



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Highlights of 2008 Federal Budget

The budget contains many expected items referred to in recent weeks in the media (e.g., help for the automotive industry). Below is a summary of measures we believe to be most relevant to IIAC members.

Of interest to retail members

Tax-free savings account (TFSA): Effective 2009, Canadians older than 17 (and with no age limit) will be allowed to save up to \$5,000 yearly in a TFSA. TFSAs will be managed by the Canada Revenue Agency in the same way RRSPs are and TFSA issuers will have to file annual information returns. Contributions will not be deductible but investment income, including capital gains, will accumulate and can be withdrawn for *any* purpose tax-free. Unused TFSA contribution room can be carried forward to future years and amounts withdrawn can be put back in the TFSA at a later date without affecting contribution room (the annual amount or unused room carried forward). Neither income earned in a TFSA nor withdrawals will affect eligibility for federal income-tested benefits and credits. Like RRSPs, contributions can be made to a spouse's TFSA and TFSA assets can be transferred to a spouse upon death without deductions. Interest on money borrowed to invest in a TFSA will not be deductible; TFSA assets can be used as collateral. In contrast, contributions to RRSPs are deductible and withdrawals are added to income and taxed at rates in effect at withdrawal (other details are available). The same assets as qualify for RRSPs will qualify for TFSAs except to the extent that they are not at arm's length with the investor.

Locked-in Funds (LIFs): Individuals 55 or older will have more flexibility in light of an increase in "partial" retirements; they will be: (a) able to, if their account holds \$22,450 or less, wind up their accounts with an option to convert to a tax-deferred savings vehicle; (b) entitled to a one-time conversion of up to 50 per cent of LIF holdings into a tax-deferred savings vehicle with maximum withdrawal limits; (c) able to unlock up to \$22,450 for financial hardship reasons.

Registered education savings plans (RESPs): The budget extends the maximum contribution period by increasing the time RESPs may remain open from 25 to 35 years.

Dividend tax credit: Adjustments will be made in 2010 through 2012 to adjust the dividend tax credit down to reflect the reduction in corporate income tax rates – this was not unexpected.

"Specified Investment Flow-Through" trusts and partnerships (SIFTs): The SIFT tax applicable on distribution of non-portfolio earnings from publicly traded income trusts (including business and energy trusts) and partnerships (for SIFTs that existed on October 31, 2006, the SIFT Tax will not apply until 2011, as long as their growth does not exceed certain limits). The provincial component of the SIFT tax will be based instead on the general provincial corporate income tax rate in each province in which the SIFT has a permanent establishment to ensure that the rate of the tax is the same as the federal-provincial tax rate for large public corporations with the same activities. Taxable distributions not allocated to any province would be subject to

a 10 per cent rate constituting the provincial component. Taxable distributions allocated to Quebec will be deemed to be nil to take into account the SIFT tax imposed by that province.

Donations of securities: The budget will exempt capital gains on certain exchangeable securities where the securities acquired on the exchange are eligible for the exemption and are donated to a registered charity within 30 days of the exchange; a provision will be made to measure the exempt capital gain if the exchangeable security is a partnership interest.

Cross-border withholding and filing rules: The budget exempts dispositions by non-residents of treaty-protected property from withholding requirements; ensures that a person that buys property from a non-resident is not liable for withholding tax in certain circumstances; and eliminates the need for a non-resident to file a Canadian income tax return in certain circumstances where no Canadian tax is payable.

Of interest to institutional/corporate finance firms

Scientific research and experimental development (SR&ED) tax credits: R&D benefits for CCPCs will be enhanced: from expenditures of \$2 million to \$3 million, from a taxable capital phase-out at \$50 million (up from \$15) million; from a taxable income phase-out of \$700,000 (up from \$600,000); to allow 10 per cent of costs to be from offshore expenditures in limited circumstances (e.g., access to a desert or tropical climate); and to include administrative improvements.

Bank of Canada: The *Bank of Canada Act* will be updated to provide for “new core instruments” for the Bank to use for the stability of the financial system. These are likely to be released following the expected April 2008 release of the report of the Financial Stability Forum set up by the G7 finance ministers to examine “recent events” (understood to mean subprime, asset-backed commercial paper, lack of transparency and contagion). Priorities identified, when the ministers met in February, which will likely lead to action are: disclosure of losses and risk exposures by financial institutions, liquidity risk management, incentives structures in the financial industry, rating agencies and Basle II capital adequacy. The IIAC will be monitoring for and may respond once this is released.

Crown corporation borrowings: As announced last year, starting April 1, 2008, the government will fully consolidate borrowings for the Business Development Bank of Canada (BDBC), Canada Mortgage and Housing Corporation (CMHC) and Farm Credit Corporation (FCC) into the federal debt program, enhancing liquidity and saving on the spread. The Export Development Corporation (EDC), Canadian Wheat Board and Canada Housing Trust will continue to fund separately in the marketplace.

Mineral Exploration Tax Credit (METC): The METC is extended for an additional year to flow-through share agreements entered into on or before March 31, 2009; funds raised with the credit during the first three months of 2009 can support eligible exploration until the end of 2010.

Capital cost allowance (CCA): The 50-per-cent straight-line accelerated treatment for investment in machinery and equipment is extended for a year and on a declining basis over a two-year period.

Venture capital: The budget provides for \$75 million to be given to the Business Development Bank of Canada to fund a new privately run venture capital fund.

For All Members

Administrative burden reduction: The government will continue to implement reviews of all departmental spending over a four-year cycle with the savings realized going to fund new initiatives in these organizations and elsewhere. The Canada Revenue Agency is supposed to be saving \$5.9 million in 2008-09; \$14.3 million in 2009-10; and \$23.9 million in 2010-11 through better use of technology and more effective use of internal resources.

Paperwork simplification: Record-keeping requirements for automobile expense deductions will be simplified.

Staff shortages: Changes will be made to the immigration system that are aimed at accelerating bringing in immigrants with critical skills.

What's not there... for now

TSX and Montreal Exchange shares: Long-promised legislative and regulatory changes to clarify treatment of gains on TSX and ME shares, tabled in draft in November 2007, are "earmarked" for release with the second stage of budget legislation (following release of the Ways and Means Motion this week) – this is now expected in June of this year.

Registered retirement investment funds (RRIFs): The IIAC's requested account transfer option was not accepted; Finance officials in the lock-up pressed the IIAC to get credit unions, caisse populaires and insurance companies to buy in and the IIAC will be undertaking further work in this regard.

SR&ED for small public and mid-sized private companies: SR&ED benefits were not extended to companies that have just gone from private to public, nor to being refundable benefits as the IIAC had requested; Finance officials in the lock-up said that SR&ED benefits were not phased out on becoming public due to concerns regarding understanding ownership relationships, an argument that had not been heard before and which will be investigated further.

GST legislation changes: The budget continues to mention that un-GST-harmonized provinces could benefit businesses in their jurisdictions the most by harmonizing their sales taxes to broaden the base, reduce the rate and reduce tax on tax built into prices. Also, changes specific to financial services, tabled in draft in January of last year, are "earmarked" for release with other budget-related amendments in the second stage of budget legislation in or around June 2008. These are expected to have some negative consequences for some members and a member-only session with a GST expert is being arranged for March 20.