

The

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Manager

Federal Budget Issue

Produced by Rich Rotstein Chartered Accountants

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The first budget of the new millennium was delivered by the honourable Paul Martin on February 28, 2000. Both individuals and corporations are to receive assistance in the form of badly needed tax cuts. Let's examine some of the budget proposals in more detail.

Individuals

Changes to the personal tax system include the following:

- Effective January 1, 2000 full indexation will be restored to the basic personal tax credit, the goods and services tax credit, the old age credit and the old age security reduction threshold. The thresholds for the 3 tax rate brackets will rise by 1.4% for the 2000 taxation year. This will eliminate "tax bracket creep" as coined by the press. The Government also plans to raise the amount individuals can receive tax free to a minimum of \$8,000. For 2000, the basic personal exemption is increased to \$7,231. The spousal amount is increased to \$6,140.
- Commencing July 1, 2000 the middle tax bracket of 26% will be lowered to 24%. The rate will eventually drop to 23%. For the year 2000, the basic federal tax structure will look as follows:

		Taxable Income
	29%	Above \$60,009
Rate	25%	Between \$30,004 and \$60,009
	17%	Up to \$30,004

Over the next five years the govern-

ment plans on increasing the lowest

has a net gain in one period and a net

loss in the other period, the 2 amounts are netted to determine the net gain or loss for the year. Capital losses carried forward from prior years (at a rate of 75%) will be adjusted to the net inclusion rate for the year before being applied against year 2000 capital gains.

- For 2000, the top marginal tax rate in Ontario will be reached at \$74,241 of taxable income (including surtaxes). With the reduction in the capital gains rate, the combined Federal and Ontario top tax rates for 2000 looks like this:

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Income Type	Top Marginal Rate
Interest and ordinary income	47.87%
Capital gains	31.91%
Canadian dividends	32.32%

- Stock option plans have been popular, especially with public companies, as a form of remunerating top employees, executives. A downside of receiving stock options of public company stock was that the employment income inclusion from the stock option benefit (calculated as the excess of the value of the shares over the exercise price) was to be included in income when the options were exercised. The timing of this benefit was problematic in that employees could be forced to sell the shares acquired at the time of exercise in order to pay



ment plans on increasing the lowest bracket to at least \$35,000 and the starting point for the upper bracket to at least \$70,000.

- The 5% surtax currently applies to taxable income in excess of around \$65,000. Effective July 1, 2000, the threshold will be increased to approximately \$85,000 of taxable income. Starting next year, the surtax is to be reduced to 4% and completely eliminated within the next five years.
- The inclusion rate for capital gains is being reduced to 2/3 from the current 3/4, effective for capital gains realized after February 27, 2000. Capital gains and losses are to be reported separately as pre February 28, 2000 and post February 27, 2000. If a taxpayer has capital gains and losses in both periods, the net gain for each period is to be determined and added together to arrive at the net capital gain or loss for the year. If the taxpayer

the tax on the stock option benefit.

The government is now going to allow an annual deferral of \$100,000 of the value of public company stock option benefits. The annual \$100,000 deferral will be taxed when the common shares are sold. The annual deferral will be available to employees who deal at arm's length with the corporation and who own less than 10% of all classes of stock of the corporation.

Finally, the stock option benefit deduction of 25% is to be increased to 1/3. This is consistent with the change in the capital gains inclusion rate changing from 3/4 to 2/3.

- Charitable donations are being modified in a couple of ways. In respect of an individual's death after 1998, the charitable donations tax credit will be available with respect to donations of RRSP, RRIF and life insurance proceeds made through direct beneficiary designations. The tax department is closing the donating of art loophole to obtain a charitable tax credit. The \$1,000 deemed minimum proceeds and cost rule will not apply for property acquired after February 27, 2000 which is donated as a charitable gift.
- For Registered Retirement Savings Plans (RRSP) a welcome change is the increase in the foreign content rules. For 2000, the amount of foreign property that can be held in an RRSP is increased from 20% to 25% and increasing to 30% after 2000.
- The tax free exemption for scholarships is increasing from \$500 to \$3000 for full time students.

- To assist in the financing of small business corporations, a tax free rollover of \$500,000 will be available on the disposition of an eligible small business investment after February 27, 2000 where the proceeds of disposition are used to make other small business investments. The cost base of the new investment is reduced by the amount of the deferred capital gain. An eligible small business investment must be in common shares, 90% of the assets of the small business must be used in an active business carried on primarily in Canada, and the book value of the assets must be less than \$2.5 million before the investment.

Corporations

Changes to the personal tax system include the following:

- To make Canada more competitive, the budget proposes to reduce the federal corporate tax rate from 28% to 21% within five years. The rate is reduced to 27% starting January 1, 2001. The reduction affects those corporations not already getting preferential tax rate treatment.
- The \$200,000 small business low tax rate on active business income of Canadian controlled private corporations has not been adjusted since 1981. The budget proposes a tax rate reduction from 28% to 21% on active business income between \$200,000 and \$300,000 starting January 1, 2001. It now remains to be seen if Ontario in their May budget matches this proposal.
- Both the federal government and Ontario offer Scientific research and experimental development (SRTC) tax

credits. Ontario also allow a special deduction from income called the super allowance. For taxation years ending after February 2000, the federal government will reduce the federal SRTC tax credit by the amount of the Ontario super allowance deduction multiplied by the applicable provincial tax rate of the corporation.

- Canadian corporations with foreign debt can only deduct the portion of interest expense on the debt where the debt is not greater than 3 times the equity of the corporation. Starting in 2001, the debt to equity ratio on foreign debt eligible for the interest deduction is being reduced to 2:1.
- Non-resident owned investment corporation status (NRO) is discontinued after February 27, 2000. Existing NROs can continue until their last taxation year end before 2003.
- Eligible manufacturing and processing depreciable assets (Class 43) acquired after February 27, 2000 can be put in a separate capital cost allowance class. This will allow faster write-off of the undepreciated balance of these assets upon their disposition.
- A new export distribution centre program will be setup January 1, 2001 to assist businesses that export substantially all of their output. Eligible businesses will use a certificate to import goods and services on a GST free basis, easing their cash flow burden. Transactions must be greater than \$1,000.

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