

287 Richmond Road
Ottawa, Ontario
K1Z 6X4

Tel: 613-728-5831
Fax: 613-728-8085
Email: info@ggfl.ca
www.ggfl.ca



Leon Gluzman, CA
Richard W. Fage, CA
L. Gerald Levitz, FCA
Bruce A. Johnston, CA
Jeffrey N. Miller, CA, CFE
Deborah M. Bourchier, CA
Patricia Day, CA, CBV
Hugh Faloon, CA
John Baldwin, CA
Alan Freed, CA

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GGFL FEDERAL BUDGET COMMENTARY – MARCH 23, 2004

INTRODUCTION

In his 2004 Federal Budget, Finance Minister Ralph Goodale introduced a potpourri of tax changes that will impact GGFL clients to varying degrees. The following is a brief look at the major proposals and our take on how the changes will affect you.

BUSINESS TAX CHANGES

To recognize the rapid pace of obsolescence inherent in such purchases, the capital cost allowance rate for computer equipment is to be raised from its current 30% rate to 45% per year for assets acquired after March 22, 2004. The rate for data network infrastructure equipment (items such as switches, routers, hubs, modems, etc. used to control, transfer, modulate and direct data) is to be similarly increased from 20% to 30%. The current “half year” rule continues to apply for the year of acquisition.

The carry-forward period for non-capital losses and unused foreign tax credits is to be extended from 7 years to 10 years for losses and credits arising in taxation years ending after March 22, 2004.

Currently, many fines and penalties incurred in the ordinary course of business are deductible for income tax purposes. (A notable exception is fines and penalties imposed under the Income Tax Act). The government feels that this is contrary to public policy and so proposes to disallow the deduction of statutory (i.e. government or court imposed) fines and penalties levied after March 22, 2004. GST penalties will continue to be deductible however.

The increase in the small business deduction limit to \$300,000 is to be accelerated by one year, to 2005. Also, to prevent so called “trading” of charitable donation entitlements, unused charitable donations of corporations will now expire on an acquisition of control.

PERSONAL TAX CHANGES

SAVING FOR EDUCATION

The budget proposes significant enhancements to the RESP (“registered education savings plan”) program for lower and middle income taxpayers. The “Canada Learning Bond” (“CLB”) will be

created effective January 1, 2004 that will provide education funds for children born after 2003 and whose parents are entitled to National Child Tax Benefit (“CTB”) supplements. The CLB will be paid into the child’s RESP in an amount of \$500 initially, and an additional \$100 per year (to a lifetime maximum of \$2,000) for every year up to age 15 where the CTB supplement is payable in that year. Note that the CTB supplement is generally payable where family income is less than \$35,000.

The Canada Education Savings Grant program will be extended effective 2005 such that the grant payable to lower income families (incomes under \$35,000) will increase to 40% for the first \$500 of eligible RESP contributions per child per year. Middle income families (income from \$35,001 to \$70,000) will enjoy an enhanced credit of 30% for the first \$500 of eligible RESP contributions. There will be no carry-forward of access to the enhanced grant, so it will be important for affected persons to make regular RESP contributions of at least \$500 per year to maximize the amount of enhanced grants received.

In addition, for low income families, there will be a grant to first-year post-secondary students of one-half of their tuition costs, up to a maximum of \$3,000, starting in 2005. For disabled students, there is an additional grant of \$2,000.

The education tax credit, which is provided in recognition of non tuition costs of post secondary education and allowed at a rate of \$400 per month of full time educational attendance (\$120 per month for part time) will be allowed for students who pursue post secondary education relating to their current employment starting in 2004.

MEDICAL EXPENSES

Currently, claims for medical expenses paid by a parent for a minor child who earns income greater than \$8,012 are restricted by the so called “notch” provision. The net effect is that if the child’s income exceeds the \$8,012 limitation to any significant extent, medical expenses paid for that child may be of no benefit to the parent. The budget provides that these rules be revised so that for 2004 and subsequent years, medical expenses of dependant children can be pooled with the expenses of the parent regardless of the child’s income. Further, medical expenses of dependants other than children may be claimed up to \$5,000 to the extent that those expenses exceed the lesser of \$1,813 and 3% of the dependant’s net income.

PERSONS WITH DISABILITIES

The treatment of certain expenses incurred by disabled persons for the purpose of pursuing education or employment is to be revised. Currently a wide range of expenses such as voice recognition software, tutoring services used by learning disabled persons and electronics speech synthesizers can be claimed as medical expenses. It is proposed that such items be deductible in computing income (to the extent of “earned” income) where the expenses are incurred for employment or education instead of claiming them as medical expenses, potentially providing greater tax relief to the disabled person.

MISCELLANEOUS

- The temporary mineral exploration tax credit for flow through share investors is to be extended until December 31, 2005.
- Starting in 2005, a request for a credit adjustment or refund relating to a past tax year will only be allowed going back 10 years.
- Within certain limits, employment income earned by military or police personnel in certain high risk areas outside Canada will be tax free.

REGISTERED CHARITIES

Numerous changes are being proposed to the tax rules that apply to registered charities. Currently, a charity's federal charitable registration can be revoked for relatively minor breaches of compliance. Revocation results in the loss of tax exempt status and the loss of the ability to issue tax receipts among other things. It is proposed that in the case of minor compliance oversights other penalties be applied as an alternative to revocation such as:

- taxation of gross revenue generated by a charity that carries on a prohibited income earning activity
- suspension of a charity's tax receipting privileges for using donated funds for other than charitable purposes
- monetary penalties for failure to file an annual information return on a timely basis

Currently registered charities may be required to spend certain stipulated percentages of their income and capital base on charitable activities every year. These rules, referred to as the "disbursement quota" rules are to be revised such that the disbursement quota rate (the percentage of the fair market value of investment assets that must be disbursed annually) will be reduced from its current 4.5% rate to 3.5%.

Further details on the 2004 Federal Budget are available on the Department of Finance's Website at www.fin.gc.ca/budtoce/2004/budliste.htm or contact your GGFL advisor.

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