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2004 FEDERAL BUDGET COMMENTARY

RETURN TO THE MARTIN PHILOSOPHY



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INTRODUCTION

The new Budget 2004 has Prime Minister Paul Martin's signature all over it and continues to demonstrate a prudent approach to fiscal management. The 7th year for a balanced budget is something that no other government since Confederation has been able to accomplish. At first glance the budget does not appear to have much oomph in it but in reality the Budget represents "a back to the basic" model of a fiscally conservative plan. Mr. Goodale is remaining fiscally conservative while spending the least amount of money to please the most people.

IMPROVED SPENDING MANAGEMENT AND OVERSIGHT

The Government appears to be committed to leaving the Sponsorship Scandal behind it through the reimplementation of the Office of the Controller General and enhanced internal audit procedures and controls. This should go a long way in helping to convince Canadians that Mr. Martin means business in connection with the Sponsorship Scandal. Let's hope he really does. The balanced budget with a \$3 billion contingency reserve is maintained along with a \$1 billion economic prudence reserve being restored for the 2005 and 2006 fiscal year. The Government is making an effort to reduce the GDP ratio. The Government has set a target to have the ratio fall from 42% this year to 25% within ten years. In addition, budgeted program expenses are expected to grow in line with the projected growth in the economy.

The Government expects to reap some benefits from the new management approach which will be used to meet Budget commitments. The Cabinet Committee on Expenditure Review will examine all programs to identify at least \$3 billion in annual savings. The Government also intends to sell the remaining shares in Petro Canada in the next fiscal period. It is hard to argue with improved spending management and oversight being introduced under the leadership of the President of the Treasury Board. After listening and reading about the Sponsorship Scandal for the last several months it appears there is no where to go but up and better spending management and oversight is long over due.

HEALTH

The Government reconfirmed its additional \$2 billion support to the Provinces and Territories for Health provided under the February 2003 First Minister's Accord on Health Care and Renewal.

The Government will also establish a new Public Health Agency as a focal point for disease control and emergency response; with \$665 million in the first fiscal year and the next two years to improve Canada's readiness to deal with Public Health emergencies. This amount is in addition to the \$400 million being transferred from Health Canada to the new Agency.

LEARNING

The new Learning Bond will provide low income families with children born after 2003 up to \$2000 for Post Secondary Education. There will be an enhancement of the Canadian Education Savings matching grant for low and middle income families. A new grant of up to \$3000 will be introduced for first year post secondary dependent children from low income families. Another upfront annual grant of up to \$2000 for Post Secondary students with disabilities is included in Mr. Goodale's budget. There is an increase in the ceiling for Canadian Student Loans to \$219 a week from \$165 a week. The maximum amount of debt reduction for students facing financial difficulty has been increased to \$26,000 from \$20,000. An extension of the Education Tax Credit to employees who pursue career related activities at the employee's own expense (some CA students will be glad to hear this). Further, an investment of \$165 million over five years for the Aboriginal Human Resource Development Strategy and other support for the Urban Aboriginal Strategy is included in the Budget.

IMPORTANCE OF COMMUNITIES

The previously announced \$7 billion in GST and HST relief for municipalities over the next ten years has been confirmed in the Budget. These funds are badly needed funds for municipalities.

The acceleration of the \$1 billion Municipality Rural Infrastructure Fund over the next five years, rather than ten years, and a stronger voice for the municipalities in decisions which affect the municipalities are all areas which communities should welcome. The Government intends to provide \$4 billion in funding over the next ten years to clean up contaminated sites, including the Sydney Tar Ponds.

New funding of \$1 billion over seven years is provided to support the development of and commercialization of new environmental technology with a little help from funds from the sale

of Petro Canada. The government is implementing more effective tax rules for registered charities and ongoing support for the Voluntary Sector Initiatives.

KNOWLEDGE AND COMMERCIALIZATION

The budget will increase annual funding by \$90 million to Canada's three Federal granting councils. An increase of \$20 million annually to help offset the indirect costs of research by universities and research hospitals; sixty million dollars to Genome Canada to strengthen its research, additional funding, improve the capacity for commercialization at universities, hospitals and other research activities. The Budget introduces new funding of \$270 million to enhance access to venture capital financing for companies turning promising research into products and services. The \$300,000 small business limit applicable to corporations carrying on active business will be accelerated to take effect in 2005. There is also an increase in the Capital Cost Allowance rate for computer equipment to 45% from 30%. The rate for broadband, Internet and other data network infrastructure equipment will be increased to 30% from 20%. The CCA rate is more appropriate considering how quickly computers and computer related equipment become obsolete.

CANADA AND THE WORLD

The Government will increase spending in connection with Afghanistan by \$250 million; another \$50 million for peace keeping in Haiti; and make a commitment of a further \$650 million to address security issues. There will be a small reduction in the Air Travel Security charge and an increase of \$248 million or eight per cent in international assistance. Canadian forces, personnel and police on high risk international missions will have an exemption from tax.

HIGHLIGHTS OF THE 2004 FEDERAL BUDGET

BUSINESS TAX CHANGES

SMALL BUSINESS DEDUCTION LIMIT RISES TO \$300,000 FOR 2005

The Government announced that it will accelerate the scheduled increase in the small business deduction limit to \$300,000 for 2005 and later years, instead of 2006 and later years as announced in the 2003 budget. Thus in 2005, the New Brunswick combined federal provincial rate for a small business will be 16.12% for active business income under \$300,000.

CAPITAL COST ALLOWANCE RATES FOR COMPUTER AND NETWORK INFRASTRUCTURE EQUIPMENT

The 2004 budget proposes to increase the capital cost allowance (CCA) rate applying to computer equipment to 45 per cent (from 30 %), and to increase the CCA rate applying to broadband, Internet and other data network infrastructure equipment to 30% (from 20%). These measures apply to acquisitions made after March 22, 2004.

CARRYFORWARD PERIOD FOR BUSINESS LOSSES EXTENDED TO 10 YEARS

For tax years ending after March 22, 2004, the Budget proposes to extend the carryforward period to 10 years (from seven years) for:

- Non-capital losses
- Unused foreign tax credits
- Non-capital losses applied under Part IV of the *Income Tax Act*
- Life insurer's taxable Canadian life insurance losses under Part XII.3.

OTHER MEASURES

The budget proposes more restrictive rules with respect to the refundable R&D ITC rules.

The budget clarifies that the general anti-avoidance rule (GAAR) applies beyond the *Income Tax Act* to a misuse or abuse of the provisions of the *Income Tax Regulations*, the *Income Tax Application Rules*, and Canada's tax treaties.

The tax rules will be amended to prevent persons, other than co-operatives and credit unions, from deducting patronage dividends paid after March 22, 2004, to non-arm's length persons.

The federal budget proposes to deny the deductibility of any fine or penalty imposed by law (including federal, provincial, municipal and foreign laws) after March 22, 2004.

The budget proposes that charitable donations deductions of a corporation that are unused at the time of an acquisition of control will be claimable only for tax years that end before control was acquired. This amendment will apply in respect of gifts made after March 22, 2004.

The existing "affiliated persons" rules do not deal comprehensively with trusts. The budget proposes that, after March 22, 2004, a trust will be "affiliated" with any beneficiary who is entitled to a majority of the trust income or capital, and also with any person affiliated with such a beneficiary. Further, after March 22, 2004, two trusts will be "affiliated" if the following two conditions are met:

- A contributor to one trust is affiliated with a contributor to the other trust, and
- A majority interest beneficiary of one trust is affiliated with a majority interest beneficiary of the other trust.

Mineral exploration credit extended to end of 2005

Income trusts — Investment restrictions for pension funds

Changes to tax treatment of non-residents' mutual fund investments

PERSONAL TAX CHANGES

MORE TAX ASSISTANCE FOR EDUCATION SAVINGS

Starting in 2005, the Canada Education Savings Grant (CESG) rate will rise to 40% for families with income under \$35,000 and to 30% for families with income between \$35,000 and \$70,000. The maximum contribution eligible for the CESG will remain at \$2,000, while the maximum CESG payable for a year will be increased from \$400 for low and middle income families to accommodate the enhanced CESG rates. For example, a lower income family contributes \$2,000 in a year could receive a CESG totalling \$500 — that is, 40% on the first \$500 (\$200) and 20% on the remaining \$1,500 (\$300).

The education tax credit to students will be extended to students who pursue post-secondary education related to their current employment for 2004 and later years, if costs are not reimbursed by the employer. The credit is based on a maximum amount of \$400 per month of full-time post-secondary education study (\$120 per month for part-time study).

The government will introduce Canada Learning Bonds (CLB) for children of low-income families. Each child born in 2004 and later years will be eligible for a CLB in each year that the child's family is entitled to the National Child Benefit, up to and including the year in which the child turns age 15. The amount of the CLB will be \$500 in the first year of entitlement (which could be any year from the year of birth to the year the child is age 15), and \$100 for each subsequent year of entitlement.

OVERALL COMMENTS

The Budget for 2004 is a balanced approach confirming important commitments given to communities and extends a hand for participation in decision making to communities. Mr. Goodale's budget extends the sound financial fiscal management approach implemented by Paul Martin, as previous Finance Minister, which helped Canada become one of the *Super Stars* in fiscal management in the G7.

The reintroduction of the Office of the Controller General may dampen the bad press the Government has received over the Sponsorship Scandal.

Certainly it is difficult to argue with better spending management and oversight given the scandals that have come to light. The Budget also provides some assistance in Health and the learning area which will be welcomed albeit not enough but than again there is never enough. A reasoned and balanced approach to fiscal management should keep Canada in good stead in this decade. The Budget in brief is what you would expect from Paul Martin and his new Finance Minister. It will be interesting to see how the electorate interprets the Budget in the upcoming election.

RALPH H GREEN & ASSOCIATES has produced this publication to inform readers of developments as at the date of publication. It is neither a definitive analysis of the law nor a substitute for the professional advice that readers should obtain to determine how the matters discussed here apply to their specific situations.