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**2002-2003 PROVINCIAL SUPPLEMENTARY STATEMENT  
MARCH 19, 2002**

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Tax Division  
Audit & Tax Service  
Economic Studies

**INFORMATION BULLETIN**



Fédération des caisses  
Desjardins du Québec

# ECONOMIC COMMENTS

## No New Measures in a Supplementary Statement with Political Undertones

Today, Pauline Marois, deputy Prime minister and minister of State for the Economy and Finance, tabled an update to last fall's budget. By releasing the supplementary statement, the government aims to reflect what happened since last November's budget that changed the budget parameters of the ministère des Finances du Québec. The minister is also taking the opportunity to introduce several new tax measures and expenditures. Furthermore, she is providing a follow-up on the debate on fiscal imbalance and shedding some light on the impact of the changes in the calculation of Québec's share of the equalization payments.

### The Economy: A Big Gamble that Paid Off

Prior to 2001, the steady growth of the economy helped the government of Québec restore public finances. However, in 2001, Québec experienced a significant slowdown in economic growth, as did most of industrialized economies. In fact, the situation was so serious that when the 2002-2003 budget was tabled, the risk of a return to deficits loomed heavily.

However, in the latter part of the year, the Québec economy outpaced the U.S. and Canadian economies, showing higher production and job-creation increases. In addition, the shock of 9-11, although significant, was only temporary and relatively limited. Madame Marois' boldness was a stroke of luck for the government, even if this was a big gamble by the deputy Prime minister, as Québec avoided the recession and maintained a balanced budget.

With a strong economic recovery taking shape, the Québec government will be able to build itself a nest egg because of economic growth in 2002 and 2003 that is definitely stronger than

the ministère des Finances forecasts. The revised economic outlook indicates, as anticipated in the November budget, real GDP growth of 1.1% in 2001 and 1.7% in 2002. In 2003, the growth of the GDP jumps from 1.9% to 2.9%. We believe that the growth of the Québec economy could be higher than the ministère forecasts, by 0.6% in 2002 and 0.8% in 2003.

However, our interest-rate forecasts are higher than those of the government. Because debt servicing will increase as a result, this will eliminate several million dollars in the nest egg that should be established in 2002 and 2003. There should nevertheless be a budget surplus, unless the minister spends more during the year or earmarks funds to debt reduction once the fiscal year is over.

All the while, keep in mind that the state of public finances in Québec is still shaky. The tabling of the budget last November

Québec Economic and Financial Forecasts									
	2002-2003 Budget Forecasts (November 2001)			March 2002 Statement Forecasts			Desjardins Forecasts March 2002		
	2001f	2002f	2003f	2001f	2002f	2003f	2001f	2002f	2003f
Nominal GDP - Québec (%)	3.3	3.0	3.2	2.4	1.9	4.8	3.0	3.3	5.7
Real GDP - Québec (%)	1.1	1.7	1.9	1.1	1.7	2.9	1.1	2.3	3.7
3-month Canada Treasury Bills (%)	3.9	3.0	4.4	3.8	1.9	3.7	3.9	2.5	4.0
10-year Canada Bonds (%)	5.5	5.5	6.2	5.5	5.2	5.9	5.5	5.8	6.2

f: forecast  
Source: 2002-2003 Québec Budget, March 2002 Supplementary Statement and Mouvement Desjardins.

### SUMMARY OF BUDGETARY TRANSACTIONS (in millions of dollars)

	1998-99	1999-00	2000-01	2001-02' according to the Novembre 01 budget	2001-02' according to the Mars 02 Statement	2002-03' according to the Novembre 01 budget	2002-03' according to the March 02 Statement	2003-04' according to the Mars 02 Statement
Own-source Revenues	38,649	41,076	42,895	40,298	40,806	42,691	43,065	45,231
Ann. Var. %	7.79	6.28	4.43	-5.97	-4.87	5.94	5.54	5.03
Federal Transfers	8,071	6,334	8,145	9,660	9,287	9,247	8,842	8,074
Ann. Var. %	34.40	-21.52	28.59	18.37	14.02	-4.28	-4.79	-8.69
Operating Expenditures	-39,407	-40,031	-42,057	-43,506	-43,671	-44,582	-44,713	-45,699
Ann. Var. %	7.45	1.58	5.06	3.69	3.84	2.47	2.39	2.21
Operating Balance	7,313	7,379	8,983	6,452	6,422	7,356	7,194	7,606
Reserve for Health, Education, etc.			-950			0	0	0
Reserve Used for Expenditures				280	280			
Reserve Used for Balancing Budget				670	670			
Public Debt Charges	-7,187	-7,372	-7,606	-7,402	-7,372	-7,356	7,194	-7,606
Ann. Var. %	-2.12	2.57	3.17	-2.68	-3.08	-0.62	2.41	5.73
Budget Balance	126	7	427	0	0	0	0	0
No-budgetary Surplus	397	703	-943	-707	655	-645	-872	-705
Net Financial Needs	523	710	-516	-707	655	-645	-872	-705

Source: 2002-2003 Québec Budget and March 2002 Supplementary Statement.  
f: Forecasts

revealed that the government elected to use the \$950 million reserve of fiscal 2000-2001 that it had set aside and earmarked \$280 million of it to current expenditures and \$670 million to balance its budget. As it were, fiscal 2001-2002 shows a "technical deficit".

By examining the supplementary statement made public today, it is plain to see that the ministère des Finances does not have much leeway. For instance, despite the establishment of a new "nest egg," new expenditures should eliminate any leeway, however large, while new cuts in federal transfer payments could push the government back into the throes of budget deficits.

### Very Modest Budget Measures

Québec taxpayers will only benefit from a few new measures, very modest in nature, commensurate with minister Marois' new leeway. The most significant measures are aimed at fighting poverty: \$300 million are earmarked over three years to index all social assistance benefits starting in January 2003. The penalty for a social assistance recipient who shares housing with another adult will be eliminated and \$20 million will be added in 2002-2003 and 2003-2004 to support community action.

Somme additional measures are also proposed to strengthen the shift to the new economy. Accordingly, the Landry government is putting forward support measures for the capitalization of biotechnology companies (Bio-Levier program) totalling \$25 million in 2002-2003 and the building of infrastructures for the biotechnology industry. As well, the government is including improvements to the development program of the Cité de l'optique and additional credits of \$15 million over the next three fiscal years to support innovative SMEs.

On the tax front, taxpayers and businesses will have very little to nibble on. The statement proposes a host of measures that are aimed at improving the equity of the personal tax system. In point of fact, Québec taxpayers will see their tax burden go down by only a few extra million. Accordingly, personal income tax will go down by an additional \$17 million in 2002-2003. Businesses will not fare any better since they will benefit from an insignificant \$10 million in 2003-2004 for biotechnology companies and innovation centres.

So, close to \$78 million in new funds will be injected in the Québec economy in 2002-2003 and approximately \$142 million in 2003-2004. This is equivalent to a 0.4% increase in expenditures and a decrease of 0.06% in own-source revenues for the Québec government. Indeed, a very tiny drop in the bucket.

### Will the General Election Be the Next Meeting?

Delivered in the wake of the terrorist attacks on the U.S., last November's budget occurred in a difficult economic context, filled with many uncertainties hanging over the national and international scenes. At the time, minister Marois based her forecasts on economic growth assumptions that were seen as overoptimistic, but the recovery of North American economies showed that the officials at the ministère des Finances were right. In such circumstances, the improvement of economic conditions justified the need to get things straight and adjust the budget parameters set only a few months ago.

The ministère des Finances has very few new financial resources, which explains the scant additional measures proposed in this statement. However, as it did last fall, the Landry government wanted to polish its social image as the majority of new measures announced today are aimed at low-income Quebecers.

Finally, the statement is more noticeable for its political undertones, as a large part of it focuses on bringing Quebecers up to date on the disagreement with Ottawa. The government is using the opportunity to act on the Commission on Fiscal Imbalance, whose report was made public on March 7. At the heart of the debate is Ottawa's recent decision to review the relative wealth of the provinces, which could mean hundreds of millions of dollars of potential cuts in equalization payments for Québec. Keep in mind that elections are likely to be called by the end of the year and that by-elections are in progress. This definitely played a role in the decision to update the budget this spring.

Financial markets should be relieved to see the budget statement. The strength of the Québec economy will probably offer some added leeway to the province's treasury department, which will help maintain balanced public finances in Québec.

## SUMMARY OF THE CHANGES IN FEDERAL TRANSFERS (in millions of dollars)

	2000-2001		2001-2002		
	Real Results	November 1 Budget Speech	Preliminary Results	Variation in comparison with the budget	Variation in comparison with 2000-2001 (%)
Equalization	5,650	5,777	4,867	-910	-13.9
Canada Health and Social Transfer	1,597	2,915	2,993	78	87.4
Other Transfers Related to Fiscal Arrangements	30	15	15	--	-50.0
Other Programs	618	531	518	-13	-16.2
Consolidated Organizations	250	422	424	2	69.6
Subtotal	8,145	9,660	8,817	-843	8.3
Property Tax Deferral (Equalization)	--	--	470	470	--
<b>Total</b>	<b>8,145</b>	<b>9,660</b>	<b>9,287</b>	<b>-373</b>	<b>14.0</b>

## FISCAL COMMENTS

Namely to update the economic data and budget forecasts already announced, Pauline Marois, minister of State for the Economy and Finance of Québec, tabled this afternoon a Supplementary Statement to the 2002-2003 Budget, tabled on November 1, 2001.

Here is an outline of the tax measures that were announced.

### MEASURES AFFECTING INDIVIDUALS

#### **Transfer of all non-refundable tax credits from one spouse to the other**

Starting in 2003, the tax system will be improved so that all households may benefit fully from the non-refundable tax credits to which each spouse is entitled.

Accordingly, spouses will be able to transfer to their partners non-refundable tax credits they do not need to bring down their income to zero even if they use the general tax system.

With this improvement, couples – and more specifically the elderly and families – will benefit from a decrease in the tax burden of \$94 million per year.

#### **Deductions and non-refundable tax credits allocated in the simplified system**

The simplified tax system is also improved by allowing households to benefit from the following deductions and non-refundable tax credits:

- deductions for support payments;
- deductions for remote areas;
- tax credits for medical care;
- other deductions and tax credits.

This improvement will bring the tax burden of households down by \$78 million per year.

In addition, the new deductions granted in the simplified system will be considered in calculating the family income. This last change will improve the tax credits and transfer programs that are calculated according to family income.

These changes are also applicable beginning in 2003.

#### **Employees who make deductible support payments or who live in a designated remote area**

There will be a standardization of the net income concept in the general and simplified tax systems. Accordingly, starting in 2003, employees who make deductible support payments or who live in a designated remote area will only need to indicate to the employer, through the Source Deductions Return, an amount they feel can

be taken into account, in the calculation of their income, as a deduction for support payments and a deduction for residents of designated remote areas. These employees will no longer need to make specific calculations.

#### **Tables describing the personal tax system**

Attached to the fiscal comments are tables that summarize the deductions and tax credits that will be granted in the two tax systems and various tax breaks, in the form of deductions or non-refundable tax credits, that will continue to be replaced by the flat amount under the simplified tax system. As indicated, the data will be applicable beginning in 2003.

The shaded parts of the table highlight the deductions and the non-refundable tax credits that, as of the 2003 taxation year, will also be available under the simplified tax system

## **MEASURES AFFECTING BUSINESSES**

### **Employees participating in the Cooperative Investment Plan (CIP)**

The eligible cooperatives may set up a "Cooperative Investment Plan" (CIP) whose goal is to provide their members with a deduction in the calculation of their taxable income when they acquire eligible units of the cooperative.

For any pay period ending after April 30, 2002, when the member is also an employee, the employer must deduct from the remuneration, for the purpose of calculating the Québec source deduction, the deductible amount to acquire preferred units eligible to the CIP. The employer must also deduct from the remuneration paid an amount equal to the contribution consisting of preferred units acquired by the employee through a source deduction from his or her remuneration and transferred by the employer to an RRSP under which the employee or the employee's spouse is the annuitant.

Thus, the amount withheld from an employee's remuneration to acquire qualifying preferred shares in a CIP will give entitlement to a maximum deduction of 250% of the amount withheld.

### **Improvement of various refundable tax credits granted in various regions**

In recent years, three refundable tax credits were set up in order to bolster job creation in Québec's resource regions, 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.

#### Broadening of the notion of eligible employee

These tax credits are granted with respect to increase in payroll attributable to eligible employees of an eligible corporation. The notion of eligible employee will be broadened to allow more eligible corporations to benefit from these tax credits.

#### Refundable tax credit for processing activities in the resource regions

Previously, the recognized processing activities for purpose of this tax credit were as follows:

- the second or third processing of lumber or metals;
- the processing of food;
- the production of non-conventional energy;
- aquaculture or the manufacturing or processing of finished or semi-finished products from precious stones or fine stones.

These activities are broadened to include:

- setting precious stones or fine stones;
- making jewels;
- printing or publishing, including activities relating to typesetting, printing, collating, folding and bundling;
- drying of structural lumber in ovens and planing of structural lumber of a plant.

### **Adjustment to tax assistance regarding E-commerce Place**

E-Commerce Place, located in downtown Montréal, consists of buildings to be constructed on land bounded by de la Montagne, Saint-Antoine and Lucien-L'Allier streets as well as René-Lévesque boulevard.

Briefly, the tax assistance an eligible corporation that moves into E-Commerce Place can claim consists of a refundable tax credit of 35% on the eligible salary, incurred no later than December 31, 2013, and paid to its eligible employees to carry out eligible activities, as well as a five-year tax holiday for foreign experts it employs.

The amount of the tax credit is however limited to \$12,500 per eligible employee.

To further sustain job creation and accelerate the development of E-Commerce Place, the method of payment of this tax assistance may be changed, if the eligible corporation so elects.

Accordingly, an eligible corporation may henceforth elect on an annual basis to receive either the existing refundable tax credit or a refundable credit of employer contributions to the Health Services Fund (HSF).

### **Other measures concerning businesses**

The other measures mainly focus on bringing improvements and broadening the procedural requirements concerning the granting of tax credits in the technological sectors, such as biotechnology and information technology.

## **MEASURES AFFECTING DESJARDINS - BUSINESSES**

### **International Financial Centres (IFC)**

These measures concern some Desjardins entities that operate an international financial centre (IFC).

To ensure that the objectives of the measures relating to IFCs are achieved, various amendments will be brought to the legislation.

A first amendment will be brought in order to specify that all qualified international financial transactions (QIFT) can be carried out in a place other than the place where the activities of the business are located within the territory of the city of Montréal.

The law will also be amended so that discount transactions regarding letters of credit and/or commercial instruments may constitute a QIFT.

Another amendment will be brought so that the back office support carried out on behalf of someone relating to a QIFT and carried out by that person may constitute a QIFT.

Finally, the law will be amended so that money deposit activities, trust services and investment dealing and securities advisement, carried out by an IFC operator for an immigrant investor as part of the Immigrant Investor Program and that are directly related with the program requirement may constitute a QIFT.

## APPENDIX

Table 1.1

**DEDUCTIONS AND TAX CREDIT GRANTED UNDER THE TWO TAX SYSTEMS – 2003 TAXATION YEAR****Deductions in the calculation of net income**

The same amounts will be deductible in the calculation of net income under both tax systems. Essentially, these deductions pertain to:

:

Contributions to a registered pension plan (RPP)  
 Contributions to a registered retirement savings plan (RRSP)  
 Repayments of amounts overpaid  
 Contributions to the Québec Pension Plan (QPP) on income from self-employment  
 Repayments of certain federal benefits  
 Transfers to an RPP, an RRSP or a registered retirement income fund (RRIF)  
 Attendance-care expenses  
 Deductible support payments  
 Residents of designated remote areas  
 Moving expenses  
 Expenses incurred to earn investment income  
 Allowable business investment losses  
 Flow-through shares –100% basic deduction  
 Judicial expenses and expenses relating to an objection  
 Exploration fees incurred in Québec  
 Repayment of a student loan granted under the SLPW

**Deductions in the calculation of taxable income**

Deduction respecting certain benefits (workers' compensation, federal supplements, indemnities from the Société de l'assurance automobile du Québec and certain other income replacement indemnities)  
 Deduction for scholarships, bursaries, and prizes for a remarkable achievement  
 Deduction relating to the Cooperative Investment Plan (CIP)  
 Deduction for assistance granted under certain government programs to defray tuition fees relative to adult basic education  
 Deduction for an Indian or a person of Indian ancestry  
 Deduction for income-splitting  
 Deduction respecting retroactive payments  
 Deduction respecting an amount exempt from income tax under a tax treaty or agreement

**Non-refundable tax credits**

Basic tax credit  
 Tax credits for a person living alone, with respect to age and for retirement income  
 Tax credits for dependent children and other dependants  
 Tax credit for a severe and prolonged mental or physical impairment  
 Tax credit respecting a dependant, other than the spouse, for a severe and prolonged mental or physical impairment  
 Tax credit for charitable donations, gifts to the government and other gifts  
 Tax credit for contributions to authorized Québec political parties  
 Tax reduction in respect of families  
 Tax credits for the acquisition of shares in labour-sponsored funds (FSTQ or Fondation) or in the Capital régional et coopératif Desjardins  
 Tax credit respecting the reimbursement of support payments  
 Tax credit for medical expenses  
 Tax credit for expenses relating to medical care not available in the area of residence  
 Tax credit for moving expenses relating to medical care  
 Foreign tax credit  
 Tax credit respecting support-payment arrears  
 Transfer of non-refundable tax credits from one spouse to the other

**Refundable tax credits<sup>1</sup>**

All refundable tax credits provided for in the taxation system can be claimed under both the simplified and the general tax systems. Essentially, these tax credits are the following:

Québec sales tax (QST) credit  
 Real estate tax refund  
 Tax credit for child-care expenses  
 QST rebate for employees or members of a partnership  
 Tax credit respecting home-support services for seniors  
 Tax credit respecting the housing of a parent  
 Tax credit for medical expenses  
 Tax credit for adoption expenses  
 Tax credit for the treatment of infertility  
 Tax credit for a top-level athlete  
 Tax credit for individuals living in a northern village  
 Property estate tax refund for forest producers  
 Tax credit for taxi drivers or taxi owners  
 Tax credit for the renewal of the stock of taxi vehicles  
 Tax credit for job creation in the clothing and footwear industry  
 Tax credit respecting the maintenance of a racehorse  
 Tax credit respecting the reimbursement of salaries or wages  
 Tax credit for an on-the-job training period  
 Tax credit respecting the income tax paid by an environmental trust  
 Tax credit with respect to the reporting of tips  
 Tax credits for scientific research and experimental development (R&D)  
 Tax credits respecting an international financial centre (IFC) operated by a partnership

—  
<sup>1</sup> Also includes certain refunds granted under a tax law other than the *Taxation Act*.

Note: The shaded parts of the Table highlight the deductions and non-refundable tax credits that, as of the 2003 taxation year, will also be available under the simplified tax system.

TABLE 1.2

**DEDUCTIONS AND NON-REFUNDABLE TAX CREDITS REPLACED BY THE FLAT AMOUNT — 2003 TAXATION YEAR****Deductions in the calculation of taxable income**

Flow-through shares – additional deductions of 25% and 50%  
 Tax holiday for foreign researchers (R&D)  
 Tax holiday for Québec seamen  
 Tax holiday for foreign professors  
 Tax holiday for foreign post-doctoral interns  
 Tax holidays for foreign experts  
 Tax holidays for foreign specialists  
 Deduction respecting a home-relocation loan  
 Deduction respecting certain flow-through share issue costs  
 Deduction for farm losses of part-time farmers  
 Deduction respecting shares received in exchange for mining property  
 Deduction for employees of certain government international organizations  
 Deduction for independent financial derivatives traders  
 Deduction for foreign producers  
 Deduction for options to purchase units of a mutual fund trust  
 Deduction for an eligible rebate  
 Deduction for workers employed abroad  
 Deduction for artists respecting copyright income  
 Deduction for a member of a partnership operating an IFC  
 Deduction for a stock savings plan (SSP)  
 Deduction respecting the donation of securities acquired under a stock option  
 Deduction respecting certified Québec films  
 Deduction respecting Québec Business Investment Companies (QBICs)  
 Deductions for stock options granted to employees  
 Additional capital gains exemption respecting certain resource property  
 Tax exemptions for IFC employees  
 Lifetime \$500 000 capital gains exemption on small business corporation shares  
 Lifetime \$500 000 capital gains exemption on farm property  
 Loss carry-overs (capital losses, non-capital losses, farm losses and fishing losses)

**Non-refundable tax credits**

Tax credit respecting interest paid on a student loan  
 Tax credit for employment insurance premiums  
 Tax credit for contributions to the Health Services Fund (HSF)  
 Tax credit for contributions to the QPP  
 Tax credit for union or professional dues  
 Dividend tax credit  
 Tax credit for tuition or examination fees  
 Tax credit for members of a religious order  
 Tax credit respecting alternative minimum tax carried forward  
 Deduction for logging tax