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# Federal Budget Commentary

December 10, 2001

## 2001 BUDGET OVERVIEW

Finance Minister Paul Martin tabled his eighth Budget – although the first since February, 2000 – in Parliament on December 10, 2001. As was widely expected, it focuses primarily on issues relating to Canadian security in the wake of the September 11 terrorist attacks in the United States and, to a lesser extent, on providing a federal government spending boost in response to a slowing national and global economy. The Budget contains few significant changes to Canada's tax regime, and virtually no tax cuts, although it leaves untouched the tax reductions of roughly \$100 billion over five years that were announced in 2000. It also provides no additional financial support to the provinces for health-care programs.

From a fiscal standpoint, the finance minister said that the government recorded a budget surplus of \$17.1 billion in 2000-01, and will have a balanced budget for 2001-02, which will mark the fifth year in succession without a budget deficit. He cited private sector forecasts to predict that Canada's economy will grow by 1.3 percent in 2001 and 1.1 percent in 2002. An economic recovery is expected in the second half of 2002, leading to growth of 3.9 percent in 2003 and "balanced or better" budgets in 2002-03 and 2003-04. He also predicted that Canada's debt-to-GDP ratio will fall below 50 percent in 2002-03, for the first time in 17 years.

While noting that the government has reduced Canada's national debt by some \$36 billion over the last four years, Mr. Martin indicated that some of the Contingency Reserve will be used to finance initiatives proposed in this Budget and that Canada's debt will remain at \$547.4 billion through fiscal 2003-04.

Most major provisions of the Budget fall under the heading of "enhancing security for Canadians." In total, it proposes spending of \$7.7 billion over the next five years in this area, including \$6.5 billion for increased air security and Canada's military, and \$1.2 billion to strengthen border security infrastructure, procedures and personnel. Key security measures include \$1.6 billion for beefed-up intelligence and policing, \$1 billion to improve the screening of visitors, immigrants and refugee claimants, and \$1.1 billion on emergency preparedness and military deployment, including doubling the capacity of elite anti-terrorist units and supporting Canada's participation in the international war on terrorism.

Air security measures totalling \$2.2 billion over five years will include putting armed undercover police officers on aircraft and enhancing personnel and technology for passenger and luggage screening. The air security measures are to be paid for by a new Air Travellers Security Charge of \$12 per flight, starting April 1, 2002.

Non-security measures proposed in the Budget fall under the category of "strategic investments," reflecting the government's long-standing commitment to focus new spending on health care, education and innovation, Mr. Martin said. Provisions include extending education tax credits for individuals receiving Employment Insurance assistance for

post-secondary and adult education, increased grants for students with disabilities, new programs to help aboriginal children, and increased funding for the Canada Foundation for Innovation and for Canada's 29 sector councils to improve skills development. The Budget also proposes to create a new Strategic Infrastructure Foundation to work with provincial and municipal governments and the private sector to meet the essential infrastructure needs of the 21<sup>st</sup> century.

In an initiative which Mr. Martin said recognizes the vital role that small and medium-sized business play in the creation of jobs and growth in our economy, the Budget proposes to allow such businesses to defer their corporate tax instalments for the next three months – that is, January, February and March of 2002 – for a period of at least six months.

Finally, the Budget proposes to spend \$500 million on the creation of a new Africa Fund to reduce poverty and provide primary education in that continent.

## PERSONAL TAX CHANGES

### **Apprentice Mechanics' Tools**

Effective for the 2002 and subsequent taxation years, a person employed as an apprentice mechanic registered in a provincial licensing program for the repair of motorized vehicles will be entitled to deduct his or her "deductible tool costs" to the extent of the individual's income for the year. The excess, if any, can be carried forward indefinitely and deducted against employment income of any type, in future years.

"Deductible tool costs" for a particular year is defined to be the cost of new tools and ancillary equipment acquired while the individual is an apprentice provided that the individual's employer certifies that they are required as a condition of, and for use in, the apprenticeship to the extent that such cost exceeds the greater of \$1,000 and 5% of the individual's income for the year from the apprenticeship.

The tax value of tools will be reduced by the deductible portion. Proceeds of disposition in excess of the reduced cost will be included in income in the year of disposition.

### **Donations of Publicly Traded Securities**

The reduction in the inclusion rate from 50% to 25% for capital gains related to donations of publicly traded securities was to expire on December 31, 2001. This incentive has been extended indefinitely.

The additional 25% reduction in taxable income arising on the donation of publicly traded securities acquired upon the exercise of stock options was also to expire with securities acquired by December 31, 2001. This incentive will also be extended indefinitely.

### **Education**

Retroactive to 1997, an individual will be able to reduce taxable income by certain amounts received to assist in the payment of tuition fees that do not qualify for the tuition fee credit.

The amounts in question are those received under a program established by the Canada Employment Insurance Commission or by a similar government program.

For 2001 and subsequent years, the inclusion in income of financial assistance which is described above or which is received under a program established under the authority of the *Department of Human Resources Development Act* or a prescribed program, will not affect eligibility for the education tax credit.

Administrative procedures will be established to implement this provision for years prior to 2001.

**Goods and Services Tax Credit**

Effective July 2002, the quarterly payment of the GST Credit will be based on an individual's family circumstances at the end of the preceding quarter. Previously, payments were based on family circumstances at the end of the prior calendar year. Such family circumstances include: births, deaths, marriages, reaching the age of 19 years, and becoming or ceasing to be a resident of Canada.

**Intergenerational Transfer of Woodlots**

The Budget proposes to modify the existing intergenerational rollovers for farm property as they relate to commercial woodlots. Where the regular and continuous activity test set out in the existing rules cannot be met, an alternative test will be available. The new test will require only that the transferor or a family member be actively involved to the extent required by a prescribed forest management plan. Specific criteria for prescribed forest management plans will be developed in consultation with interested parties. This proposal will apply to transfers after December 10, 2001.

## C O R P O R A T E T A X C H A N G E S

### **Construction Work Camps**

Currently, a full deduction is allowed for meals at a semi-remote work site if the site is at least 30 kilometres from the nearest urban centre of at least 40,000 people and the employee cannot be expected to return home daily. The Budget proposes to extend this full deduction where the 30 kilometre requirement is not met, to meals provided to an employee housed at a temporary work camp constructed or installed specifically for the purpose of providing meals and accommodation to employees working at a construction site. Since the GST/HST follows the income tax rules in its treatment of meal expenses, 100 percent of the GST/HST paid or payable by an employer on the cost of fully deductible meals will be recoverable by the employer as input tax credits. This proposal applies to expenses incurred after 2001.

### **Tax Incentives for Renewable Energy and Energy Efficiency**

The Budget proposes to increase the upper limit for small hydro-electric projects that qualify for class 43.1 (30%) from 15 to 50 megawatts of annual average generating capacity for property acquired after December 10, 2001.

### **Deferral of Corporate Tax for Small Businesses**

In order to provide a cash flow benefit to small corporations, the Budget proposes to defer payment of their federal corporate tax instalments for the months of January, February and March 2002 for a period of at least six months, without charging interest or penalties.

A small corporation is one that did not have more than \$15 million of taxable capital (for large corporation's tax purposes) in the prior year and was not a member of an associated group with more than \$15 million of taxable capital.

To ensure that all corporations get at least a six-month deferral, the Balance-Due Day will be extended for 2002 taxation years ending January to June 2002. This not only extends the payment of instalments for these three months but also extends the date when the final balance of most taxes other than Part IV taxes is due.

The Balance-Due Day is generally two months after the end of the taxation year. However, it is three months for Canadian-controlled private corporations that claimed the small business deduction in the year or the immediately preceding year, provided that the taxable income of the company and associated companies for the preceding year did not exceed its business limit of \$200,000.

Corporations that pay their provincial tax to the federal government will also get to defer their provincial instalments. This will have no effect on instalments that have to be paid to Ontario, Alberta and Quebec which collect their own taxes.

Eligible corporations should be adjusting the due date for their January, February and March 2002 instalments and also the due date for the balance of taxes as shown on the following chart.

Taxation Year-End	Instalments Deferred			Balance-Due Day [BDD]
	January 2002	February 2002	March 2002	
January 2002	July 2002	—	—	Extended to July 2002
February 2002	August 2002	August 2002	—	Extended to August 2002
March 2002	September 2002	September 2002	September 2002	Extended to September 2002
April 2002	September 2002	September 2002	September 2002	Extended to September 2002
May 2002	September 2002	September 2002	September 2002	Extended to September 2002
June 2002	September 2002	September 2002	September 2002	Remains or extended to September 2002
July 2002	July 2002	BDD	BDD	Remains September or October 2002
August 2002	July 2002	August 2002	BDD	Remains October or November 2002
September 2002	July 2002	August 2002	September 2002	Remains November or December 2002
October 2002	July 2002	August 2002	September 2002	Remains December 2002 or January 2003
November 2002	July 2002	August 2002	September 2002	Remains January or February 2003
December 2002	July 2002	August 2002	September 2002	Remains February or March 2003
January 2003	—	August 2002	September 2002	Remains March or April 2003
February 2003	—	—	September 2002	Remains April or May 2003

## OTHER MEASURES

### **First Nations Taxation**

The Government currently has taxation arrangements allowing seven First Nations to levy a tax on their reserves for sales of fuel, tobacco products and alcoholic beverages. In addition, agreements have been entered into involving personal income tax collection and sharing arrangements.

The Government continues to express its willingness to discuss and put into effect similar arrangements in respect of direct taxation with other First Nations.

### **Venture Capital Partnerships**

The 30% ownership restriction for pensions and tax-exempt investors investing in qualified limited partnerships will be removed. Instead, the investors will be treated as owning a proportionate interest in each property owned by the qualified limited partnership. This measure is effective after 2001.

The rules will be relaxed for foreign investors who invest in Canada through partnerships.

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