

The J Thomas McCallum Letter

advancing the understanding of income tax and valuation matters

Federal Budget Edition May 2, 2006

Except for some of the GST changes, this special release reviews only the income tax measures contained in today's federal budget. Those interested in other aspects of the budget can download the budget document from

<http://www.fin.gc.ca/budtoce/2006/budliste.htm>

GST cut

The GST will be reduced to 6% from 7% on July 1st. This also brings changes to GST applicable on taxable benefits. The GST on an automobile operating benefit, for example, will be 4.5% for 2006 and 4% thereafter. Remittances rates for businesses which use the 'quick method' also change as at July 1st.

The excise tax on tobacco and alcohol is *increased* to offset what would otherwise be a reduction in the price paid by consumers for these products due to the GST reduction.

There are also a number of transition 'rules' put in place to bridge and/or eliminate 'restructuring opportunities' on transactions occurring between today's budget and July 1st.

There is *no* special one-time credit, as some were forecasting there would be, for businesses who will incur costs to transition to the new GST rate.

Personal Tax Changes

Tax Rate

The tax rate applied to the lowest tax bracket will increase to 15.5% from 15% as at July 1st. So the lowest tax rate for 2006 will be 15.25%. For 2006 the ceiling on taxable income taxed at this rate will be \$36,378.

Personal Tax Amounts

The basic personal amount was \$8,648 in 2005. For the first six months of 2006 it will be \$9,039 (as was put in place by the previous government). For the last six months of 2006 it will be *reduced* to \$8,639. The *real* basic personal amount for 2006 will be \$8,839 (average of the two amounts).

\$100 (plus indexation) will be added to the \$8,639 basic personal amount in 2007. In 2008, \$200 (plus indexation) will be added, and in 2009 \$600 (plus indexation) will be added (or whatever greater amount is required to bring it to \$10,000).

The basic personal amount for spouses, common-law partners and wholly dependent relatives will also undergo similar changes. Without boring you with the 2006 up/down details, these will be \$7,505 in 2006. In 2007 this will be increased by \$85 (plus indexation), in 2008 \$170 (plus indexation) will be added, and

in 2009 \$510 (plus indexation) will be added (or whatever greater amount is required to bring it to \$8,500).

Employment Credit

A new tax credit for employment income starts on July 1st. The base amount for this credit is \$500 (so it's \$250 for 2006), and increases to \$1,000 on January 1, 2007. If employment income is less than the base amount, then the base amount will be the actual employment income.

Turn Back The Clock

This credit really only re-instates a similar item that was allowed several years ago (at that time it was a deduction) — 3% of employment income. There's nothing new under the taxation sun is there?

Fishermen

The \$500,000 capital gains deduction is [finally!] being extended to property (real, depreciable and eligible capital property) used in a fishing business. *While this is proposed to be effective only for dispositions after May 1, 2006, I'll go out on a limb and predict that it will be made retroactive (at least to January 1, 2006).*

Additionally, rules are being proposed which will essentially place fishermen in the same position as farmers when it comes to inter-generational transfers of fishing property.

Flow-Through Shares

The mineral exploration tax credit is renewed and available on flow-through

share agreements arranged from May 2, 2006 to March 31, 2007.

Tradesperson Tool Deduction

Employed trades persons who are required (by their employer) to provide their own tools will be allowed a deduction for the cost of new tools (acquired after May 1, 2006). The deduction is set at a maximum of \$500, *but it applies only to the cost of tools in excess of a \$1,000 threshold.*

Apprentice vehicle mechanics will be allowed this new deduction *in addition* to the existing tools deduction available to them (although there is — from my reading — a small modification (starting in 2007) to the threshold of that deduction.

Textbook Tax Credit

Beginning in 2006, a textbook credit will be added to the existing tuition and education tax credit amounts. The new textbook credit will be based on \$65 for each month the student is eligible for the full-time education tax credit, and \$20 for each month the student is eligible for the part-time education tax credit.

Scholarships, etc

Beginning in 2006 the \$3,000 limit on scholarships, bursaries and fellowships which are excluded from income is removed. These amounts will now be totally non-taxable. This exemption only applies where the student is enrolled in a program eligible for education tax credit.

Child Fitness Tax Credit

Beginning in 2007, a new child fitness tax credit will be available on up to \$500 in fees paid for an eligible physical activity

program (yet to be defined) where the enrolled child is under 16-years of age. To be certain the program is a 'qualifying' program, official CRA approved receipts will be required. Amounts claimed under this credit will not be eligible for the child care expense deduction.

Pension Income Tax Credit

The pension income credit is currently limited to the first \$1,000 of pension income. For 2006 this is increased to \$2,000.

Medical Expenses

For 2006 the refundable medical expense supplement will be increased to \$1,000 from \$767.

Public Transit Tax Credit

Beginning in 2006, there will a new tax credit for the cost of public transit passes (monthly or greater) of the taxpayer, his/her spouse or common-law partner, and dependent children under the age of nineteen. [No maximum has yet been established](#). This measure is effective July 1st and so only the portion of pass costs applicable post-July 1st are eligible.

Public transit is local bus, streetcar, subway, commuter train, commuter bus, and local ferry.

Donations & Capital Gains

Effective May 2, 2006 donations of listed publicly-traded securities will not attract any capital gains taxes. More simply, the income inclusion rate will be zero. This will also apply to those securities acquired under a stock option. That is, the employment benefit will be zero.

[It wouldn't surprise me if the government is pressured to make this retroactive to January 1, 2006.](#)

The same measure will also apply to donations of ecologically-sensitive land (at the same May 2nd start date).

Dividends

As previously announced by this government, they will be proceeding with the proposed revisions (announced by the previous government) to the dividend tax credit.

Business Tax Changes

Tax Rates

The general corporate tax rate will decrease from 21% to 19% by 2010 (as proposed by the previous government). The stages are: 20.5% on 1/1/08, 20% on 1/1/09 and 19% on 1/1/10.

The 4% surtax will be eliminated for all corporations (not just small business) on January 1, 2008.

Small Business

The annual limit for small business income will increase to \$400,000 from \$300,000 on January 1, 2007. The tax rate will decrease (from 12%) to 11.5% on January 1, 2008 and to 11% on January 1, 2009.

Non-capital Losses & ITCs

The carry-forward period for non-capital losses and investment tax credits is **doubled** from 10-years to 20-years. This applies to non-capital losses and ITCs incurred/earned in taxation years ending *after* 2005.

Federal Capital Tax

The capital tax was scheduled to end on January 1, 2008, *but it has now been eliminated as of January 1, 2006.*

The threshold before which the federal capital tax on financial institutions is levied is increased to \$1 billion as at July 1st. A single tax rate of 1.25%, replacing the current scaled rates, is also effective at July 1st.

Apprentice Tax Credit

A new non-refundable tax credit begins May 2, 2006 for employers who hire qualifying apprentices. The credit will be 10% of salary/wages, it's 'capped' at \$2,000 (10% of \$20,000 wages/salaries). Any unused credit can be carried back three years and carried forward 20 years.

CCA on Tools

Currently there is a cost limit of \$200 on tools eligible for 100% CCA. For tools acquired after May 1st this is increased to \$500.

This proposal will also apply to kitchen utensils and medical or dental instruments.

Standardized Accounting

Finance Canada has previously announced that it wants to harmonize the rules under various Acts regarding administration, interest and penalties. This is referred to as "standardized accounting". Consequently, this Budget contains a number of 'harmonization' amendments.

Among the changes proposed are that penalties/interest under the Excise Act, the Air Traveller's Security Charge Act and

GST/HST are now to be non-deductible for income tax purposes. This will be effective on the [yet unknown] "implementation date".

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