
CURRENT DEVELOPMENTS

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QUÉBEC BUDGET

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INTRODUCTION

Finance Minister Yves Séguin delivered the *2004-2005 budget speech* before the National Assembly today. The budget does not change the tax rates applicable to individuals or corporations. Following is a summary of the more significant tax and related measures.

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MEASURES CONCERNING INDIVIDUALS

LIMIT ON THE DEDUCTIBILITY OF INVESTMENT EXPENSES

The deductibility of expenditures incurred by an individual (including a trust), referred to here as "investment expenses", will now be limited to the income from such investments earned during a taxation year. For greater clarity, this will not apply to investment expenses incurred to earn active income, such as income from a business, or income from the rental of an asset.

Investment expenses

The investment expenses considered in calculating the limitation on deductibility will be all the expenditures incurred to earn income from property, other than rental income, and will include:

- investment administration or management expenses;
- stock or securities custody expenses;
- fees paid to investment advisers;
- interest paid on borrowings contracted to acquire bonds, stocks, or units of a mutual fund trust;
- the portion of the loss of a partnership of which the individual is a limited or a passive member.

The investment income considered in calculating the limit on the deductibility of investment expenses will be all income from property and will include:

- taxable dividends of taxable Canadian corporations;
- interest from Canadian sources;
- the share of the income of a partnership of which the individual is a limited or a passive member;
- gross foreign investment income;
- taxable capital gains not eligible for the exemption on taxable capital gains;
- benefits received as a shareholder of a corporation;
- income from a trust;
- income from property attributed to shareholders.

However, income and losses from the rental of property will not be considered for the purposes of this measure.

Investment expenses that cannot be deducted in a given taxation year may be applied against investment income earned in one of the three preceding taxation years or in any subsequent taxation year.

For the taxation year during which an individual died and for the preceding taxation year, the investment expenses not previously deducted will be deductible in calculating his income.

These changes will apply as of March 30, 2004. However for 2004 the limit on the deductibility of investment expenses will apply only regarding the portion of investment expenses in excess of investment income, calculated in proportion to the number of days following March 30, 2004 compared to the number of days of the taxation year.

DEDUCTION FOR SECURITIES OPTIONS

The deduction for securities options granted to employees will decrease from 37.5% to 25%.

REFORM OF GOVERNMENT ASSISTANCE FOR FAMILIES

Family benefits, the non-refundable tax credits respecting dependent children, the tax reduction in respect of families and the Parental Wage Assistance program will be replaced with a non-taxable child assistance payment and a non-taxable work premium as of January 1, 2005.

The child assistance payment, to be paid in quarterly instalments, will be universal.

CHILD ASSISTANCE PAYMENT - 2005

Parameters	Amount (\$)
Maximum amounts	
- 1st child	2,000
- 2nd and 3rd children	1,000
- 4th and subsequent children	1,500
- single-parent family	700
Minimum amounts	
- 1st child	553
- 2nd and subsequent children	510
- single-parent family	276
Reduction threshold	
- couple	42,800
- single-parent family	31,600
Monthly allowance for handicapped children	119.22

WORK PREMIUM - 2005

	Person Living Alone	Couple Without Children	Single-Parent Family	Couple With Children
Earned income excluded	\$2,400	\$3,600	\$2,400	\$3,600
Rate of tax credit	7%	7%	30%	25%
Maximum premium	\$511	\$784	\$2,190	\$2,800
Reduction				
- threshold	\$9,700	\$14,800	\$9,700	\$14,800
- rate	10%	10%	10%	10%
Eligibility limit	\$14,810	\$22,640	\$31,600	\$42,800

Tax credit for child-care expenses

The definition of "eligible child" will be changed to exclude a child with income greater than \$6,275. A new mechanism for advance payment of the tax credit will be introduced as of 2005.

PERSONAL INCOME TAX SYSTEM

The simplified system will be eliminated as of the 2005 taxation year. However the basic personal tax credit will be adjusted. Also, starting January 1, 2005, a new indexing factor will be used to index the main parameters of the personal income tax system.

As always, readers are reminded that while budget proposals are customarily given the effect of law immediately, the amending legislation, when ultimately adopted by the Assembly, may be altered to some degree.

AVERAGING OF INCOME FROM ARTISTIC ACTIVITIES

Commencing in 2004, a recognized artist who acquires an eligible income-averaging annuity may spread, over a maximum period of seven years, the tax applicable to the portion of his year's income derived from artistic activities that exceeds \$50,000.

Taxpayers must include, in the calculation of their income for a given taxation year, any amount from an eligible income-averaging annuity received during that year. A special tax of 24% will be withheld from amounts received from an eligible annuity, however an individual who is resident in Québec at the end of a given taxation year will be entitled to a refundable tax credit equal to the amount withheld at source. In addition, an individual will not be authorized to deduct borrowing costs where the borrowing is used to acquire an income-averaging annuity contract.

MEASURES CONCERNING BUSINESS

DEDUCTION IN THE CALCULATION OF PAID-UP CAPITAL RAISED

The deduction of \$600,000 in the calculation of paid-up capital for tax on capital purposes will be raised to \$1 million for 2005 and subsequent calendar years.

A reduction of the \$1 million deduction will apply to 2005 and subsequent calendar years, when paid-up capital is between \$1 million and \$4 million.

Also, the amount of customer accounts receivable that enable a corporation to claim a reduction for investments in calculating its paid-up capital for purposes of the tax on capital must be reduced by the reserves for doubtful debts deducted regarding such customer accounts. The application of this amendment will be declaratory.

IMPROVEMENT TO TAX BENEFITS RELATING TO NATURAL RESOURCES

The basic flow-through share system will be made permanent once again. In the same way, the deduction regarding certain issue expenses and the additional capital gains exemption regarding certain assets relating to resources will also become permanent measures.

Some rates of the tax credit for resources will be improved and the carry-forward period of the non-refundable portion of this tax credit will be raised from seven to ten years, as of March 30, 2004.

TAX HOLIDAY FOR NEW CORPORATIONS

The five-year tax holiday for new businesses will be eliminated as of March 30, 2004.

Consequently, only corporations whose first taxation year begins prior to March 30, 2004 may benefit from the tax holiday, according to previously stipulated terms and conditions.

FIVE-YEAR TAX HOLIDAYS GRANTED TO CERTAIN FOREIGN EMPLOYEES

The tax legislation will be amended in relation to an employment contract concluded after March 30, 2004 so that:

- the five-year exemption period henceforth is continuous and begins on the day when the employee first commenced employment in a job that qualifies for one of the tax holidays;
- tax assistance is gradually reduced during the five-year exemption period.

CEILING APPLICABLE TO THE DEDUCTION FOR ENTERTAINMENT EXPENSES

From now on, the ceiling will depend on annual sales and will be calculated according to the following parameters:

Annual Sales	Ceiling
\$32,500 or less	2%
Between \$32,500 and \$52,000	\$650
\$52,000 or more	1.25%

These changes will apply regarding a taxation year of a taxpayer or a fiscal year of a partnership, as the case may be, ending after March 30, 2004.

However, for a taxation year or a fiscal year, as the case may be, that began before June 12, 2003, these changes will apply regarding entertainment expenses and sales, both calculated in proportion to the number of days of such taxation year or such fiscal year, as the case may be, after June 12, 2003.

TECHNOLOGY ADAPTATION SERVICES

The rate of the refundable tax credit will be raised from 30% to 50% and the criterion relating to the amount of a corporation's assets will be eliminated.

The subscription fees for liaison and transfer products and services will no longer be eligible expenditures. In addition, the component of the tax credit relating to competitive information will be eliminated.

CONSUMPTION TAXES AND OTHER MEASURES

ZERO-RATING OF CHILDREN'S DIAPERS

The Québec sales tax (QST) system will be changed to zero-rate the supply of diapers and training pants designed especially for children, as well as the supply of items used for breast-feeding and bottle-feeding.

This measure will apply in respect of a supply made after March 30, 2004.

TAXATION OF INSURANCE PREMIUMS

The tax legislation will be amended to allow mandataries to choose between reporting this tax on an annual or a quarterly basis, depending on the amount of tax on insurance premiums they pay in the course of the 12 months preceding the month in which they make their choice.

Also, the requirement imposed on travel agents to remit to the MRQ the tax collected on the premiums they receive will be eliminated.

The sole responsibility of travel agents in respect of the tax on insurance premiums will be to collect it at the same time as the premiums to which it applies, and to remit it to the insurers along with these premiums.

This change will apply in respect of tax on insurance premiums collected or to be collected by travel agents after May 31, 2004.

INCREASE IN THE RATE OF CERTAIN PENALTIES

The *Act respecting the Ministère du Revenu* will be amended to raise from 25% to 50% the rate of the penalty provided for in cases where a false statement or an omission is made in a document made or filed for the purposes of a tax law or a regulation made under such law.

LOGBOOK FOR AN AUTOMOBILE

For 2005 and onward, an employee who benefits from an automobile made available by his employer will have to supply the employer with a copy of the detailed logbook he or she maintains with respect to the automobile so as to allow the employer to accurately determine the employee's taxable benefits. The copy of the logbook has to be provided within ten days from the end of the year or from the end of the period in which the automobile was made available to the employee. Failure to provide the logbook to the employer will result in a penalty to the employee of \$200.

FEDERAL LEGISLATION AND REGULATIONS

Québec's tax legislation and regulations will be amended to incorporate, with adaptations based on their general principles, most of the tax measures announced in the Federal Budget Speech of March 23, 2004.

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