITY TAX CREDIT (DTC)

CCRA has been extremely vigorous in challenging the claims of taxpayers for the DTC. Some of these challenges have been so absurd that the courts have been quite critical of some of CCRA's methods. Last year the Federal Court of Appeal upheld the appeal by a taxpayer claiming that severe food allergies that caused the taxpayer to spend substantial time shopping for and preparing meals. This has caused concern within the government that the court has opened the door too wide. In reply, the budget proposes three changes to the eligibility requirements.

The first change is actually a clarification that makes the credit available to more taxpayers by separating the restriction for people who are markedly restricted in feeding ***and*** dressing themselves to be either feeding ***or*** dressing themselves making these disabilities mutually exclusive.

The second change is that the restriction based on **feeding** will be limited to those that have a physical restriction in their ability to prepare meals and will not be available for those that are restricted based on a dietary requirement.

The third change limits the **dressing** activity to not include shopping or procuring clothes.

MEDICAL EXPENSES

The list of eligible medical expenses will be expanded for 2003 to include the following:

- The cost of real-time captioning for individuals with speech or hearing impairment
- The cost of note-taking and voice-recognition software for individuals with a physical impairment if prescribed by a medical practitioner.
- The incremental cost for individuals with celiac disease to purchase gluten-free food products.

REGISTERED PENSION PLANS (RPP), REGISTERED RETIREMENT SAVINGS PLANS (RRSP) AND DEFERRED PROFIT SHARING PLANS (DPSP)

The long-anticipated and much delayed increase to contribution limits has finally been proposed. The following new limits and their effective dates are expected to be made available:

- The limit for money purchase RPP will increase to $15,500 for 2003, $16,500 for 2004 and $18,000 for 2005.
- The limit for defined benefit RPP will remain at $1,722 for 2003 and increase to $1,833 for 2004 and $2,000 for 2005.

- The DPSP limit will remain at 50% of the money purchase RPP limit.
- The RRSP limit will increase to $14,500 for 2003, $15,500 for 2004, $16,500 for 2005 and $18,000 for 2006.
- The RPP and DPSP limits will be indexed beginning in 2006 and RRSP limit will be indexed beginning in 2007.
- RRSP limits will still be restricted to 18% of earned income.
- RPP members will now be eligible to transfer their funds to a Registered Retirement Income Fund (RRIF) upon retirement.

SMALL BUSINESS INVESTMENT

In 2000 the government introduced a capital gains rollover for shareholders of small business corporations who sell their shares and then reinvest the funds in another small business corporation. This was intended to allow the investor to defer the tax liability on the sale of the shares as the result of the reinvestment. It appears that very little use was made of this measure so it has been proposed, effective immediately, to make the rules somewhat more flexible by eliminating the dollar limits on the funds invested and extending the time limit to 120 days after the end of the year of disposition.

It remains to be seen if this will encourage any use of these provisions.

QUALIFIED LIMITED PARTNERSHIPS (QLP)

The government is introducing a loosening of the rules related to limited partnerships holding foreign property. It should be noted that it appears that these rules are being made for the benefit of pension fund managers making venture capital investments and will not likely be available for closely held investments. However, it will be interesting to see what creative planning may be in store for structuring foreign investments on a tax-effective basis.

AUTOMOBILE BENEFITS

While much may have been said about the desire of the government to adjust the limits on automobile costs and benefits the proposed change is related only to the calculation of the standby charge for the personal use of employer-provided vehicles.

Currently the standby charge is 2% per month of the original cost of the vehicle or 2/3 of the lease payment. If the personal use is less than 12,000 km per year and the vehicle is used at least 90% for business purposes than the standby charge is reduced.

The proposed amendment effective for 2003 will increase the personal use limit to 20,000 km and the business use limit requirement will be reduced to 50%.

The budget has also proposed to exclude extended cab trucks and emergency-response police and fire vehicles from the definition of automobiles for purposes of the deduction limits in certain circumstances.

SMALL BUSINESS DEDUCTION

The basic federal corporate tax rate for small business income has been reduced to 12% effective 2003. In addition, the budget proposes to increase the amount of active business income eligible for this rate from the current $200,000 by $25,000 per year beginning in 2003 until 2006 when it reaches $300,000. The limits will be pro-rated for non-calendar year-ends.

The current reduced rate of 21% for active business income between $200,000 and $300,000 will still be available for year-ends beginning prior to 2004.

As the result of the limit changes investment tax credits claimed by Canadian-controlled private corporations (CCPC) will have the phase-out parameters changed from between $200,000 and $400,000 to between $300,000 and $500,000 for taxation years ending after 2002.

When combined with 2003 provincial rates the following will apply for active business income in a CCPC:

- British Columbia — 16.5% on the first $225,000
34.50% on the next $75,000
39.62% over $300,000
- Ontario — 17.5% on the first $225,000
26.5% on the next $75,000
31.62% on the next $20,000
37.12% over $320,000
- Quebec — 21.04% on the first $225,000
30.04 on the next $75,000
35.16% over $300,000
- New Brunswick — 16% on the first $225,000
25% on the next $75,000
42.12% over $300,000

- Nova Scotia — 17% on the first $225,000
  37% on the next $75,000
  42.12% over $300,000

FEDERAL CAPITAL TAX

This large corporation capital tax will only apply to corporations with taxable capital exceeding $50 million from the previous $10 million limit effective for 2004 and is expected to be eliminated over the following 5 years.

OTHER CORPORATE MEASURES

Various changes have been made to tax measures related to resource companies, mining exploration tax credits and capital cost allowance for renewable and alternative energy equipment

TAX SHELTERS

The requirement for promoters to obtain a tax shelter identification number is expanded to include arrangements that only deduct tax credits including those that promote charitable donation credits. In addition, non-recourse or limited-recourse debts will be deducted from the available tax credit or deduction. These measures are effective from the budget date.

The tax credit for film and video productions will be increased from 11% to 16% effective immediately.

FUTURE TAX MEASURES

The budget announcement includes certain matters that will be actively pursued for consideration in future budgets.

- A comprehensive evaluation of the disability tax credit system to determine the evaluation policy for the recognition of disabilities.

- The possible introduction of tax pre-paid savings plans where the contributions are not deductible and the withdrawals are non-taxable.

- The ongoing uncertainty related to the deductibility of interest resulting from recent court decisions.

- The tax treatment of cross-border share-for-share exchanges such as those involving Chrysler and Daimler.

GST/HST

Certain changes have been introduced relating to rebates for public sector bodies. In addition a review of the rebate for health care institutions will be undertaken.

TAX ADMINISTRATION

The budget proposes to simplify the system for tax collections and enforcement procedures. While this has probably been stated in every budget from every finance minister since the introduction of income taxes we can always hope that something positive may come out of this.