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*is pleased to provide you with CGA-Canada's commentary and analysis of the 2008 Federal Budget.*

# Budget Highlights

The 2008 federal budget introduces a handful of new initiatives that will affect both individuals and businesses.

The most significant personal tax measure is the introduction of a new Tax-Free Savings Account (TFSA). With personal savings at historic lows, this provides Canadians with a new tax incentive to save their money. The budget also includes a new tax incentive to assist older workers, plus several enhancements to education.

To assist business, the government has introduced significant changes to the federal scientific research and experimental development (SR&ED) tax credit for small and medium sized Canadian controlled private corporations. The budget also provides further support to a manufacturing industry facing hard times by extending favourable tax write-off rates on investments in certain manufacturing and processing-related machinery and equipment.

# What This Budget Means for Individuals

Perhaps the biggest surprise in this year's federal budget was the introduction of a Tax-Free Savings Account (TFSA) to provide Canadians with a new tax incentive to set money aside for their future.

The TFSA, which will be available to Canadian residents 18 and over beginning January 1, 2009, starts off with an annual contribution limit of $5,000; this limit will subsequently be indexed to inflation beginning in 2010. Investment income and capital gains earned from the TFSA will not be taxed.

If, for instance, an individual was able to contribute the limit of $5,000 to their TFSA and earn eight per cent interest of $400, that amount will not be subject to tax. Over time, they may be able to accumulate significant tax-free investment income and capital gains through this new account.

Generally speaking, all investments which are eligible for contribution to a registered retirement savings plan (RRSP) can also be deposited to a TFSA. Like an RRSP, unused TFSA contribution room can be carried forward indefinitely, and taxpayers will also have an opportunity to contribute to a spousal TFSA if their spouse has available contribution room.

Unlike an RRSP, however, TFSA contributions will not be tax deductible, nor will withdrawals from the account be subject to tax. And money can be withdrawn and re-deposited at any time without penalty. Say, for example, somebody had accumulated $40,000 in their TFSA over eight years and wanted to withdraw $25,000 to take an exotic vacation. They could access those funds from their TFSA tax-free and have the opportunity to replenish the $25,000 in future on whatever timetable they desired.

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# What This Budget Means for Individuals

In contrast, had an individual in the 40 per cent combined federal-provincial tax bracket withdrawn $25,000 from an RRSP under such circumstances, they would have been hit with an immediate tax bill of $10,000 on the withdrawn funds; and never have the opportunity to put that amount back into their plan.

Another advantage with the TFSA is that income earned through that account will not affect individuals' eligibility for federal income-tested benefits and credits. This will not, for instance, affect the amount that senior citizens are eligible to collect in old age security.

On death, the TFSA will lose its tax exempt status in that any future income or capital gains will become taxable. This will not occur if the TFSA is transferred to a spouse or common law partner or to his or her own TFSA.

The 2008 budget contains a couple of key financial incentives designed to encourage older income earners to remain in the workforce. It raises the Guaranteed Income Supplement (GIS) earned income exemption level to $3,500 – seven times higher than the current limit of $500. This means individuals who qualify for the GIS can now earn up to $3,500 before their earnings will begin to reduce benefits.

It also provides additional funding to extend the federal government's Targeted Initiative for Older Workers until 2012. This initiative, originally introduced in 2006, is designed to assist unemployed older workers that reside in communities experiencing economic difficulties. It does so through efforts to improve the employability of people – particularly those in the 55 to 64-year age range – via activities such as prior learning assessment, skills upgrading and providing experience in new lines of work.

This year's budget also contains several education-related incentives, including substantive changes to the registered education savings plan (RESP). Contributions can now be made into an RESP for up to 31 years (up from 21 years) after the plan's inception – that limit increases to 35 years (from 25 years) for beneficiaries who are eligible for the disability tax credit.

Furthermore, contributions to family plans now extend to beneficiaries up to 31 years of age, rather than age 21. Under a family plan, more than one beneficiary can be designated to receive RESP proceeds, which can be particularly advantageous if one sibling requires more post-secondary education funding than another. Extending the age limit by ten years means families can now pool education savings for a longer period of time which may, for example, provide significant benefits to an adult child that is attending graduate school.

Another change to the RESP program provides more flexibility for students in respect of the Educational Assistance Payments (EAP) they may receive from the plans. Budget 2008 proposes that students be eligible for receiving EAPs for up to six months after ceasing to be enrolled in a qualifying program.

The 2008 federal budget allocates additional funds to streamline and modernize the Canada Student Loans Program; to establish a new scholarship award for both Canadian and international doctoral students; and to provide additional funding for Canadian graduate scholarship recipients to study abroad. It also establishes a new Canada Student Grant Program, scheduled to begin in 2009.

## Other personal measures include:

- Additional donations of publicly traded securities may become eligible for the capital gains exemption if they involve donations of certain newly acquired public securities that were received in exchange for unlisted securities; and are then donated to a registered charity within 30 days of that exchange. This provision applies for donations made on or after February 26, 2008. There are several special rules that apply to these transfers, so taxpayers should discuss this with their tax advisors before using these new provisions.
- Increased flexibility for Canadians to remove proceeds from their locked-in life income fund (LIF) pensions. Budget 2008 provides three opportunities in this regard. Individuals who are 55 or older with holdings of up to $22,450 will be able to wind up their accounts with an option of converting the LIF proceeds to a tax-deferred savings vehicle. People in that age group can also convert up to 50 per cent of their total LIF holdings, regardless of amount, into a tax-deferred savings instrument. Alternatively, all individuals facing financial hardship, such as a medical emergency or severe disability, will be able to unlock up to $22,450 from their plan.
- Reduced record-keeping required with respect to automobile expense deductions and taxable benefits. Final administrative details have yet to be worked out, but the budget proposes that maintaining a detailed logbook over a sample period of time should be sufficient to support calculations involving motor vehicle expenses and taxable benefits.
- Streamlined cross-border tax withholding and return-filing rules.

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## What This Budget Means for Business

The 2008 budget also contains a few significant business measures, including enhanced tax incentives for small and medium sized Canadian controlled private corporations (CCPC) wishing to claim a scientific research and experimental development (SR&ED) tax credit.

The SR&ED expenditure ceiling for which investment tax credits (ITC) of up to 35 per cent can be claimed has been increased to $3 million (from $2 million). Furthermore, in order to assist CCPCs grow, the upper limit of the taxable income phase-out range which determines eligibility to claim the favourable CCPC ITC rate has been raised from $600,000 to $700,000, with the top threshold for taxable capital of eligible firms significantly increased from $15 million to $50 million.

These new limits take effect for corporate tax years ending on or after February 26, 2008.

The budget also proposes to extend the new SR&ED ITC provisions to include certain activities, within expenditure limits, that are carried on outside of Canada.

Adjustments to the federal dividend tax credit (DTC), to take effect in 2010, were also announced. Budget 2008 proposes to adjust the dividend gross-up factor

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# What This Budget Means for Business

and DTC rate for eligible dividends to reflect scheduled corporate income tax rate reductions.

The eligible dividend gross-up will reduce from its current level of 45 per cent, to 44 per cent in 2010, 41 per cent in 2011 and 38 per cent in 2012. The enhanced DTC rate will reduce from its current level of 11/18 of the gross-up amount, to 10/17 in 2010, 13/23 in 2011 and 6/11 in 2012. Thus, the effective credit resulting from these changes will align with the scheduled general corporate tax rate of 18 per cent in 2010, 16.5 per cent in 2011 and 15 per cent in 2012.

Another substantive business measure in the 2008 document involves extending the accelerated two-year 50 per cent straight line capital cost allowance (CCA) treatment for capital investment in certain manufacturing and processing related machinery and equipment until December 31, 2009.

Straight line CCA, as opposed to writing off costs on a declining balance, reduces taxable business income faster.

Those favourable rates will, however, be phased out in 2010 and 2011. Assets acquired in 2010 will be subject to a declining balance rate CCA of 50 per cent during their first year in operation, followed by 40 per cent the second year, and 30 per cent thereafter. Assets acquired in 2011 will be subject to a declining balance of 40 per cent in the first year; followed by 30 per cent thereafter.

## Other business measures include:

- Additional funding to help support Canada's troubled forestry sector, which has been hit hard by the economic slowdown in the United States, especially in terms of supplying that country's depressed housing market; and
- The extension of GST/HST relief with respect to land leased for the purpose of locating wind or solar-power equipment used to produce electricity.
- Administrative changes with respect to the late remittance of income tax source deductions due on or after February 26, 2008 – from a 10 per cent fixed penalty to a graduated penalty as follows:
  - 3 per cent for remittances received up to and including three days late
  - 5 per cent for remittances received four or five days late
  - 7 per cent for remittances received six or seven days late
  - 10 per cent for remittances received more than seven days late.

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