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A Detailed Review of the Personal and Small Business Income Tax Implications Contained in the February 23, 2005 Federal Budget

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The February 23, 2005 federal budget delivered by Finance Minister Ralph Goodale in the House of Commons was the first budget presented by a minority government in 25 years.

The budget contains many proposals including increases to RSP and RPP contribution limits, the elimination of foreign content restrictions on registered plans, enhancements to certain personal tax credits, corporate tax reductions commencing in 2008.

While these proposals need to be passed in the House of Commons in order to become law, it is generally the practice of the Canada Revenue Agency (CRA) to administer the proposals presented in the budget as having taken effect immediately.

The highlights of the tax changes announced in the February 23,2005 budget are summarized below.

Personal Tax and Related Measures

Foreign Content Limit

Beginning January 2005, the budget proposes to eliminate the current 30% foreign content limit for pension funds and tax deferred retirement plans such as RSPs and RIFs.

RPP and RSP Limits

To facilitate and encourage retirement savings, the budget proposes to increase the maximum contribution limits for RSPs and RPPs.

Existing and proposed RPP/RSP limits are summarized in the following chart:

	2005	2006	2007	2008	2009	2010	2011
RSP contribution limit							
Existing	16,500	18,000	indexed				
Proposed	16,500	18,000	19,000	20,000	21,000	22,000	indexed
Money purchase RPP limit							
Existing	18,000	indexed					
Proposed	18,000	19,000	20,000	21,000	22,000	indexed	

Federally Regulated Locked-In RSPs

The budget proposes to eliminate the requirement for a holder of a federally regulated LIF to convert the remaining funds into an annuity when reaching the age of 80. This rule is effective for future transfers of locked-in RSP into a LIF.

Qualified RSP Investments

RSP and other tax deferred plans must adhere to a list of qualified investments as prescribed by the Income Tax Regulations. The budget proposes to add investment-grade gold and silver bullion coins, bars and certificates to the list of qualified investments. Certain conditions need to be met in order for these investments to qualify. These changes are effective for investments made on or after February 23, 2005.

Basic Personal Amount

The tax system currently includes personal credits to allow individuals to receive a basic amount of income on a tax-free basis. For 2005, the basic personal amount is $8,149. The budget proposes that by 2009, the amount of tax-free income that a Canadian can receive will gradually increase to $10,000. The proposed increase of $100 for 2006 will generate federal tax savings of $16.

Additionally, the tax system includes personal credits in respect of a spouse or common law partner. The budget proposes to progressively increase the spousal credit from $6,920 in 2005 to $8,500 by 2009.

Increasing the Guaranteed Income Supplement

Low income seniors receiving Old Age Security pension may qualify for an increase in the Guaranteed Income Supplement (GIS). The budget proposes an increase to the maximum monthly GIS benefit ($36 for singles and $58 for couples). Half of the increase is effective on January 1, 2006 and remaining increase will be effective January 1, 2007.

Medical Expense Tax Credits

The budget has proposed several additions to the list of eligible expenses, most notably medical marijuana. As well, a two-criteria test for determining whether home renovation expenses qualify for the credit was proposed. The first criteria is that the expense must not typically be expected to increase the value of the home. The second criteria is that the expense would not ordinarily be incurred by a person without a disability. These changes apply to expenses incurred on or after February 23, 2005.

Tax Relief for Caregivers

The maximum eligible amount of medical and disability related expenses that could be claimed as a medical tax credit for a dependent relative was doubled from $5,000 to $10,000.

Adoption Expense Tax Credit

Up to $10,000 of expenses incurred for the purposes of adopting a child, age 18 or younger, from outside Canada, would qualify for a new 16% non-refundable tax credit. This tax credit can be split between two adoptive parents and would commence in the 2005 tax year.

Tax Measures for Persons with Disabilities

The budget proposes a number of income tax changes that benefit persons with disabilities. This includes changes to Registered Education Savings Plans (RESPs) that accommodate the time that students with disabilities may require in order to begin or complete post-secondary education. The budget proposes that if an RESP beneficiary qualifies for the disability tax credit in the 21st year following the year in which the plan was entered into:

i) The maximum contribution period to make contributions to an individual RESP be extended from 21 to 25 years following the year in which the plan was entered into; and,
ii) The termination date of the RESP be extended from 25 to 30 years following the year in which the plan was entered into.

Other changes include amendments to extend and clarify the eligibility for the disability tax credit and improve tax assistance for persons with disabilities.

Deposit Insurance

The budget increases the amount of federal deposit insurance coverage from $60,000 for insurance deposits to $100,000 effective immediately.

Small Business Related Measures

Corporate Surtax

All corporations are subject to surtax at a rate of 4% of the federal corporate tax payable. The net federal corporate tax of 28% would generate a surtax liability of 1.12%. The budget proposes elimination of the corporate surtax of 1.12% effective on January 1, 2008.

Corporate Tax Rate Reduction

The budget proposes to reduce the general corporate income tax rate on certain types of income. The rate reduction will not apply to investment income earned by a Canadian-controlled private corporation (CCPC). Other types of income not affected by the proposed rate reduction include income subject to the small business deduction and income that already qualifies for special tax provisions.

Business income in excess of the small business deduction limit ($300,000 in 2005) will be subject to a proposed reduction of 2% phased in over a period of three years beginning in 2008 and ending in 2010. The general corporate income tax rate will be reduced to 19% by January 1, 2010 from the current 21%.

Capital Cost Allowance

The budget proposes to address the impact of several changes, including technological advances, on the expected useful life of certain assets by increasing applicable CCA rates to ensure that the new rates provide an adequate recognition of capital costs.

The new CCA rates will generally apply to assets acquired on or after February 23, 2005 that have not been used or acquired for use before that date.

Issues for Future Consideration

Certain measures were addressed but not proposed to be implemented in this budget as the government requires further review and will provide more information in the future. Some of these measures are:

Interest Deductibility

In October 2003, the Department of Finance released, for public consultation, a legislative proposal regarding the tax deductibility of interest and other expenses. A public consultation on the proposal was conducted in 2004 and many commentators expressed concerns with the proposal's structure. The 2005 budget noted that the Department will release an alternative proposal for comment.

Cross-Border share for share exchanges

The 2000 Mini Budget and subsequent budgets indicated the government's intention to develop rules that would provide an explicit rollover of cost for cross-border share for share exchanges. A discussion draft of proposed income tax amendments to implement this initiative will be released in the near future.

Income Trusts

The 2004 budget proposed to limit the level of pension fund investment in business income trusts. During the public consultation, a number of commentators expressed concern about the impact of the proposal. In response, the government decided to suspend the implementation of these measures and to engage in further consultation.

High Ratio Mortgages

The government is seeking views on providing more flexibility to residential mortgage lenders and homebuyers by removing the statutory restriction on residential mortgages exceeding 75% of the value of the property.

Note: The above information is based on the current and proposed tax law in effect as of the date of this article. The article is for information purposes only and should not be construed as offering tax or legal advice. Individuals should consult with a qualified tax and legal advisor before taking any action based upon the information contained in this article.