

The J Thomas McCallum Letter

Advancing the understanding of income tax and valuation matters

Federal Budget 2004

Attendant Care Deduction

For 2004, the attendant care deduction allowed under §64 is renamed the “disability supports deduction” and is revised to add amounts paid for “disability supports” connected with employment or education. Examples of disability supports include talking text books, teletypewriters, and sign language interpreters (see budget papers for a complete list).

Refundable Medical Credit

For 2004, this refundable credit is expanded to add 25% of the above “disability supports” deduction.

Medical Expenses Tax Credit

For 2004, taxpayers will be allowed to claim medical expenses paid for a dependant *other than* their spouse or common-law partner or a child under 18 years of age.

Only medical expenses beyond the *dependant's* medical expense threshold (lesser of 3% of net income and \$1,813), to a maximum of \$5,000 will be eligible.

Education Tax Credit

Beginning in 2004, the education tax credit is expanded to include qualifying programs taken in connection with, or as part of the duties of, employment.

Small Business Deduction

The annual business limit (active business income eligible for the small business

deduction), which was scheduled to increase to \$300,000 in 2006 (annual \$25,000 increases from 2003 on), will instead increase to \$300,000 in 2005.

For corporations with fiscal years, the 2005 annual business limit will be prorated based on days in the fiscal year before 2005 and days after.

Refundable SR&ED

Corporations can be considered associated because of the “group control” concept where two or more persons each own shares in the capital of a corporation.

This association concept will not apply (for SR&ED purposes only) to CCPC's with year-ends after March 22, 2004 where there is at least one shareholder who does not own shares in the other corporation. The affected SR&ED areas are:—

- the expenditure limit,
- the business limit (for determining the expenditure limit), and
- calculations involving the corporation's refundable investment tax credit.

To qualify for this “exemption” from being associated corporations it is necessary that:—

- the corporations not otherwise be associated, and
- it can be established that the “at least one other shareholder” is not there solely to qualify for the “exemption”.

Carry Forward Period

Non-capital losses and unused foreign tax credits can now (for year ends after March 22, 2004) carry forward for 10-years rather than seven.

Mineral Exploration Credit

The definition of a “flow through mining expenditure” was scheduled to apply only to certain expenses incurred before 2005. That is now extended to **before 2006**.

Fines and Penalties

To the surprise of no one, fines and penalties (excluding prescribed ones, but including those imposed by Canada, a province or a foreign state) imposed after March 22, 2004 will no longer be deductible. This will not apply to interest on penalties under the *Excise Act*, *Air Traveller's Security Charge Act*, and GST/HST under the *Excise Tax Act*.

GAAR

The general anti-avoidance rule does not apply where there's no direct or indirect misuse or abuse of the Act when read as a whole. For greater certainty the reference to “the Act” is expanded to include a reference to all the taxing authorities (the ITA, ITA Regulations, Tax Treaties, and ITARs) and amendments thereto.

Taxpayer Adjustments

A major change — Beginning in 2005, taxpayers (individuals and testamentary trusts) will not be able to be re-assessed, nor receive refunds, waivers of penalties and interest, or extend the time for filing, revoking or amending an election, beyond 10-years. Previously,

taxpayers could request changes back to 1985.

Armed Forces and Police

Police and armed forces personnel employed at a high-risk mission outside of Canada (Level 3 or higher) will be allowed to deduct their regular salary earned on that mission which is otherwise included in their income.

The deduction, which begins in 2004, cannot exceed the pay amount for a non-commissioned person (presumably that means an NCO).

Charities

A substantial number of regulatory reforms for registered charities are proposed. These are far too comprehensive to detail in this letter.

Stop-Donation Rule

Unused charitable donations of a corporation will now expire where there is an acquisition of control of that corporation. This stop-donation rule only applies to donations made after March 22, 2004.

This new “stop-donation” rule will also apply to property acquired by the corporation in advance of the acquisition of the control where there was pre-existing arrangement to donate the property.

Patronage Dividends

Patronage dividends can be deducted as an expense (unlike dividends which cannot be). To prevent possible abuse, the deduction for patronage dividends

paid after March 22, 2004 will be limited to cooperatives and credit unions.

Affiliated Persons

The rules concerning who is an “affiliated person” are revised, effective March 22, 2004, to expand the circumstances of when trusts, including trusts and their beneficiaries, will be considered affiliated. These changes are designed to ensure application of the loss-deferral rules where there is no real change in economic interests.

The Taxable Canadian Property of a mutual fund

Non-residents can often avoid paying Canadian taxes on taxable Canadian property by investing in such property through a mutual fund. This creates a disparity between investors.

After March 22, 2004 every mutual fund (whether a corporation or a trust) will be required to maintain a “taxable Canadian property gains distribution account”. Non-residents will be required to pay Canadian income tax on distributions from that account.

Income Trusts

As expected, the budget did not alter the taxation of income trusts. This may be temporary as these continue to be studied. However, the budget did impose restrictions on pension funds which invest in income trusts. The budget describes these as necessary to prevent a substantial imbalance in the Canadian capital market.

Essentially, the limitations are:—

- a maximum investment of 1% of the book value of the pension fund’s assets, and
- a maximum investment of 5% of any particular income trust’s units.

CCA Changes

Computer equipment acquired after March 22, 2004 will be eligible for CCA at 45% rather than 30%. This equipment will *not* be eligible for the election to treat each asset as a separate class.

Data network infrastructure equipment acquired after March 22, 2004 will be included in a new class, the CCA rate of which will be 30%. Such equipment is currently included in Class 8 (20%).

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J Thomas McCallum, FCGA, CBV
Whitby Ontario
1-800-265-2686 or 905-579-0022
jtmc@jthomasmccallum.com