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CHARTERED ACCOUNTANTS

KNV TAX MEMO

FEDERAL BUDGET - FEBRUARY 23, 2005

INTRODUCTION

Today's federal budget offered no dramatic tax policy changes, but did continue the recent trend of offering modest tax reductions. The following is a brief summary of the more important changes affecting KNV clients.

PERSONAL TAX CHANGES

PERSONAL TAX CREDITS INCREASED

The budget proposes increases to the basic personal amount credit, which is an allowance that eliminates federal income tax on a base threshold of income earned. Furthermore, there will be increases in the personal amounts granted for spouses, common-law partners and other wholly-dependent relatives. These increases are to be phased in as follows:

	<u>Basic Personal Amount</u>	<u>Spousal Amount</u>
Current	\$ 8,012	\$ 6,803
2006	8,112	6,888
2007	8,212	6,973
2008	8,612	7,313

For 2006, the increase in the basic amount will generate a tax saving of \$16.

These increases are in addition to the regular increases via indexation of the tax system.

RETIREMENT SAVINGS

Registered Pension Plan (“RPP”), and Registered Retirement Savings Plan (“RRSP”) contribution limits are to be increased as follows:

	<u>RRSP’s</u>	<u>Money Purchase RPP’s ❶</u>
2005	\$16,500	\$18,000
2006	18,000	19,000
2007	19,000	20,000
2008	20,000	21,000
2009	21,000	22,000
2010	22,000	Indexed
2011	Indexed	

❶ Similar limit increases will apply to defined benefit RPP’s.

Effective for 2005, the rules will be changed to eliminate the 30% limit on foreign properties held by RPP’s, RRSP’s and other deferred income funds.

PERSONS WITH DISABILITIES

In response to the recommendations of the Technical Advisory Committee on Tax Measures for Persons with Disabilities, the budget proposes numerous technical changes. Among other things, the changes are intended to clarify under what circumstances taxpayers will be eligible for the Disability Tax Credit (“DTC”), and what medical practitioners can certify eligibility. In general, these changes should allow a somewhat broader range of taxpayers to qualify for the DTC, although this is an inherently complex area and it is anticipated that interpretation difficulties will continue to arise.

MEDICAL EXPENSES

The list of expenses eligible for the medical expense tax credit is once again to be expanded for 2005 to include costs for phototherapy equipment for skin disorders, expenses incurred to operate an oxygen concentrator, and Special Access drugs and medical marijuana. Credit for purchases of the latter will be limited to specifically approved circumstances.

Caregivers may claim medical or disability expenses for dependent relatives that exceed the lesser of 3% of the dependent’s net income and \$1,844. The maximum eligible expense amount that may be claimed under this rule is to be increased from \$5,000 to \$10,000 for 2005.

ADOPTION EXPENSES

The budget proposes to provide a 16% non-refundable tax credit for certain adoption expenses starting in 2005. Expenses will be creditable for completed adoptions for children under age 18 and include (among other things) licensed agency fees, legal costs, and travel costs. The maximum credit amount will initially be \$10,000 and be indexed after 2005.

CORPORATE INCOME TAX CHANGES

To foster investment and growth, the budget proposes to eliminate the corporate surtax in 2008 and reduce the general corporate income tax rate by 2 percentage points by 2010.

CORPORATE SURTAX

Originally introduced in 1987 as a deficit reduction measure, the corporate surtax applies to all corporations and is equivalent to 1.12% of corporate income tax rates. The budget proposes to eliminate the corporate surtax on January 1, 2008, prorated for taxation years that include that date. While the elimination of the surtax will benefit all corporations, it will be of particular benefit to small business corporations since the surtax represents a larger proportion of their overall tax payable.

CORPORATE TAX RATE REDUCTION

The budget proposes to reduce the general corporate income tax rate to 19% from 21% by 2010. The rate reductions will apply to all types of corporate income, other than: small business income that is already eligible for the low 12% corporate rate; investment income of a Canadian-controlled private corporation ("CCPC"), which income is eligible for a special refundable tax; the income of credit unions and the income of mutual fund corporations, mortgage investment corporations, and investment corporations, which income already qualifies for special tax provisions.

Summary**Federal Corporate Income Tax Rates**

	Legislated Rates up to and including 2008	Proposed Rates		
		2008	2009	2010
On first \$300,000 of CCPCs active business income	13.12	12.0	12.0	12.0
On other business income	22.12	20.5	20.0	19.0

Federal and BC combined Corporate Income Tax Rates

	Legislated Rates up to and including 2008	Proposed Rates		
		2008	2009	2010
On first \$300,000 of CCPCs active business income	17.62	16.50	16.50	16.50
\$300,000 to \$400,000	26.62	25.00	24.50	23.50
On other business income	35.62	34.00	33.50	32.50

CAPITAL COST ALLOWANCE (“CCA”)

CCA rates should, as a general principle, reflect the useful life of an asset and thus provide adequate recognition of capital costs. The useful life of assets can change over time for several reasons, including technological change. The budget proposes adjustments to CCA rates for hydrocarbon transmission pipelines and related pumping and compression equipment, combustion turbines generating electricity, electricity transmission and distribution equipment, and cables used for telecommunications infrastructure.

The budget proposes to include certain highly fossil-fuel-efficient and renewable energy generation equipment – which is currently eligible for the 30% CCA rate under Class 43.1 – in a new class eligible for a 50% CCA rate. The increased rate will apply to such equipment acquired on or after February 23, 2005 and before 2012.

GST AND EXCISE TAX MEASURES

An excise tax of 10% is imposed under the Excise Tax Act on jewellery manufactured and sold in, or imported into, Canada. The budget proposes that the excise tax on jewellery be phased-out through a series of rate reductions over the next four years. The rate will be reduced to 8% from 10% effective February 24, 2005, and reduced to 0% by March 1, 2009.

The budget proposes to extend, effective January 1, 2005, the application of the 83% GST rebate to eligible charities and non-profit organizations that provide health care services similar to those traditionally performed in hospitals.

The budget proposes to provide that a director of a corporation, who did not exercise due diligence, may be held liable not only for unremitted GST/HST amounts, but also for GST/HST net tax refund amounts received to which the corporation was not entitled to. The extension of directors' liability to GST/HST net tax refunds will apply in respect of net tax refund amounts paid on or after Royal Assent (i.e., after the enabling legislation is enacted).

MISCELLANEOUS

Where scientific research and experimental development (“SR&ED”) is carried out on a Canadian coastline, expenditures incurred on or after February 23, 2005 in Canada's Exclusive Economic Zone will now be eligible for SR&ED incentives.

Further details on the 2005 Federal Budget are available on the Department of Finance's Website at <http://www.fin.gc.ca/budtoce/2005/budliste.htm> or contact your KNV advisor.

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