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2005 Provincial Budget Summary

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INTRODUCTION

Finance Minister Michel Audet tabled the Québec government's 2005-2006 Budget before the National Assembly on April 21, 2005. "This budget allows us to enter a new phase in the actions undertaken by our government since we took office," said the Minister. The following is a summary of the measures he announced.

1. MEASURES CONCERNING INDIVIDUALS

1.1 *New \$500 deduction for workers*

Calculation of the deduction for work-related expenses

Individuals will be able to deduct, in the calculation of their income for a given taxation year, an amount equal to 6% of their eligible earned income for the year, up to \$500.

1.2 *Improvement of the tax assistance for persons with a mental or physical impairment*

Indexation of the amount used to calculate the tax credit

For the 2006 taxation year, the amount used to calculate the tax credit respecting a severe and prolonged mental or physical impairment will be raised from \$2,200 to \$2,250.

1.3 *Enhancement of the tax assistance for natural caregivers*

1.3.1 **Increase of the supplement for handicapped children**

The tax credit respecting a dependent child with an impairment will be replaced, as of the 2006 taxation year, by an improved supplement for handicapped children.

1.3.2 **Introduction of a refundable tax credit for natural caregivers of adults**

The various measures for natural caregivers of adults will be replaced by a refundable tax credit, as of the 2006 taxation year.

Amount of the tax credit

The new tax credit will consist of, for each eligible relative housed, a universal basic amount of \$550, plus a supplement of \$450 that may be reduced on the basis of the eligible relative's income for the year for which the tax credit is being claimed.

TAX ASSISTANCE GRANTED TO NATURAL CAREGIVERS OF ADULTS

(in dollars)

Eligible relatives by age group and state of health	Maximum amount	Current assistance		New assistance
		Transfer of the non-refundable tax credit for impairment	Refundable tax credit for an individual housing a parent	Refundable tax credit for natural caregivers of adults
	Amount	Minimum amount	Maximum amount	
Age 18 to 59 (with an impairment)				
Child/grandchild/nephew/niece	440	n.a.	550	1,000
Brother/sister	440	n.a.	550	1,000
Father/mother/grandparent/other ascendant	440	n.a.	550	1,000
Uncle/aunt/great-uncle/great-aunt	440	n.a.	550	1,000
Age 60 or more (with an impairment)				
Child/grandchild/nephew/niece	440	n.a.	550	1,000
Brother/sister	440	n.a.	550	1,000
Father/mother/grandparent/other ascendant	440	550	550	1,000
Uncle/aunt/great-uncle/great-aunt	440	550	550	1,000
Aged 70 or more (without an impairment)				
Father/mother/grandparent/other ascendant	n.a.	550	550	1,000
Uncle/aunt/great-uncle/great-aunt	n.a.	550	550	1,000

1.3.3 Easing of the tax credit for a child engaged in vocational training or postsecondary studies

The tax legislation will be amended to stipulate that when a child has a major functional deficiency and is pursuing studies on a part-time basis, the child will be deemed to be pursuing such studies on a full-time basis in the given taxation year.

1.4 Changes to the tax credits for medical expenses

1.4.1 Tightening of the list of eligible medical expenses

Expenses paid for a service provided for purely cosmetic purposes

The tax legislation will be amended to provide that expenses incurred after April 21, 2005 to obtain medical, paramedical or dental services for purely cosmetic purposes will no longer be considered eligible expenses for the purposes of the non-refundable tax credit for medical expenses.

Consequently, the tax legislation will be amended to provide that transportation, travel or accommodation expenses paid after April 21, 2005 to obtain services for purely cosmetic purposes will no longer be eligible.

Expenses paid for glasses

The tax legislation will be amended to provide that the portion of all expenses incurred for eyeglass frames, by a taxpayer or the taxpayer's spouse after April 21, 2005, will be limited to \$200 per person.

1.4.2 Clarifications respecting certain eligible medical expenses

Premiums paid to a private health services plan

The tax legislation will be amended to provide that, as of the 2005 taxation year, plans that afford moderate coverage of expenses not giving entitlement to the non-refundable tax credit for medical expenses can qualify as private health services plans if their main purpose is to cover eligible expenses.

Services provided by a recognized practitioner

To take into account Revenu Québec's administrative practice and the growing influence of certain alternative medicine professions, the notion of "practitioner" will be clarified. Lists will be provided of recognized professions and other professions in which only certain services will be eligible.

1.4.3 Improvement to the refundable tax credit for medical expenses

To increase the tax assistance available through this tax credit and make the credit available to more low-income workers, the maximum amount of \$543 will be raised to \$750 as of the 2005 taxation year.

1.5 ***Application of the tax system to the parental insurance plan***

On March 1, 2005, the Québec and federal governments reached an agreement on the implementation, on January 1, 2006, of the Québec parental insurance plan.

2. **MEASURES CONCERNING BUSINESSES**

2.1 ***Significant reduction in the tax on capital and technical changes***

The rate of the tax on capital of corporations that are not financial institutions, currently 0.6%, will be gradually reduced to 0.29%. These rate reductions will take effect on January 1 of each year.

RATE OF THE TAX ON CAPITAL

(Per cent)

	Current	2006	2007	2008	2009
Rate of the tax on capital	0.6	0.525	0.49	0.36	0.29

The rate effectively applicable for such taxation year that straddles two calendar years will be a weighted rate.

The rate of the tax on capital of financial institutions, currently 1.2%, will be gradually reduced to 0.58%.

2.1.2 **Introduction of a capital tax credit regarding certain types of investments**

A corporation other than a financial institution that makes an eligible investment may claim a non-refundable capital tax credit, for such taxation year, equal to 5% of the amount of such eligible investment.

For such taxation year, the non-refundable portion of such capital tax credit that exceeds the tax on capital otherwise payable for such taxation year may be carried over to subsequent taxation years.

Eligible investments

Amounts paid for new manufacturing and processing equipment included in class 43, used within a period of at least 730 days, solely in Québec and mainly in the course of carrying on a business, will be considered eligible investments. These assets will have to be acquired after April 21, 2005 and before January 1, 2008.

A corporation will be allowed to apply this capital tax credit against its instalments.

2.1.3 Technical change concerning the calculation of total assets

The tax legislation will be amended to stipulate that a corporation must neither include nor deduct, in calculating the corporation's assets, an amount shown in its financial statements resulting from an operation between it and a partnership or a joint venture of which it is a member. The application of this change will be declaratory.

2.1.4 Application of the minimum 120-day holding period rule to bonds issued by partnerships

The tax legislation will be amended to stipulate that bonds issued by a partnership will be subject to the minimum holding period of 120 days including the end of the taxation year.

This change will apply to taxation years ending after April 21, 2005.

2.2 Major adjustment to corporate income tax

The tax rate applicable to active income will be raised gradually, from 2006 to 2009, by 3 percentage points.

However, Canadian-controlled private corporations (CCPCs) will be entitled to a reduction in their tax rate. This reduction will apply only to the first \$400,000 of annual income from an eligible business carried on by a CCPC.

The tax rate applicable for a taxation year that straddles two calendar years will be a weighted tax rate.

Private corporations with paid-up capital greater than \$15 million will not be able to claim this reduction. This reduction will gradually be lost as of \$10 million in paid-up capital.

TAX RATES APPLICABLE TO INCOME ELIGIBLE FOR THE SMALL BUSINESS DEDUCTION

(Per cent)

	Current	2006	2007	2008	2009
Tax rates applicable to active income	8.9	9.9	9.9	11.4	11.9
Small business deduction	(0)	(1.4)	(1.4)	(2.9)	(3.4)
Tax rates applicable to income eligible for the small business deduction	8.9	8.5	8.5	8.5	8.5

2.3 ***Changes to various refundable tax credits granted in certain regions***

Three tax credits (namely the refundable tax credit for processing activities in the resource regions, the refundable tax credit for Gaspésie and certain maritime regions of Québec and the refundable tax credit for the Vallée de l'aluminium) will be changed so that the period during which currently eligible corporations may receive tax assistance will be established on the basis of a common deadline, that is December 31, 2009. The notion of certified business will be adjusted for the purposes of the three refundable tax credits and a clarification will be made to the terms and conditions for issuing eligibility certificates.

2.4 ***Increase in the level of tax assistance for R&D granted to SMEs***

The tax legislation will be amended so that the rate that a Canadian-controlled corporation that qualifies as an SME can claim will henceforth vary from 17.5% to 37.5% on the first \$2 million of R&D spending, according to the same terms and conditions as those that currently prevail.

Assets of the corporation (Millions of dollars)	Current rates (Per cent)	New rates (Per cent)
25 or less	35	37.5
30	31.5	33.5
35	28	29.5
37.5	26.25	27.5
40	24.5	25.5
45	21	21.5
50	17.5	17.5

This change will apply to R&D expenditures incurred after April 21, 2005 for R&D work done after such day.

2.4.1 ***Obligation to carry on a business in Québec and have an establishment there***

The tax legislation will be amended so that a person or partnership is required to carry on a business in Québec and have an establishment there to be eligible for the refundable tax credit.

2.4.2 **Adjustment to the refundable tax credit for design**

The tax legislation will be standardized for the purposes of the two components of the design tax credit so that the gross income of the business that is carried on by a corporation will have to be at least \$150,000 for such corporation to be eligible.

Eligible expenditures

In-house component

The in-house component of this tax credit will be broadened to the entire industrial sector and the number of designers will no longer be limited.

Moreover, concerning the fashion sector, the salary paid to an eligible patternmaker will henceforth be included in the base of the in-house component of the design tax credit, but will be capped at \$40,000.

External component

The scope of the external component of this tax credit will be broadened.

This change will apply to an eligible expenditure incurred by an eligible corporation after April 21, 2005 regarding work for an eligible design activity or an eligible pattern drawing activity done after such day.

New eligibility criterion based on production in Québec

To be eligible for the in-house component or the external component of the design tax credit concerning the fashion sector, a corporation must show that 20% of its total production (50% for the industrial sector) for the preceding fiscal year is attributable to goods that the corporation made itself in Québec.

2.5 ***Introduction of the SME Growth Stock Plan***

At the conceptual level, the rules of the new plan essentially will incorporate the application details of the former SSP, change some of its basic features and ignore the components that no longer correspond to current needs.

This new plan will have a limited span, and will end on December 31, 2009. A single deduction rate, i.e. 100% of the adjusted cost of eligible shares, will apply.

The former SSP will not be revived and will be wound down gradually.

Eligible share

An eligible share means a common share with an unrestricted voting right that satisfies the conditions formerly applicable to a qualifying share under the former SSP.

In addition, a share may not be recognized as an eligible share when the use, announced in the final prospectus, of the proceeds of the offering in the course of which it is acquired, relates to activities to be carried out outside Québec.

Eligible issuing corporation

An eligible issuing corporation is a corporation that makes a public offering of shares and which meets certain criteria:

- asset criterion;
- Québec attachment criterion;
- five employees / twelve months criterion;
- 50% of the value of property criterion.

The new plan will require that the investor hold in his SME Growth Stock Plan on December 31 of the year of acquisition and on **December 31 of the three following taxation years**, eligible shares, valid shares or eligible securities the total adjusted costs of which are at least equivalent to the amount of deductions claimed during the preceding three taxation years in relation to the SME Growth Stock Plan.

Almost permanent coverage obligation

Rules will be put in place to encourage almost permanent coverage.

The annual deduction cap of 10% of the individual's total income for a year that applied under the former SSP will apply under the new plan.

2.6. *Changes to various refundable tax credits in the cultural field***2.6.1 Tax credit for Québec film and television production****Withdrawal of the minimum program length required for documentaries intended for children**

The Regulation will be amended to stipulate that a documentary intended for children under age 13 will not be subject to the requirement of a minimum programming length of 30 minutes.

2.6.2 Tax credit for book publishing

The regulations relating to this tax credit will be amended to stipulate that a book must have a minimum print run of 100 copies to be recognized as an eligible book.

2.6.3 Addition of a limit on book grouping

The regulations relating to this tax credit will be amended to stipulate a maximum period of 36 months between the date of first printing of the first book of a group of books and the date of first printing of the last book of the same group of books.

2.6.4 Refundable tax credit for the production of shows

The regulations will be amended to stipulate that a show that is a component of a game or an activity or food service is not an eligible production for the tax credit for the production of shows.

2.6.5 Increase in the depreciation rate of works of art by a Canadian artist

The depreciation rate of works of art by a Canadian artist will be raised from 20% to 33 $\frac{1}{3}$ %. This change will apply to works of art acquired after April 21, 2005.

2.6.6 Broadening of the deduction for a subscription to certain cultural activities

The tax legislation will be amended to add different types of performing arts (comedy and musical comedy, for instance) and museum exhibits to the list of eligible cultural events for the purposes of the exception relating to the cost of a subscription or block purchase of tickets, provided such events take place in Québec.

2.7 *Introduction of a refundable tax credit for the production of ethanol in Québec*

This tax credit will be granted, for a maximum of ten years beginning no earlier than April 1, 2006 and ending no later than March 31, 2018, regarding the production of ethanol in Québec by an eligible corporation.

2.8 *Introduction of a refundable tax credit for major employment-generating projects*

An eligible corporation may claim a refundable tax credit equal to 25% of the eligible salaries (maximum \$60,000 per employee) it incurs as of January 1, 2005 and pays to eligible employees working in the information technology sector. An eligible corporation may receive this tax credit regarding salaries incurred (minimum of 500 jobs, maximum of 2,000 jobs created within 24 months) in relation to such contract, until December 31, 2016.

2.9 *Other changes*

2.9.1 International financial centres

Renewal of the government's commitment

To support the City of Montréal as an international finance centre, the government is renewing its commitment to maintain, until at least 2008, the tax benefits granted to IFC operators.

2.9.2 Capital gains exemption for the establishment of a servitude

The tax legislation will be amended to stipulate that the gain resulting from the establishment of a real servitude affecting an immovable may give rise to a capital gains exemption for qualified farm property or a capital gains exemption for a principal residence, where the immovable concerned satisfies the criteria for qualified farm property or a principal residence.

This change will apply in respect of a real servitude established after April 21, 2005.

2.9.3 Deductibility of certain expenditures related to the use of part of an individual's domicile as a private reception residence

In order to foster tax fairness among the various businesses in the home lodging sector, the tax legislation will be amended to stipulate that private reception residences will not be subject to the 50% limit applicable to the deduction of certain expenditures related to the use of part of an individual's domicile in the carrying on of a business.

This change will apply to taxation years ending after April 21, 2005.

3. FEDERAL LEGISLATION AND REGULATIONS

3.1 *Federal Budget Speech of February 23, 2005*

3.1.1 **Measures relating to the *Income Tax Act***

Measures retained

Québec's tax legislation and regulations will be amended to incorporate the measures relating to:

1. the tax credit for a severe and prolonged mental or physical impairment (BR 6), with the exception of the amendments relating to life-sustaining therapy;
2. the disability supports deduction (BR 7);
3. the increase in the refundable medical expense supplement (BR 8);
4. registered education savings plans, where the beneficiary of the plan is a person with a severe and prolonged mental or physical impairment (BR 9);
5. the addition of certain expenses to the list of eligible expenses for the purposes of the non-refundable medical expense tax credit (BR 11);
6. the provisions of the non-refundable medical expense tax credit pertaining to the eligibility of expenses related to the renovation or alteration of a dwelling (BR 12);
7. emergency medical services vehicles (BR 15);
8. gifts for tsunami relief (BR 17), except as regards the requirement according to which gifts must be made in cash or by cheque, credit card or money order, and subject to a corporation, whose taxation year ends on December 31, 2004, also being able to take advantage of the extension of the deadline applicable to such gifts;
9. the definition of "Canada" for the purposes of the SR&ED deduction (BR 20);
10. all of the amendments pertaining to capital cost allowance respecting certain types of property.

Measures not retained

Some measures were not retained because the Québec tax system is satisfactory in that regard. This applies to the measures pertaining to the basic personal amounts (BR 1 to BR 3), the Child Disability Benefit Supplement (BR 10), the non-refundable medical expense tax credit (BR 13), the adoption expense tax credit (BR 14), agricultural cooperatives (BR 16) and the corporate tax rate reduction (BR 19).

Should you require additional information concerning this provincial budget, please do not hesitate to contact us at:

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