

# BUDGET

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March 30, 2004

### QUÉBEC BUDGET SPEECH OF MARCH 30, 2004

- Tax measures
- Economic Viewpoint

**INFORMATION BULLETIN**



**Desjardins**  
Fédération des caisses  
du Québec

Office of the Vice-president, Tax Service  
Office of the Vice-president, Economic Studies



March 30, 2004

Finance Minister Yves Séguin tabled this afternoon his 2004-2005 budget. One of the announcements made in this budget is that Capital régional et coopératif Desjardins may issue \$100 million in capital in the current period.

Family support measures are revised thoroughly as certain tax credits are turned into non-taxable benefits, some of which are general in application. Then, a restriction is introduced with respect to the deductibility of interests paid to earn investment income. Finally, very limited concrete measures are announced in terms of corporate taxes.

### Highlights

#### Measures affecting Desjardins - Entreprises

- Issues of Capital régional et coopératif Desjardins (CRCD) and labour funds
- New Development Fund
- Relaxation of the ceiling on entertainment expenses
- Improvement of the tax credit for on-the-job training periods
- Deduction for depreciation applicable to computers
- Cashing of government cheques
- Other Measures Concerning the Financial Sector

#### Measures affecting individuals

- Limit on the deductibility of investment expenses
- Child Assistance Payment
- Replacing the PWA program with a work premium
- Adjustment of other tax credits respecting dependants
- Advance payment of the refundable tax credit for child-care expenses
- Simplification of the personal tax system
- New Indexing Formula for Tax Credit and Income Brackets
- Refundable Tax Credit for New Graduates in a Remote Resource Region
- Eligibility of performers or the deduction respecting copyright income
- Averaging of income from artistic activities
- Measures relating to donations and gifts
- Rules concerning the reimbursement of salaries and wages or wage loss insurance
- Reducing unfairness related to the reception of certain payments (CSST, SAAQ, etc.)
- Reduction of the amount of the deduction for securities options
- Tax Relief for Canadian Forces Personnel and Police
- Zero-rating of children's diapers and items used to feed infants
- Logbook for an automobile made available to an employee
- Registration Duty - Vehicles With Large Displacement Engines

#### Measures concerning Businesses and various measures

- Tax on capital – Deduction in the calculation of paid-up capital raised to \$1 million
- Improvement and greater accessibility to various refundable tax credits granted in certain regions
- Elimination of the five-year tax holiday for new corporations
- Tax on Capital – Customer Accounts
- Reform of the Cooperative Investment Plan (CIP)
- Moratoriums concerning the Québec stock savings plan and Québec business investment companies maintained
- Moratorium concerning major investment projects maintained
- Replacement of the tax on telecommunications, natural gas and electricity networks
- Improvement to tax benefits relating to natural resources
- Five-year tax holidays granted to certain foreign employees
- Simplification of the taxation of insurance premiums
- Liability for the payment of duties, interest and penalties
- The carry-forward period of non capital losses
- Increase in the rate of certain penalties
- Various measures

## MEASURES AFFECTING DESJARDINS - ENTREPRISES

### Issues of Capital régional et coopératif Desjardins (CRCD) and labour funds

The moratorium applied with respect to Capital régional et coopératif Desjardins issues will be lifted as of March 31, 2004. CRCD will then be able to launch a new capital-raising period that will end on February 28, 2005. In practice, the shares of the capital-raising period will be available in a few weeks.

However, during such period, its authorized capital may increase by only \$100 million, rather than the \$150 million anticipated initially.

The minister also indicated that for any capital-raising period ending after 2005, the paid-up capital of the issued and outstanding shares of CRCD may again increase by \$150 million per capital-raising period, reaching a maximum amount of \$1,375 billion at maturity.

For labour funds, the amount of capital raised by them during their fiscal year beginning June 1, 2004 and ending May 31, 2005 will be limited, in the case of Fondation, to \$100 million and, in the case of the Fonds de solidarité des travailleurs du Québec, to \$700 million.

### New Development Fund

A new \$300 million development fund, the regional economic intervention fund, will be created to foster the development of regional economic projects. The fund will be financed as follows:

- Government of Québec \$200 million
- Fonds de solidarité FTQ \$50 million
- CRCD \$25 million
- Fondation \$25 million

### Relaxation of the ceiling on entertainment expenses

It was announced in the June 12, 2003 Budget Speech that the tax legislation would be amended to further limit deductible entertainment expenses to an amount equal to 1% of a taxpayer's sales for the year.

The ceiling is raised as follows:

<u>Sales</u>	<u>Ceiling</u>
\$32,500 or less	2%
Between \$32,500 and \$52,000	\$650
\$52,000 or more	1.25%

These changes apply to financial years ending after March 30, 2004. If the year began before June 12, 2003, the ceiling apply in proportion to the number of days before and after this date.

### Improvement of the tax credit for on-the-job training periods

Employers who accept eligible trainees are entitled to a credit for on-the-job training. A measure in this budget is designed to improve the credit for training periods occurring in eligible resource regions.

So, for these regions, the maximum weekly eligible expenditure applicable regarding an eligible intern will be raised from \$625 to \$1 250 and from \$500 to \$1 000 respectively, i.e. double the current amounts.

As well, the maximum hourly rate of wages and salaries that an eligible employer may consider regarding an eligible intern is raised from \$15 to \$25.

These changes will apply regarding an eligible expenditure incurred after March 30, 2004, in relation to an eligible training period beginning after that day.

### Deduction for depreciation applicable to computers

Québec is harmonizing the measure announced in the federal budget last week. So, in order to adequately reflect the useful life of computer hardware and related material, the budget proposes that the rate of deductions be raised from 30% to 45% for the depreciation applicable to these goods.

### Cashing of government cheques

Currently, a number of financial institutions doing business in Québec refuse to cash Québec government cheques if the payees are not customers of their institution.

As of May 1, 2004, any person who receives a cheque for \$1,500 or less from the Québec government will be able to cash it, at no charge, at any branch of the eight largest financial institutions doing business in Québec, including Caisses Desjardins.

For identification, the payee will be required to show one official identification document bearing both his signature and photograph or two identification documents bearing his signature.

### Other Measures Concerning the Financial Sector

- Adjustments concerning international financial centres
- Elimination of the deduction for market makers

## MEASURES AFFECTING INDIVIDUALS

### Limit on the deductibility of investment expenses

Under existing tax provisions, an individual may deduct, subject to certain conditions, the expenses incurred during a taxation year to earn income from a business or from property.

For purposes of investment income, this budget establishes a limit to the deductibility of investment expenses. Accordingly, the investment expenses incurred to gain investment income during that same taxation year will be deductible up to the investment income earned during this same taxation year. For greater clarity, the limitation will not apply to investment expenses incurred to earn income from a business, or income from the rental of an asset.

Investment expenses that cannot be deducted in a given taxation year may be carried over against investment income earned in one of the three preceding taxation years or in any subsequent taxation year, provided the investment income earned in any of these years exceeds the expenses then deducted. The tax treatment of investment expenses will thus be similar to that applied regarding a capital loss, without regard to the 50% rule.

The main investment expenses concerned by this limit are:

- Interest paid on borrowings contracted to acquire bonds, shares, units of mutual fund trusts;
- Investment administration or management fees;
- Custody fees for share or securities;
- Fees paid to investment advisors.

In calculating the limit, the main investment revenues are:

- taxable dividends of taxable Canadian corporations;
- interests from Canadian sources
- gross foreign investment incomes;
- taxable capital gains not eligible for the exemption on taxable capital gains;
- royalties from Canadian sources;
- accumulated incomes of a life insurance policy;
- incomes from a trust.

These changes will apply as of 2004. However, regarding taxation year 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.

### Child Assistance Payment

In order to increase government assistance to families and ensure greater coherence between measures targeting income support, work incentives and the fulfilment of children's recognized essential needs, the government abolishes the following measures as of 2005 and replaces them by an assistance payment for children (universal) and a work premium:

- family allowances
- non refundable tax credits for dependent children
- tax cuts for families and
- the PWA program.

So, starting January 1, 2005, each family will receive an annual non taxable minimum amount of \$553 for the first child and \$510 for each of the other eligible children. An added minimum amount of \$276 may be added in the case of a single-parent family. These figures will be indexed as of 2005.

In addition, single-parent families earning less than \$31,600 and couples earning less than \$42,800 will see their child assistance payments reach \$2,000 per year for the first child, an additional \$1,000 for the second and third child and \$1,500 for each of the following children. The reference income will be that of the second previous year of taxation for the first 6 months of the years and that of the previous year for the last 6 months. In all cases, a monthly amount of \$119.22 will be added for any handicapped child. The figures will be indexed as of 2006.

Child payments will be made quarterly. Each instalment will be made on the 15<sup>th</sup> day of the months of January, April, July and October for the current quarter.

In general, an eligible dependent child will be someone under 18 years of age. To be entitled to the assistance payment for a child, an individual must be the father or the mother of the eligible dependent child and must reside with the child. In cases of shared custody, the parents may agree to determine which of the two is deemed to be mainly responsible for the child's care and education.

The Régie des rentes du Québec will be responsible for administering the program.

### Replacing the PWA program with a work premium

The PWA program is part of the Québec income support system. To benefit from the program, the value of the goods and liquid assets of a household must be taken into consideration.

As of January 1, 2005, the PWA program will be replaced by a refundable tax credit offering low- and middle-income workers a work premium designed to encourage them to enter, re-enter or stay in the labour market. Workers will be entitled to the new tax credit regardless of the value of their property or liquid assets and regardless of whether they have dependent children.

The maximum premium will vary between \$511 for a single person to \$2,800 for a couple with children. However, the threshold will be lowered by 10% starting at \$9,700 of income for a single person and to \$14,800 for a couple with children. It will amount to nil when the income of a single person reaches \$14,810 and that of a couple with children reaches \$42,800.

The change will allow more than 500,000 extra households to benefit for tax relief.

The impact of the two measures on various types of family situations is summarized in the attached chart.

### Adjustment of other tax credits respecting dependants

Despite the termination of the non refundable tax credit for dependent children, the government is maintaining as of 2005 in a similar way to the current rules the amount for postsecondary education and the amount for single-parent families.

First, an amount of \$1,755 for any child engaged in vocational training or postsecondary education will be granted for each completed term, without exceeding two.

For an adult child who is a student, the parent can claim an amount of \$2,765 for the first child and of \$2,550 for the others. In the case of a single-parent family, the head of the family can claim an additional amount of \$1,380 in proportion to the number of months in the year during which this condition is met.

In the case of adult dependent children who do not pursue their eligible studies, an amount of \$2,550 will be granted to the individual provided that during the year, this person be at least 18 years of age, be the dependent of a taxpayer and resides ordinarily with that person.

In a case where the dependent person is someone with a disability, the \$2,550 amount will be replaced by an amount of \$6,275.

The various amounts will be indexed as of January 1, 2005 to take inflation into account.

### Advance payment of the refundable tax credit for child-care expenses

Under the taxation system, parents who do not pay the reduced contribution for child-care services can claim a refundable tax credit for child-care expenses they pay in order to work, continue their studies or actively seek employment.

The refundable tax credit for child-care expenses is determined by applying, to eligible child-care expenses, a rate established on the basis of family income. The rate varies from 75% to 26%.

The refundable tax is determined in conjunction with the processing of the taxpayer's income tax return, which must generally be filed by April 30 of the following year.

However, some parents can benefit in advance from all or part of the refundable tax credit through a reduction of the amount to be deducted from their remuneration.

A new mechanism of advance payment of the tax credit will be established as of 2005.

Upon request by an individual who believes he is entitled to the refundable tax credit for child-care expenses for a given taxation year, the Minister of Revenue may pay part of the tax credit in advance.

The request for advance payment must be made on the prescribed form no later than September 1 of that year.

Each year, on the 15th of January, April, July and October, the Minister of Revenue will make advance payments of the tax credit.

### Simplification of the personal tax system

Since 1998, individuals have had to choose between two tax systems the general system and the simplified system. The simplified system gives taxpayers the possibility of claiming a flat amount instead of a series of deductions and tax credits.

The simplified tax system will be abolished as of 2005.

However, the basic personal tax credit will always be equal to at least \$9,200.

### **New Indexing Formula for Tax Credit and Income Brackets**

The government decided to incorporate into the Act the method used in 2004 to establish the indexing rate of tax credits and income brackets at 2%.

Starting January 1, 2005, a new indexing factor, which will notably disregard any change in liquor and tobacco taxes, will be used to automatically index the main parameters of the personal income tax system.

### **Refundable Tax Credit for New Graduates in a Remote Resource Region**

In the last Parti Québécois budget on March 11, 2003, the government announced a measure designed to encourage new graduates to go and work in remote resource regions. However, in his June 12, 2003, budget, Minister Séguin announced that this measure would not be implemented. Yet, we learn today that this measure is now reintroduced with respect to an “eligible individual” who will begin holding an “eligible job” after March 30, 2004.

So, an individual living at the end of the year in an eligible region will be able to claim a refundable tax credit equal to 40% for his yearly wage up to an cumulative amount of \$8,000.

An “eligible individual” is someone who successfully completed the training leading to a vocational, college or university diploma, who received an eligible salary during the year from an “eligible job”. In general, a job of this kind is the one taken up within 24 months after receiving the recognized diploma, provided the training is related with the job held and the work place is located in an “eligible region”.

The term “eligible region” means the territories included in the following administrative regions and regional county municipalities (RCMs):

- Bas-Saint-Laurent (region 01);
- Saguenay Lac-Saint-Jean (region 02);
- the Haut-Saint-Maurice RCM;
- the Mékinac RCM;
- AbitibiTémiscamingue (region 08);
- Côte-Nord (region 09);
- Nord-du-Québec (region 10);
- Gaspésie Îles-de-la-Madeleine (region 11);
- the Antoine-Labelle RCM;
- the Vallée-de-la-Gatineau RCM;
- the Pontiac RCM.

### **Eligibility of performers for the deduction respecting copyright income**

The current tax system provides that an individual who, in a taxation year, is a recognized artist may claim, for that year, a deduction in the calculation of taxable income so as to exempt from income tax part of the income from copyrights of which he is the first owner.

For the purposes of application of this deduction, the income of performing artists that derives from the copyright with respect to a performance or a neighbouring right is not covered by this deduction.

The tax legislation will be amended to extend the deduction respecting copyright income to income derived from a performer’s copyright in his performance.

To account for the fact that the amounts received by performers pursuant to their right to equitable remuneration are closely related to the royalties received by authors of musical works for their copyright, notably for radio play of their music, the tax legislation will be amended so that these royalties are also considered for the purposes of the deduction respecting copyright income.

### **Averaging of income from artistic activities**

A new measure will be introduced to enable some artists to defer the tax on a portion of their income.

In short, 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.

An eligible income-averaging annuity must be acquired from a person licensed or otherwise authorized under the laws of Québec to carry on an annuities business or offer trustee services in Québec and who is authorized by the Minister du Revenue to offer eligible income-averaging annuities.

The fees related to borrowing costs, where the borrowing is used to acquire such a contract will not be deductible.

### **Measures relating to donations and gifts**

The current tax system authorizes several entities to issue tax receipts for donations or gifts they receive from individuals or corporations. To bolster support for the development of sports in Québec, a new category of organizations, devoted to promoting amateur sports in Québec, will be authorized to issue receipts for donations and gifts, bearing the mention that they are Québec income tax receipts.

As well, the Agence de la Francophonie will also be recognized as an organization authorized to issue receipts.

These measures apply to gifts made after March 30, 2004.

### **Rules concerning the reimbursement of salaries and wages or wage loss insurance**

Currently, a tax credit is granted for the reimbursement of salaries and wages or wage loss insurance received in a previous year. In short, this refundable tax credit corresponds to the additional income tax that the individual had to pay because of the inclusion of the amount reimbursed in the preceding year.

For any reimbursement made as of 2004 (or after 1997 if the taxpayer has made such a choice) the Act will rather provide a deduction in the year of the reimbursement.

If this deduction caused a loss for an individual, this loss could be applied against the income of the three previous years (or even more in some cases) and the ten following years.

### **Reducing unfairness related to the reception of certain payments (CSST, SAAQ etc.)**

In general, an individual who is unable to work following a work-related accident or a road accident, is granted a non taxable amount equivalent to 90% of his net wage or salary when he worked. In some cases, this determination method can increase the individual's available income, which does not motivate him to return to work.

As of 2004, in order to lessen the impact of this situation, the government is establishing a special tax calculated according to special terms.

### **Reduction of the amount of the deduction for securities options**

Generally speaking, an employee who disposes of or transfers rights under an option to purchase securities of a corporation or a mutual fund trust granted to him by his employer is deemed to receive, because of his office or employment, a benefit equal to the difference between the proceeds of the alienation of these rights and the amount paid to acquire them. The value of this benefit must be included in the calculation of the employee's income.

An employee who acquires securities under such an option is also deemed to receive, because of his office or employment, a benefit equal to the difference between the value of the securities at the time of their acquisition and the amount paid or to be paid to acquire such securities as well as the associated options.

Under some conditions, the employee is entitled to a deduction equivalent to a fraction of the value of the benefit.

In the wake of the Budget Speech of June 12, 2003, the amount of this deduction was reduced from one half to 37.5% of the value of the benefit deemed to have been received.

In this budget, the amount of this deduction will be further reduced by 33.5%, to one quarter of the value of the benefit deemed to have been received. This additional reduction will apply in regard to any operation that produces an employment income occurring after March 30, 2004.

### **Tax Relief for Canadian Forces Personnel and Police**

Québec harmonized the measure announced in the federal budget concerning the Canadian Forces members and a Canadian police force posted in risky international missions. As of 2004, they will be able to deduct from the taxable income the amount of employment income for this mission.

### **Zero-rating of children's diapers and items used to feed infants**

For purchases made as of March 31, 2004, the diapers and training pants designed especially for children, as well as the supply of items used for breast-feeding and bottle-feeding will not be subject to the Québec sales tax.

### **Logbook for an automobile made available to an employee**

As of 2005, when an employer makes an automobile available to employees, they must provide their employer with a copy of the logbook for an automobile made available to them by such employer no later than the tenth day after the end of the year, under a penalty of \$200.

### **Registration Duty - Vehicles With Large Displacement Engines**

An additional registration duty will be implemented for certain vehicles where they are equipped with an engine with a displacement of 4 litres or more.

This additional registration duty, payable on a yearly basis, will be \$30 for the vehicles concerned with an engine displacement of 4 litres, and will increase by \$10 for each decilitre of engine displacement exceeding 4 litres, up to a maximum of \$150. The vehicles concerned will be "passenger vehicles," "commercial vehicles" with licence plates bearing the prefix "F" or "FZ," and motor homes.

## MEASURES CONCERNING BUSINESSES AND VARIOUS MEASURES

### MEASURES CONCERNING BUSINESSES

#### **Tax on capital – Deduction in the calculation of paid-up capital raised to \$1 million**

The June 12, 2003 Budget Speech suspended the reductions in the rates of the tax on capital of corporations that are not financial institutions. The tax rate was remain at 0.6 %. In addition, the deduction in the calculation of paid-up capital was increased to 600 000 \$. The maximum deduction is reduced if the paid-up capital determined for the preceding taxation year exceeds the amount of such deduction.

In the budget, the tax rate is still the same but the deduction in the calculation of paid-up capital will be raised to \$1 million for 2005 and subsequent calendar years. The maximum deduction will be reduced linearly when paid-up capital for the preceding taxation year is between \$1 million and \$4 million and will be null if it exceeds \$4 million.

#### **Improvement and greater accessibility to various refundable tax credits granted in certain regions**

In recent years, three refundable tax credits were put in place to encourage job creation in the resource regions of Québec, 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.

First the eligibility period for the three credits is extended for three years.

In addition, the rate of the refundable tax credit for Gaspésie and certain maritime regions of Québec will be raised from 30% to 40%.

Furthermore, to mitigate the negative impacts of the recent tightening measures, the notion of certified business will be broadened for the purposes of the refundable tax credit for processing activities in the resource regions.

#### **Elimination of the five-year tax holiday for new corporations**

The current tax legislation allows new corporations to enjoy, subject to certain restrictions and the applicable ceilings, an exemption from income tax, the tax on capital and the employer contribution to the HSF for the first five years of operation.

To make the tax system fairer, more neutral and more competitive for all businesses, 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 this day may benefit from the tax holiday.

#### **Tax on Capital – Customer Accounts**

In general, the amount of claims resulting from the sale of goods or the supply of services to another corporation (customer accounts) can give rise to the reduction for investments, when such claim has existed for more than six months, for purposes of the tax on capital.

In the current wording, it could be construed that the gross amount of customer accounts enables a corporation to benefit from the reduction for investments. This budget specifies that the amount of customer accounts that enable a corporation to claim a reduction for investments must be reduced by the reserves for doubtful debts deducted.

#### **Reform of the Cooperative Investment Plan (CIP)**

The review of the CIP has shown that government assistance for the capitalization of cooperatives is still justified. However, the review has shown the need to better target this assistance to direct it towards the cooperatives or federations of cooperatives that really need it.

Accordingly, the rules of the CIP will be changed substantially. Briefly, the new plan will feature the following major changes:

- criteria will be introduced to direct capitalization assistance towards entities that need it and with a substantial presence in Québec;
- a new category of eligible investors will be recognized to enable certain individuals who are shareholders of a corporation that is a member of an agricultural cooperative or a federation of agricultural cooperatives to directly acquire securities giving rise to a tax benefit;
- the minimum holding period of securities will be raised to five years;
- the deduction allowed eligible investors in calculating their taxable income will be determined by applying a single rate of 125% to the cost of the eligible security;
- measures to ensure the integrity of the plan will be introduced.

### **Moratoriums concerning the Québec stock savings plan and Québec business investment companies maintained**

The Minister believes it is too soon to decide on the relevance of the Québec stock savings plan (QSSP) and Québec business investment companies (QBIC) as well as their future. Consequently, the moratorium announced on June 12, 2003 regarding these two plans is maintained for an indefinite period.

### **Moratorium concerning major investment projects maintained**

The March 14, 2000 Budget Speech introduced a ten-year tax holiday for major investment projects. A moratorium was introduced in the June 12, 2003 Budget Speech with respect to these projects. The moratorium applied to this tax holiday will be maintained until a final decision regarding it is made.

### **Replacement of the tax on telecommunications, natural gas and electricity networks**

In general, municipalities collect a property tax on immovables located in their territory. However, immovables that are part of a telecommunications network, a natural gas distribution network or an electrical power production, transmission or distribution network are excluded from the regular property tax system and subject to an alternative system. Under this alternative system, the operator of any of these networks must pay to the ministère du Revenu (MRQ), as property tax, a tax calculated on the income from the operation of the network.

This tax is no longer representative of reality. So as of 2005, it will be abolished and replaced by a public utilities tax (PUT), i.e. a property tax on immovables collected by the ministère du Revenu.

### **Improvement to tax benefits relating to natural resources**

The tax credit relating to resources put forward on a temporary basis for the last three years will become permanent. The tax measures allowing individuals to benefit from added deductions regarding mining, oil and gas exploration expenses incurred in Québec will become permanent.

Lastly, the additional deductions of 25% a corporation can claim for certain exploration expenses incurred in Québec's Mid North and Far North will also be made permanent once again. Accordingly, the expenses giving rise to this additional deduction may also continue, beyond calendar year 2004, to be foregone in favour of the investor when such investor is a corporation and such exploration expenses are funded by flow-through shares.

Prior to June 12, 2003, an investor could, under the flow-through share system, receive special tax treatment under Québec's tax system, i.e. a deduction regarding certain issue expenses and an additional capital gains exemption regarding certain assets relating to resources. The moratorium on these two fiscal measures will be lifted.

Lastly, the additional deduction rebate and that of the tax credit related to resources will be improved.

All these measures apply to flow-through shares purchased after March 30, 2004.

### **Five-year tax holidays granted to certain foreign employees**

Briefly, an individual who is not a resident of Canada, and who comes to Québec to work in specialized sectors, can receive a five-year tax holiday.

Some measures relating to this holiday will be established:

- the five-year exemption period of the tax holidays granted to foreign employees henceforth is continuous and begins on the day when, for the first time, the employee commenced employment in a job that qualifies for one of the tax holidays granted to certain foreign employees;
- employee mobility continues to be allowed, but that henceforth the periods of interruption between eligible jobs be counted in the five-year exemption period;
- the amount of tax assistance of the tax holidays granted foreign employees is gradually reduced during the five-year exemption period.

These amendments will apply to contracts reached after March 30, 2004.

### **Simplification of the taxation of insurance premiums**

Currently, all mandataries who are required to collect the tax on insurance premiums must report this tax by filing a monthly return. As of June 1, 2004, the mandataries who pay a small amount will be able to produce their reports on a quarterly or annual basis.

In addition, the current presumption relating to the individual insurance of persons that is incidental to an insurance contract encompassing personal insurance and damage insurance is deemed to be damage insurance is abolished with regard to a combined insurance contract reached after March 31.

Lastly, as of March 31, 2004, the tax system governing insurance premiums will be changed to allow persons having made an overcollection of tax to refund the person who has paid it.

## OTHER MEASURES

### Liability for the payment of duties, interest and penalties

Under existing tax legislation, a person must, before the 21st day of the month following the month during which a notice of assessment was mailed to him, pay the ministère du Revenu du Québec (MRQ.).

For notices sent after October 31, 2004, the period is abolished and will be replaced by a new period that will be established by the ministère du Revenu du Québec. According to the information received, the period should be 20 days.

### The carry-forward period of non capital losses

The measure announced in the March 23 federal budget aiming to extend the carry-forward period from seven to ten years for non capital losses for taxpayers who incur such losses as part of their business is harmonized in Québec. Bear in mind that this measure applies to losses incurred during the taxation year ending after March 22, 2004.

### Increase in the rate of certain penalties

To standardize the provisions pertaining to penalties, and discourage behaviour that leads to non-compliance, the Act respecting the Ministère du Revenu will be amended to raise 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.

In addition, the rate of the penalty correlative to the revocation of a document issued by a government department or organization because of false statements or serious omissions will be increased to 50%.

These changes will become effective on the date the bill giving effect to them is assented to.

### Various Measures

- Improvement and simplification of tax assistance relating to the carrying out of activities in a biotechnology development centre
- Improvement to the refundable tax credit for technology adaptation services
- Refundable tax credit for Québec film and television production
- Refundable tax credit for sound recording production
- Competence of Investissement Québec regarding refundable tax credits for the production of multimedia titles

ANNEX

TAX RELIEF ARISING FROM THE CHILD ASSISTANCE AND WORK PREMIUM IN 2005

EXAMPLE FOR VARIOUS TYPES OF HOUSEHOLDS

<b>SINGLE-PARENT FAMILY WITH ONE CHILD</b>								
Employment income	Current system				New system			Tax relief
	Family Allowance	Tax credit for children	Tax reduction for families	Total	Child Assistance	Work Premium	Total	
15 000	1 925	337	0	2 262	2 700	1 660	4 360	2 098
25 000	80	829	1 108	2 017	2 700	660	3 360	1 343
50 000	80	829	524	1 433	1 964	0	1 964	531
75 000	0	829	0	829	964	0	964	135
85 000 et +	0	829	0	829	829	0	829	0
<b>SINGLE-PARENT FAMILY WITH TWO CHILDREN</b>								
15 000	2 550	337	0	2 887	3 700	1 660	5 360	2 473
25 000	160	1 339	598	2 097	3 700	660	4 360	2 263
50 000	160	1 339	524	2 023	2 964	0	2 964	941
75 000	0	1 339	0	1 339	1 964	0	1 964	625
85 000	0	1 339	0	1 339	1 564	0	1 564	225
100 000 et +	0	1 339	0	1 339	1 339	0	1 339	0
<b>COUPLE WITH ONE INCOME AND ONE CHILD</b>								
15 000	625	0	0	625	2 000	2 780	4 780	4 155
25 000	80	320	0	400	2 000	1 780	3 780	3 380
50 000	80	553	829	1 462	1 712	0	1 712	250
75 000	0	553	79	632	712	0	712	80
85 000 et +	0	553	0	553	553	0	553	0
<b>COUPLE WITH ONE INCOME AND TWO CHILDREN</b>								
15 000	1 250	0	0	1 250	3 000	2 780	5 780	4 530
25 000	456	320	0	776	3 000	1 780	4 780	4 004
50 000	160	1 063	829	2 052	2 712	0	2 712	660
75 000	0	1 063	79	1 142	1 712	0	1 712	570
85 000	0	1 063	0	1 063	1 312	0	1 312	249
100 000 et +	0	1 063	0	1 063	1 063	0	1 063	0

# ECONOMIC VIEWPOINT

## Québec Budget 2004

March 30, 2004

## Comments on the Québec Budget 2004

**One More Transition Budget with, as a Bonus,  
a Return to Deficits**



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### Highlights

Minister of finance Yves Séguin tabled his second budget speech today. After a first "updating" budget tabled June 12, 2003, this budget is, as it were, one more transition budget, most new measures and changes not taking effect before the beginning of 2005. Nevertheless, the Minister is giving priority to health and education. The burden of taxpayers will be reduced by \$338 million in 2004-2005 and \$1.2 billion in 2005-2006. Families will be benefiting from over three quarters of this reduction. As for businesses, there are few new significant measures except that 75% of businesses will not be paying capital tax anymore. This budget also includes several measures aimed at disadvantaged Quebecers and designed to fight poverty and social exclusion. Lastly, today's budget plan demonstrates once again how uncertain Québec's public finances are. The details are as follows:

- First and foremost, the Charest government points out that the budget was developed in a difficult context due to the financial shortfall inherited from the previous government and the persisting fiscal imbalance between Ottawa and the provinces.
- The Charest government is not happy with the equalization reform project announced in the recent federal budget. Negotiations will be ongoing between Ottawa and the provinces on equalization and next summer's meeting between the Prime Minister and the premiers will be crucial for future health care funding.
- While Minister Séguin is presenting a zero deficit before losses by the Société générale de financement, a correct reading of the budget plan rather indicates a \$694 million deficit in 2002-2003 and a \$364 million deficit in 2003-2004 once the SGF losses are included.
- Then, for 2004-2005, a balanced budget will be maintained thanks to the sale of assets worth \$880 million and the disposal of some investments. For fiscal 2005-2006, the government will have to absorb a shortfall of \$1.6 billion.
- Despite everything, the government's program spending-to-GDP ratio should keep going down and reach 17.3% in 2005-2006, i.e. the lowest level since fiscal 1970-1971. In addition, the total debt-to-GDP burden should go from the 52.2% in 1997-1998 to 42.5% in 2005-2006. Even if the debt keeps rising, the progress of the economy will be greater.

### Summary of Budgetary Transactions

In millions of \$	01-02	02-03	03-04f	04-05f	05-06f
Own-source Revenues (including the SGF losses)	38,932	40,858	42,460	45,358	45,714
- Ann. Var. in %	-4.9	4.9	3.9	6.8	0.8
Federal Transfers	8,885	8,932	9,377	8,476	7,876
- Ann. Var. in %	12.5	0.5	5.0	-9.6	-7.1
<b>Total Budgetary Revenues</b>	<b>47,817</b>	<b>49,790</b>	<b>51,837</b>	<b>53,834</b>	<b>53,590</b>
- Ann. Var. in %	<b>-2.0</b>	<b>4.1</b>	<b>4.1</b>	<b>3.9</b>	<b>-0.5</b>
Operation Expenses	-42,380	-44,316	-45,800	-47,151	-48,377
- Ann. Var. in %	4.0	4.6	3.3	2.9	2.6
Public Debt Charges	-6,687	-6,536	-6,668	-6,939	-7,053
- Ann. Var. in %	-4.1	-2.3	2.0	4.1	1.6
<b>Total Budgetary Expenses</b>	<b>-49,067</b>	<b>-50,852</b>	<b>-52,468</b>	<b>-54,090</b>	<b>-55,430</b>
- Ann. Var. in %	<b>2.8</b>	<b>3.6</b>	<b>3.2</b>	<b>3.1</b>	<b>2.5</b>
Net Figures of Consolidated Organizations	322	368	267	256	217
Reserve for Health, Education, etc.	950	--	--	--	--
<b>Budgetary Balance (including the SGF losses)</b>	<b>22</b>	<b>-694</b>	<b>-364</b>	<b>0</b>	<b>-1,623</b>
Non Budgetary Surplus	-637	-884	-1,069	-464	-244
Net Financial Needs	-615	-1,578	-1,433	-464	-1,867
Program Spending-to-GDP Ratio (%)	18.2	18.0	17.7	17.5	17.3
Debt Servicing to Budgetary (%)	14.5	13.5	13.3	13.4	13.7
Total Debt (excluding advance borrowings) (\$M)	107,175	111,387	114,798	117,103	119,190
Total Debt-to-GDP Ratio (%)	46.1	45.4	44.4	43.5	42.5

f: forecasts --: not available Source: Ministère des Finances du Québec

**Budget Analysis**

**The Government Is Disposing of Assets Worth \$880 Million to Balance its Budget**

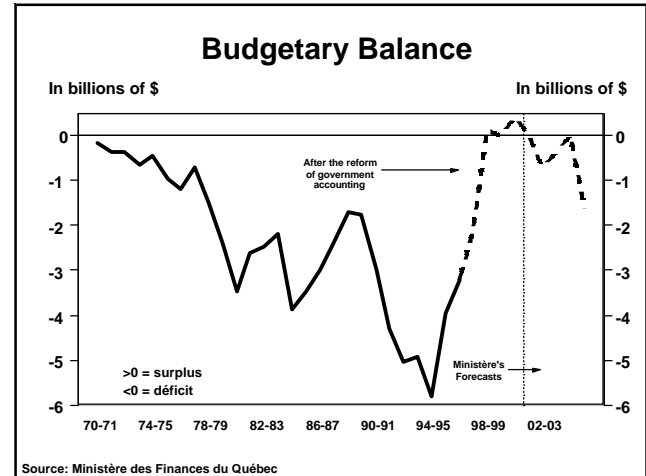
The documents delivered on March 30 bring to light a clear deterioration of the government's financial situation for the past three years. First, in the face of the balanced budgets that were announced, the fiscal 2002-2003 exercise ended with a \$694 million deficit and fiscal 2003-2004 with a \$364 million deficit. So, over the last two fiscal years, the definitive zero-deficit goal was not reached.

For the 2004-2005 budget year, Minister Séguin is promising a return to a balanced budget, but only at the cost of a sale of assets and the disposing of investments totalling \$880 million. This is a one-time cash inflow, i.e. non recurrent. In other words, the government will again be in a "technical" deficit.

In addition, nothing is assured for fiscal 2005-2006. Mr. Séguin is presenting a balanced budget, but it includes a \$1,623 million item called "Shortfall to be absorbed". Where will he find the money? No one knows. The government will then have to continue cutting budgets, counting on favourable conditions and hoping that the federal government provides assistance. Failing that, it could be a third deficit in four years. Meanwhile, the government's total debt rose by close to \$10 billion over the last three years. As of March 31, it stood at \$114.8 billion. However, Minister Séguin developed a strategy that, in his words, will limit the progress of the debt during the upcoming years. At least, the debt is rising at a slower pace than the economy. The debt-to-GDP ratio went down from 52.2% in March 1998 to 45.4% in March 2003 and then to 44.4% in March 2004.

It is also important to point out the government's efforts in reducing the growth in spending. Indeed, program spending increased at an annual rate of 4.7% during fiscal 1999-2000 and 2002-2003. This growth rate was brought down to 3.3% during fiscal 2003-2004 and will be brought down to 2.9% for fiscal 2004-2005, which is much lower than the progress of the economy (nominal GDP).

Lastly, it should be noted that the budget is based on conservative economic assumptions. Indeed, budget projections are based on a 2.7% real-GDP growth in 2004 and 2.9% growth in 2005. For the same period, we anticipate a growth of 2.6% and 3.3% respectively (see the forecast chart contra).



**Economic and Financial Forecasts**

	2003		2004		2005	
	Realized	Budget	Mouvement Desjardins	Budget	Mouvement Desjardins	
Québec Nominal GDP (%)	5.2	4.3	4.4	4.0	5.0	
Québec Real GDP (%)	1.7	2.7	2.6	2.9	3.3	
Québec GDP Deflator (%)	3.5	1.6	1.8	1.1	1.7	
3-month Canadian Treasury Bills (%)	2.9	2.2	2.0	2.7	3.0	
10-year Canadian Bonds (%)	4.8	4.8	4.6	5.2	5.4	

Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

**New Measures: Health and Low- and Middle-Income Families Are the Winners**

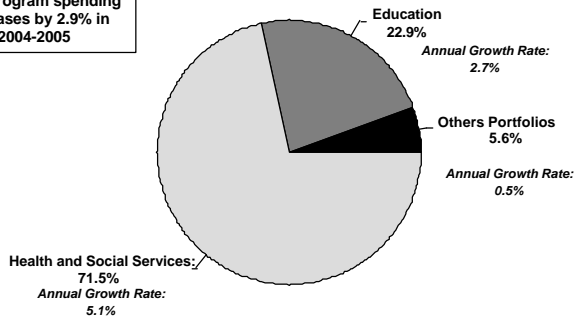
With the fiscal-imbalance problem in the background and the economic growth running out of steam over the last few quarters, it was obvious that Minister Séguin had rather limited leeway. Despite everything, he is proposing several new budget initiatives. So, focus is put on health spending and assistance to low- and middle-income families. Individual taxpayers will benefit from tax relief totalling approximately \$1 billion in 2005.

*Health Care Spending Will Increase*

After an increase of 6.7% in 2003-2004, budget spending allocated to health care will increase by 5.1% (or \$1 billion) in 2004-2005. These amounts should cut down wait times for surgical procedures and improve first-line services. In addition, the government wants to improve the efficiency of the health system. It should also be noted that education spending will increase by 2.7% in 2004-2005, while expenses excluding health and education will remain practically the same, with an annual growth of 0.5%.

### Growth Breakdown of Program Spending in 2004-2005

Total program spending increases by 2.9% in 2004-2005



Source: Ministère des Finances du Québec

#### A New Support for Families

As of January 1, 2005, Québec's family allowance program, the non refundable tax credit for children and the family tax cuts will be cancelled and replaced by a new "Child Assistance" program. While overall measures of the current system would have provided some \$1.5 billion in tax relief, the new refundable tax credit will reach \$2 billion in its first year. Low- and middle-income families will be the winners of the reform since, even if child support is universal, the assistance will be more generous for these income earners. For instance, a couple with two children whose income is under \$42,800 will benefit from \$3,000 in assistance. The same couple with an income of \$100,000 will receive \$1,063. It should be noted that the child support will be paid out in four instalments, i.e. in January, April, July and October.

#### Unified Tax System

On January 1, 2005, the ministère des Finances will return to a unified tax system for individuals. This measure should not only simplify the tax system, it should also reduce the taxes of many households. The extent of these cuts is however limited since its annual impact is estimated to be \$219 million. In fact, taxpayers will benefit from an average \$87 tax cut.

#### Help for Low-Wage Earners

The current PWA (Parental Wage Assistance) program will be replaced by another new « Work Premium » program on January 1, 2005. This work premium will allow households to increase their earned income. The maximum premium for a couple with children with an annual work income of \$14,800 will reach \$2,800 and will gradually decrease and disappear completely when the income exceeds \$42,800. The implementation of the new work premium will add \$243 million in tax relief in 2005.

#### Many Other Measures

The Charest government is also taking the opportunity to put forward a series of more modest initiatives. For instance, the exemption on capital tax for SMEs will go from \$600,000 to \$1,000,000 and several measures benefiting the regions will also be established. Similarly to what was announced in last June's budget, the ministère des Finances is intent on fighting tax evasion even more. Today's budget also anticipates \$319 million in investments over three years on social housing as 126,000 low-cost houses are built, the homes of 6,010 persons with disabilities are adapted and rent supplement is paid to over 5,000 Québec households.

In short, low- and middle-income families are the ones who will be benefiting the most from today's budget. The great majority of Québec taxpayers will have to wait until next year before seeing the beneficial effects of a reduction in their tax burden. Until then, the Québec government will have to meet the challenge of stabilizing its budget situation and negotiating with the federal government the renewing of the transfer system to the provinces.

### Tax Relief for Individuals

#### Impacts (in millions of \$)

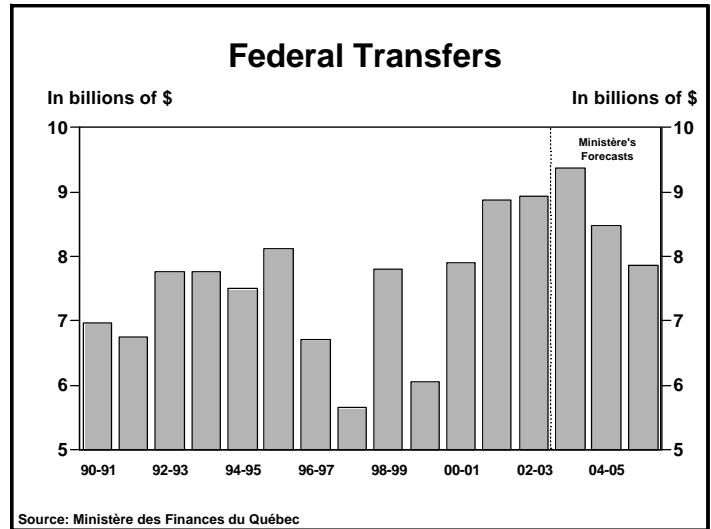
	Full Year	2004-2005	2005-2006
New « Child Assistance »	-547	-306	-975
Replacing the PWA program with the « Work Premium »	-243	-17	-115
Unified Tax System for Individuals	-219	--	-40
<b>TOTAL</b>	<b>-1,009</b>	<b>-323</b>	<b>-1,130</b>

Source: Ministère des Finances du Québec

### Impact on Financial Markets

Financial markets and rating agencies may well not appreciate the second Séguin budget. Disclosing the realization of two deficits (in 2002-2003 and 2003-2004 with the SGF losses), reaching fiscal balance in 2004-2005 thanks to the sale of assets and the \$1.6 billion budget shortfall in 2005-2006 will not reassure stakeholders. In addition, the government's total debt will continue rising. It stands at nearly \$115 billion in 2004 and will reach \$120 billion by 2006 (it was \$98 billion in 1998). However, the debt-to-GDP ratio will slightly decrease due to the Québec economy growing at a quicker rate than the debt.

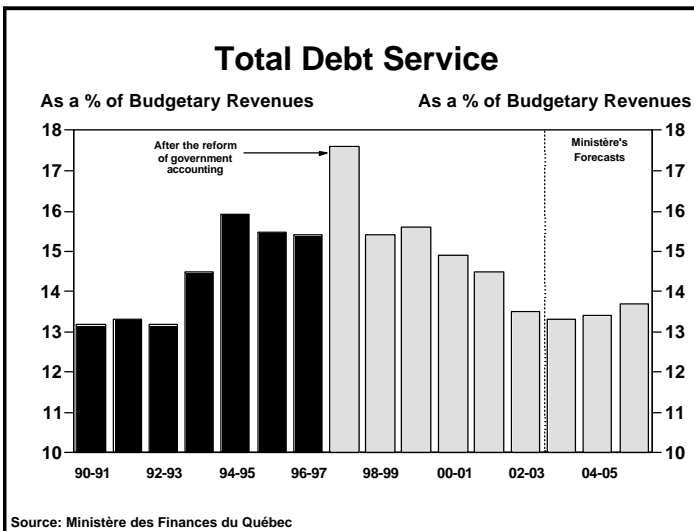
It must be mentioned that Québec's uncertain financial situation is not unique in Canada. All provinces, except Alberta, are experiencing difficulties while the federal government continues to record budget surpluses. For fiscal 2003-2004, the combined deficit of the provincial and territorial governments is estimated to be just over \$5 billion. Meanwhile, the federal government announced last week a surplus of \$5.5 billion for fiscal 2003-2004 (\$1.9 billion was earmarked for the debt and \$3.6 billion for new expenditures).



Without bringing any corrective measures to the fiscal imbalance problem, the provinces, including Québec, could be faced with a difficult financial context over the next few years.

In fact, the budget balance remains uncertain in Québec due to structural problems that weigh on Québec public finances: 1) Québec spends more than the other provinces despite lower income per capita; 2) Quebecers' tax burden is the highest in Canada; and 3) Québec's debt is the highest among Canadian provinces. Fortunately, the government announced new guidelines in order to better control the rising debt and interest charges. These guidelines include reviewing the mission of public corporations and the development and implementation of a policy with respect to capital investments in the public sector.

The new guidelines are only a first step that aims to recover some of the needed leeway to adequately fund public services and gradually reduce Quebecers' tax burden over the upcoming years. In short, the road to first-rate financial results still seems to be long and twisting.



### Federal Transfers to Québec

In millions of \$	02-03	03-04f	04-05f	05-06f
<b>Federal Transfers</b>	<b>8,932</b>	<b>9,377</b>	<b>8,476</b>	<b>7,876</b>
Variation in %	0.5	5.0	-9.6	-7.1
Including:				
<b>Canada Health and Social Transfer (CHST)</b>	<b>2,648</b>	<b>4,266</b>	<b>2,890</b>	<b>3,302</b>
Variation in %	-10.5	61.1	-32.2	14.3
<b>Equalization</b>	<b>5,315</b>	<b>4,065</b>	<b>4,942</b>	<b>3,887</b>
Variation in %	-0.4	-23.5	21.6	-21.3

As this table shows, federal transfers are very volatile. Accordingly, the payments made as part of the equalization program went through annual variations of more than 20% over the last few years. The federal government recently mentioned its intent of reforming the current system in order to stabilize the transfer payments to the provinces.

f: forecasts Source: Ministère des Finances du Québec

### Is the Balanced Budget Act still respected ?

The Balanced Budget Act states that if a government has a surplus in one financial year, it can incur cost overruns for the following financial years, up to the surplus. So, the \$649 million deficit recorded in 2002-2003 complies with the Act as it does not exceed the accumulated surplus of the previous budgetary years. The accumulated surpluses reached \$1,871 million in 2001-2002. So, despite the \$694 million deficit, a legal "leeway" of \$1,177 million is still available to the government for the next financial years. However, the losses of \$364 million in 2003-2004 and the non absorbed deficit of \$1,623 million in 2005-2006 will quickly make to theoretical line of credit disappear.

### Cumulative Surpluses under the *Balance Budget Act*

In millions of \$	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04f	04-05f	05-06f
Deficit Provided by law	-3,275	-2,200	-1,200	--	--	--	--	--	--	--
Budgetary Balance*	-3,217	-2,192	126	30	427	22	-694	-364	0	-1,623
<b>Surpluses (overruns)</b>	<b>58</b>	<b>8</b>	<b>1,326</b>	<b>30</b>	<b>427</b>	<b>22</b>	<b>-694</b>	<b>-364</b>	<b>0</b>	<b>-1,623</b>
<b>Accumulated Surpluses</b>	<b>58</b>	<b>66</b>	<b>1,392</b>	<b>1,422</b>	<b>1,849</b>	<b>1,871</b>	<b>1,177</b>	<b>813</b>	<b>813</b>	<b>-810</b>

\* : surplus (deficit) presented to public accounts

f: forecasts Source: Ministère des Finances du Québec

### Conclusion

#### A Socially-Minded Budget that Demonstrates the Government's Financial Precariousness

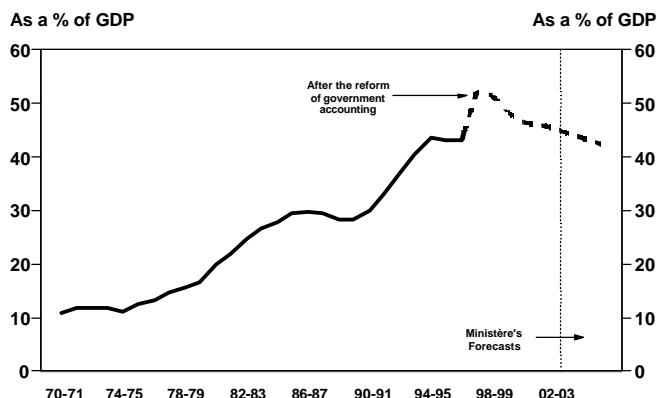
This budget brings to light the Québec state's precarious financial situation. It reveals among other things that the government was in a deficit for two years. It is presenting a balanced budget for fiscal 2004-2005, but to do so, it must turn to selling significant assets. Bear in mind that most collective agreements of public and parapublic sector employees will be terminating on June 30, 2003. The wage offers that the Liberal government will be presenting to the workers in the near future will reduce the present government's leeway by the same amount. In addition, nothing is sure for 2005-2006 since the government will have to take restraint measures totalling \$1.6 billion.

Meanwhile, the debt keeps rising. However, the Minister disclosed guidelines to limit the rise so that the reduction of the debt-to-GDP ratio will continue over the next few years. According to his projections, the debt-to-GDP ratio will go down from 44.4% as of March 31, 2004 to 42.5% as of March 31, 2005. So, Québec's financial situation is not out of control as was the case in previous years and the government is firmly intent on rectifying the situation that has deteriorated over the past three years.

The government stuck to its budget plan and prioritized to health and education. According to the 2004-2005 budget, health and social services spending will increase by 5.1%, while education will grow by 2.7%. All other departments will have to be satisfied with a mere 0.5% increase. As can be seen, the government's financial capacity is very limited and even in health, the spending increase does not reach the \$2 billion that was promised.

Given its limited leeway, the government favoured low-income households with respect to tax relief and assistance to families, which is a valid choice in the context. Think of the measures that favour job-market integration (work premiums). However, most of these measures do not come into effect before January 1, 2005. Yet, the government is to be congratulated for giving priority to rectifying its financial situation rather than granting massive broad-based tax cuts, as is the case in the United States for instance. However, everything indicates that Quebecers will remain among the most taxed individuals in North America for many years to come.

### Total Debt



Source: Ministère des Finances du Québec