

2008 Federal Budget

An Advisor's Summary
February 26, 2008

ADVISOR.CA



THIS **ADVISOR.CA** SPECIAL REPORT
IS SPONSORED BY:





Looking for the right investment solution for your client? It pays to have choices.

Having choices can make all the difference when you're selecting the right mutual funds for your clients. As an advisor, it means you can meet not only your clients' needs, but also the needs of your business as well. At TD Mutual Funds, we have a wide range of investment solutions to choose from, including domestic and global mutual funds and various industry-sector choices. As a Canadian leader in managed solutions since 1998, we also offer the TD Managed Assets

Program, which provides a full range of well-diversified portfolios. Our extensive line-up of investment solutions has unique and competitive features, including tax-efficient structures as well as multiple load and fee-based options. Consistently ranked by Morningstar® as an industry leader for excellence in fund management, TD Mutual Funds has what you and your clients are looking for. After all, having the right choices can make all the difference.

**Call your Regional Sales Team or Dealer Services
at 1-800-588-8054 or visit www.tdadvisor.com**

 **Mutual Funds**

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus, which contains detailed investment information, before investing. Mutual funds are not guaranteed or insured, their values change frequently and past performance may not be repeated. TD Mutual Funds and the TD Managed Assets Program are managed by TD Asset Management Inc. a wholly owned subsidiary of The Toronto-Dominion Bank and are available through authorized dealers. ® © 2007, Morningstar is a registered trademark of Morningstar Research Inc. All rights reserved. TD Mutual Funds and TD Managed Assets Program are trade-marks of The Toronto-Dominion Bank, used under license.

BY

KATE McCAFFERY



OVERVIEW

SHELTER FOR YOUR INVESTMENT GAINS

(Ottawa) An economic downturn might be coming and this government wants you to save for a rainy day. It hopes to encourage Canadians to do just that by introducing Tax-Free Savings Accounts.

This cornerstone in the 2008 Federal Budget was the first, and arguably the largest initiative announced. Finance Minister Jim Flaherty's speech on Tuesday, February 26, 2008, spelled out plans to allow Canadians to contribute up to \$5,000 every year to the registered plans, plus carry forward any unused room to future years. The \$5,000 is indexed to inflation and annual additions to contribution room will be rounded to the nearest \$500.

The TFSA accounts are similar to United States Roth IRA accounts and tax-free savings accounts in the United Kingdom that allow taxpayers to contribute after-tax income to tax-free savings accounts. In the U.S., Roth IRA accounts allow clients to contribute \$5,000 every year. Those over 50 years of age are allowed to contribute \$6,000 each year. In the UK, the annual contribution limit is 7,200 pounds.

The proposed savings accounts for Canadian taxpayers allow investment income and capital gains in the TFSA plan to accumulate tax-free – the funds are not subject to tax, even when clients withdraw the assets. Further, funds withdrawn from the accounts actually free up contribution room, allowing clients to replace the investment, spend gains and contribute again, all without affecting federal income tested benefits or credits like the Canada Child Tax Benefit, Goods and Services Tax Credit, Old Age Security Benefits, Guaranteed Income Supplement or Employment Insurance benefits.

"This will be especially helpful for people in their early 50s who, for whatever reason, have not done as much planning for retirement as they would like to have done," says Peter Drake, chief economist at Fidelity Investments Canada. "For people who need to try and accelerate the rate at which they're saving, this will give them some tax advantages. It's not the

BUDGET HIGHLIGHTS

Tax-Free Savings Accounts: Contribution limits of \$5,000 a year, adjusted for inflation in \$500 increments for those 18 and over. Post-tax contribution, no tax on withdrawals. Contribution room can be accumulated, and withdrawals create more contribution room. Spousal rollover on death. Withdrawals don't affect means-tested benefits.

Canada Student Grants: \$350 million in grants to replace Canada Millennium Scholarship Fund.

Canada Graduate Scholarships: \$25 million over two years.

RESPs: Accounts can be held for 35 years instead of 25. Contribution period extended by 10 years.

GIS: Earnings clawback kicks in at \$3500 instead of \$500.

Mineral Exploration Tax Credit: Extended until end of 2009.

Dividend Tax Credit: Reduced gross-up and DTC to reflect lower corporate income tax rates, effective in 2010.

barn-burner that RRSPs were when they first came out, but institutionally it is another place to put some money."

If the budget is passed, Canadians over the age of 18 could save up to \$5,000 every year, beginning in 2009. Contributions to a TFSA would not be deductible for income tax purposes. Unused contribution room could be carried forward to future years, spousal contributions would be allowed and TFSA assets could be transferred to a spouse upon death – surviving spouses would be able to roll the assets into their own savings accounts or hold both accounts +

SHELTER FOR YOUR INVESTMENT GAINS

separately. Although surviving spouses would not be allowed to make use of their deceased spouse's unused contribution room, the rollover makes their own account larger, without reducing their own contribution room.

The new accounts offer a number of interesting planning opportunities for clients and financial advisors. For seniors over 71 who can't contribute to their RRSP, "this is an alternative to create tax deferred investment income," says Dave Clarke, senior manager, Collins Barrow Ottawa, LLP. "A lot of seniors living off their investments will be able to contribute to this account, earn tax free income and withdraw to pay their living expenses. That income would be taxed outside of this plan."

Those planning to make use of the Home Buyer's Plan (HBP) to purchase a house can also invest in the accounts to build a larger down payment, more quickly once their RRSP balances exceed the \$20,000 withdrawal limit allowed under the HBP.

"And obviously, it's great for people who've maxed out their RRSPs and are looking for other ways to shelter investment income," says Clarke.

When planning for those who haven't yet maxed out their RRSPs, however, Clarke says RRSP contributions still make more sense – "more bang for your buck" – unless clients are saving for something specific, simply because clients defer initial income taxes. "Where people will need guidance is in defining their savings objectives, and then choosing the best vehicle to help them get there."

On the advice front, it also pays to remind clients to be wary of their contribution room limits; excess contributions would be subject to a tax of 1% each month.

Clients who become non-residents of the country would be allowed to maintain their TFSA holdings, with tax exempt benefits, but no contributions would be permitted while the individual is non-resident. Budget documents do not suggest the government has any plans to allow in-kind share transfers at this stage.

The accounts would generally be permitted to hold the same investments allowed in a Registered Retirement Savings Plan,

including mutual funds, public securities, government or corporate bonds, guaranteed investment certificates and, in certain cases, shares of small business corporations. TFSAs would not be able to hold investments in any entities with which the account holder does not deal at arm's length. For this purpose, specified shareholders, generally those with a 10% or greater interest in the company or investment in question, either personally or as part of a group, are not able to hold that investment in a tax-free account.

Other measures

In addition to the Tax-Free Savings Accounts, several other measures were tabled in this year's federal budget for business owners, students, seniors and clients with certain medical expenses.

Seniors: In addition to past changes that doubled the pension income amount to \$2,000, increased the Age Credit amount by \$1,000, increased the age limit for maturing RPPs and RRSPs from 69 to 71 and allowed pension income splitting for seniors and pensioners, the proposed budget would increase the amount that seniors could earn – from the current maximum exemption level of \$500 to \$3,500 – before their Guaranteed Income Supplement was clawed back.

Medical expenses: According to government documents, the list of eligible expenses under the Medical Expense Tax Credit is reviewed regularly and updated in light of new technologies and other disability-specific or medically related developments. This year, the budget proposes to add altered auditory feedback devices for speech disorder treatment, electrotherapy devices for the treatment of medical conditions or severe mobility impairment, standing devices to help severe mobility impairment and pressure pulse therapy devices for the treatment of balance disorders. The budget also proposes to extend eligibility and recognize expenses for service animals trained to assist those affected by autism or epilepsy. Currently, only expenses for service animals trained to assist deaf or blind patients are recognized.

Students: The children of those contributing to Registered Education Savings Plans could have an additional 10 years to make use of the accumulated assets – proposed changes +

SHELTER FOR YOUR CAPITAL GAINS

increase the amount of time an RESP may remain open from 25 years to 35 years. The proposal also extends the maximum contribution period by 10 years. Changes to plan termination limits and the maximum contribution period would apply to all existing and future RESPs, effective January 1, 2008.

As the Canadian Millennium Scholarship Foundation winds down, the government also plans to invest in a consolidated Canada Student Grant Program, aimed at reaching 245,000 college and undergraduate students each year, beginning in the fall of 2009. It also plans to provide \$25 million over two years to establish a new graduate scholarship award for top Canadian and international doctoral students, plus \$3 million over two years to establish a new international study stipend for the graduate scholarship recipients who wish to study at international institutions. The budget also proposes to streamline the Canada Student Loans Program.

Business owners: For businesses in the manufacturing or processing sectors, the budget proposes to implement three years of accelerated capital cost allowance (CCA) treatment that will allow business owners purchasing manufacturing and processing equipment between 2009 and 2011 to write off that equipment at an accelerated rate over the three year period.

The budget also proposes to reduce the record-keeping requirements for automobile expense deductions.

Non-residents: Those buying Canadian property from non-residents, non-residents trying to sell their Canadian property, and those who are exempt from paying Canadian income taxes under international tax treaties could benefit from streamlined cross-border tax-withholding and return filing rules.

A.C.A.

Kate McCaffery is practice management editor of Advisor.ca. kate.mccaffery@advisor.rogers.com

NET PROCEEDS FROM SAVING IN A TFSA RELATIVE TO OTHER SAVINGS VEHICLES

| | TFSA | RRSP | Unregistered Savings |
|--|-------|-------|----------------------|
| Pre-tax income | 1,000 | 1,000 | 1,000 |
| Tax (40% rate) | 400 | – | 400 |
| Net contribution ¹ | 600 | 1,000 | 600 |
| Investment income (20 years at 5.5%) | 1,151 | 1,918 | 707 ² |
| Gross proceeds | | | |
| (Net contribution + investment income) | 1,751 | 2,918 | 1,307 |
| Tax (40% rate) | – | 1,167 | – |
| Net proceeds | 1,751 | 1,751 | 1,307 |
| Net annual after-tax rate of return ³ (%) | 5.5 | 5.5 | 4.0 |

¹ Forgone consumption (saving) is \$600 in all cases. In the RRSP case, the person contributes \$1,000 but receives a \$400 reduction in tax, thereby sacrificing net consumption of \$600.

² For unregistered saving case, tax rate on investment income is 28%, representing a weighted average tax rate on an investment portfolio comprised of 30% dividends, 30% capital gains and 40% interest.

³ Measured in relation to forgone consumption of \$600. Assumes annual nominal pre-tax rate of return is 5.5% invested for 20 years.

BY

STEVEN LAMB



ECONOMIC FORECAST

TORIES CHART A CAUTIOUS COURSE

(Ottawa) There's nothing like a minority government to bring out the generous side of any political party. But having lavished tax breaks on Canadians since 2006, Stephen Harper's Conservative government had to dig deep to find new ways to help taxpayers save, while not tipping the government into a deficit position.

Finance Minister Jim Flaherty already tallied up \$60 billion in tax cuts – spread over five years – in the October Economic Statement, limiting his ability to cut much more. This time around, the government says its top priority is to guide the country through an expected economic downturn.

“Mr. Speaker, the budget is balanced. Taxes have been cut,” Flaherty said in the opening of his budget speech. “Our government is meeting the challenge of global economic uncertainty with a plan that is real. A plan that is responsible. A plan that is working.”

Absent from the Conservative government's 2008 Federal Budget were any direct cuts to personal income tax. While Flaherty touted his past cuts – ranging from raising the basic personal amount to cutting the GST to 5% – this budget he declined to further extend this generosity. The focus has now shifted from leaving money in Canadian's pockets to encouraging them to save it.

“A lot of this budget lays the groundwork for longer-term plans,” says Peter Drake, chief economist at Fidelity Investments Canada. “The government, having already spent a bunch of money on tax cuts, doesn't have a lot of room to move.”

Storm clouds on horizon

In last year's budget, the government predicted a surplus of \$9.2 billion, which would be used to pay down debt. The actual number is now expected to be \$12.9 billion, with \$10.2 billion slated for debt reduction. But the budget hints at rougher times ahead, with a projected surplus of \$3.8 billion in 2008-2009

and \$3.0 billion in fiscal 2009-2010. From these surpluses, the government plans to pay down \$2.3 billion in 2008-2009 and \$1.3 billion in 2009-2010.

In the longer term, the budget predicts a surplus of \$3.1 billion in 2010-2011 and \$5.3 billion in 2012-2013. From these surpluses, the government says it will be able to pay down a further \$3 billion in debt per year. Such aggressive repayments could put the government in a tight spot in 2010-2011, with just \$100 million left over after tax cuts and debt repayment.

“The concern I have with the overall fiscal stance is that the situation has deteriorated from the fall fiscal update,” says Drake. “They had \$3 billion which could be used as a contingency fund, which the government earmarked for debt reduction if it's not used, plus about \$1.6 billion surplus on top of that. Now they've eliminated the planned \$1.6 billion surplus and reduced the \$3 billion to \$1.3 billion. At a time of uncertainty, I might have wanted to hold on to that \$3 billion in case things get worse than they look now.”

While he appreciates some of the tax cuts the government put into place in the fall statement, Drake says others – namely the reduction of the GST to 5% – are ill-advised. “It's great politics but lousy economics. You should tax incomes as little as possible and tax consumption. That way you give people the choice of whether to invest or consume.”

Citing private-sector forecasters, the government expects real gross domestic product growth of just 1.7% in 2008, down from the 2.4% predicted in the fall Economic Statement but roughly in line with the International Monetary Fund's prediction of 1.8% released on Monday. The budget also lowers growth expectations for 2009, to 2.4%, down from the 2.7% predicted in October.

Budgetary revenues for the year ending March 31, 2008, are projected to total \$244.5 billion. According to government estimates, revenues will dip in fiscal 2008-2009 to \$241.9 +

billion, before rebounding in 2009-2010 to \$252 billion.

Program expenses, meanwhile, are expected to climb from \$201.1 billion in 2007-2008 to \$218.2 billion by 2009-2010. Program spending will be \$30 billion higher in 2009-2010 than in 2006-2007.

Despite the slower growth expectations, the government is sticking to its 2006 promise to offer tax cuts equivalent to the interest savings realized by debt retirement. This “tax-back guarantee” is expected to deliver \$2 billion in additional tax cuts by 2009-2010.

If the government is able to meet the projected debt

repayment schedule, the country will have shed \$50 billion in debt since 2005.

The budget also serves up tax savings to the manufacturing and processing sectors, allowing businesses to temporarily apply a two-year 50% straight-line accelerated capital cost allowance (CCA) treatment for investment in machinery and equipment. This measure is expected to cost the government about \$1 billion.

Flaherty also reiterated his pledge to streamline the Canadian financial system. In addition to last week’s creation of the Expert Panel on Securities Regulation, the finance minister pledged to overhaul the authority of the Bank of Canada and issue guidelines for federal entities to follow similar financial risk management strategies as the private sector.

While details are sketchy, the government promised that the Bank of Canada reforms will “support the stability of the financial system and the conduct of monetary policy.”

The government used the budget to announce a structural change to the Employment Insurance system, which will be set up as a separate, arm’s length Crown corporation. This structure would give the program independence similar to that of the Canada Mortgage and Housing Corporation, though it would not be as “arm’s reach” as the Canada Pension Plan, which is under the joint stewardship of the federal and provincial governments.

Social spending

The budget allocates \$350 million to the consolidated Canada Student Grant Program for 2009-2010, which will rise to \$430 million in 2012-2013. Drake points out that while education spending will not improve productivity in the near term, the pay-off down the road is immense.

The budget also expands the list of eligible expenses under the Medical Expense Tax Credit to include treatments for speech disorders, therapy devices for the treatment of mobility impairment and treatment of balance disorders.

The credit will also cover the cost of acquiring and keeping assistive animals for those with autism or epilepsy. This credit is already available on guide dogs for the blind and deaf. +



COMPILED BY
HEIDI STASESON

Heidi Staseson is associate editor of Advisor's Edge.
heidi.staseson@advisor.rogers.com

WORTH REPEATING

On the Whole

“There’s a lot of uncertainty in the capital markets. The government’s moving forward with its competitive investment agenda. We saw some very substantial tax cuts for business in October – the backbone for the agenda – and he’s added to that...that’s very positive on the investment front.” *Ian Russell, president and CEO, Investment Industry Association of Canada (IIAC)*

“The government continues to take steps to establish a solid financial foundation that will allow Canada to generate further economic growth and remain competitive in the global economy.” *Nancy Hughes Anthony, president and CEO, the Canadian Bankers Association (CBA)*.

“Today’s budget is very good news for the Canadian venture capital and private equity community... The CVCA looks forward to an ongoing and productive dialogue with the Government of Canada on issues facing our industry and on our collective ability to foster the development of our industrial and technological base.” *Rick Nathan, president, Canada’s Venture Capital and Private Equity Association (CVCA), and Managing Director, Kensington Capital Partners Ltd.*

Green pledges

The budget earmarks \$500 million for investments in public transit, although no specific projects have been announced.

Another \$250 million will be devoted to research and demonstration of carbon capture technologies. Transporting

all that carbon to sequestration sites will be a massive undertaking, so the government has increased the capital cost allowance on the construction of CO2 pipelines. **ACA**

*Steven Lamb is news editor of Advisor.ca.
steven.lamb@advisor.rogers.com*

WORTH REPEATING

Tax-Free Savings Accounts

“There’s something in there for the beleaguered investor, and saver, if you will. It supplements the RRSP. That’s a positive – especially to help Canadians save for their retirement. It’s recognition that there wasn’t enough tax room for Canadians [previously] to save for their retirement.”

Ian Russell, president and CEO, Investment Industry Association of Canada (IIAC)

“IFIC has been suggesting a very similar program to the government over the past two years. The mutual fund industry has long taken the stand that the federal government should help Canadians save for themselves and be less reliant on the government programs in the years ahead. The TFSA takes Canadians down that road.”

Joanne De Laurentiis, president & CEO, The Investment Funds Institute of Canada (IFIC)

“Anything that encourages Canadians to save is a good measure. We’re looking forward to working with the government to implement this savings vehicle.”

Nancy Hughes Anthony, president and CEO, the Canadian Bankers Association (CBA)

“You have more timing options. You can avoid clawbacks of government benefits and you don’t have to worry about when you withdraw – even if the tax rate is high. It allows you to shelter some more investment income without paying taxes. RRSPs are still better overall for investing for retirement. But TFSAs are better if you cannot time your withdrawal as well. They’re good for a few emergencies here and there; it’s a good rainy-day fund.”

Amin Mawani, MA, LL.M, PhD, FCMA, CFP, associate professor of taxation, Schulich School of Business, York University

“The TFSA will eliminate the need for asset classes like T-class mutual funds... You are not being taxed at all and it really is a great incentive to start saving right away. Anybody who is saving any money should be immediately moving their money into the TFSA.”

Peter Ficek, Calgary-based independent CFP

“I fear it will ultimately prove to be more beneficial to high-income earners rather than to low-income earners. Whatever one hand takes, the other hand takes back. So the good news about an RRSP is you get a deduction and if you’re a high-income earner you’re getting a bigger deduction because you’re in a higher tax bracket. This [TFSA], of course, doesn’t allow you any deduction; you just put the money in after regular, after-tax income. And when you take it out you pay no tax on it. My sense is that most Canadians who are earning enough money to maximize their RRSPs are earning a six-digit income or close. The people who are earning lower incomes are not able to maximize their RRSPs. There is hundreds of billions of dollars of unused contribution room in Canada in RRSPs. The people, in my view, who will ultimately be in a position to take advantage of this tax-deferred savings account will be the people who are maximizing their RRSPs, which is to say the people who are in the top three or four per cent of Canadian income earners. And that, to me, is disconcerting, because although frankly it is a great idea, it is not fair in terms of who will be in a position to take advantage of it. It will likely skew disproportionately toward high-income earners who will benefit from it. I’m still glad that it’s there but it will not be a particularly egalitarian move.

John De Goey, CFP, senior financial advisor, Burgeonvest Securities, author of The Professional Financial Advisor II

BY

BRYAN BORZYKOWSKI

FOCUS ON RETIREES



RETIREES BENEFIT FROM TAX-FREE SAVINGS ACCOUNT

It may not have been a spending budget, but there was much for savers, particularly seniors.

Cynthia Kett, a CFP at Stewart & Kett Financial Advisors, applauds the introduction of the new tax-free savings account. "It helps everybody," she says. "I think they were smart to do that for the dollar value that's involved."

In particular, the new account helps wealthier retirees who are withdrawing money from their RRSPs. "They can reinvest into this registered tax-free savings account and continue to tax shelter that investment income."

Bruce Taylor, a senior financial advisor at Assante Capital Management, also lauds the new savings account as a useful tool for seniors, but agrees with Kett's assessment that the account helps wealthier clients most. "It helps those with money, because those that don't have the money won't be able to throw anything at it. It's something for the haves and not so much for those that are struggling to pay down debts and invest in RRSPs or other things."

Cash-rich retirees might choose to use the TFSA as their "fun" account, he adds, which would allow them to save for specific things like a vacation or a big purchase.

"The tax-shelter investment account is great news," adds Derek Burleton, associate vice-president at TD Economics.

Burke says the fact that people can contribute without it affecting RRSP payments is important. "It provides another vehicle above and beyond RRSPs to save for retirement. We all know the power of compounding tax-free savings so it's a powerful new instrument."

One of the account's more attractive features is that it allows people to withdraw money at any time, without penalties. As well, if your client doesn't contribute the entire \$5,000 in the year, the unused portion carries over.

For younger retirees who still want to work part-time, this account allows them to save some of the money they'll earn, which they can use down the road.

"There's been a trend to semi-retire at earlier ages so people are starting to scale back income earlier," says Kett. "This gives them the opportunity to still earn some money and not spend it all."

In fact, if someone retiring at 55 puts \$5,000 away per year, at a 6% rate-of-return, they will have just over \$395,000 in the account by the time they hit 85.

"That extra money can benefit their beneficiaries or save to provide for increased health care costs at the end of their life span," says Kett.

Taylor points out that the new account won't just assist retirees; it will also help younger Canadians save for their golden years.

"The objective from the government's standpoint is to ensure more money is being put into a savings account as opposed to spending," he explains. "Therefore people need to take more responsibility for their retirement planning and here's a chance to throw in \$5,000 into a free account."

Kett adds that retirees with university-aged kids might use this account as a way to help their children buy a house. "If parents were inclined to contribute to the plan on their behalf, by the time they're ready to retire they can buy a house for their children."

Besides the tax-free savings account, the only other significant announcement for retirees is that Canadians can now make \$3,500 a year – up from \$500 – without affecting their Guaranteed Supplement Income payments.

The figure, says Taylor, is still small, but it could help lower- +

RETIREES BENEFIT FROM TAX-FREE SAVINGS ACCOUNT

income earners make a bit of extra money without being hurt financially.

Burleton agrees. "This will certainly assist some older Canadians, particularly at the low end of the spectrum," he says.

While Kett is pleased to see the amount increase, she admits it might not be significant enough. "It will allow seniors to do the odd thing and be paid for it, but I'm not sure it'll make a big difference."

Where it could come in handy is with seniors who take care of

their grandchildren. "They can help out with childcare without it affecting their GIS," she says. "A lot of grandparents look after grandchildren, now they can earn money doing something like that."

Other than the savings account and the GIS-related increase, there's not much else for seniors to take away from the new budget. "It's pretty dead financially," says Taylor. "The \$5,000 is nice, but it is good for those with money." [A.CA](#)

Bryan Borzykowski is investments reporter for Advisor.ca. bryan.borzykowski@advisor.rogers.com

WORTH REPEATING

Tax-Free Savings Accounts

"Taxpayers would be better off holding interest-earning investments rather than capital-gains earning investments inside their TFSAs and RRSPs, since capital gains are not taxed until realized even outside the TFSAs."

Amin Mawani, MA, LL.M, PhD, FCMA, CFP, associate professor of taxation, Schulich School of Business, York University

"There's nothing particularly offensive of that idea. It's of limited value, it will help a relatively small number of people – probably those who are in the upper income brackets mostly. The tax incentive is on the money coming out, not on the money going in. So unlike Registered Retirement Savings Plans, you don't get a tax break going in. Unlike Registered Education Savings Plans you don't get a matching grant going in. It's all after-tax money. Now, how many Canadians have today, [at] this minute, \$5,000 tax paid, that they could just drop into a plan like this? It would be a relatively small number. We have calculated that when you look at how much the government thinks it will forego in terms of revenue lost on this measure, it works out in the first year to about \$2 per Canadian. And after five years, it's only \$10 per Canadian. So it's a modest proposal. It's not something that you would vote against, but it's no panacea either."

The Hon. Ralph Goodale, Member of Parliament for Wascana, Official Opposition House Leader

Cross-Border Taxation

"Significant barriers to cross-border investment – the onerous Section 116 and non-resident tax filing requirements – are now being eliminated. These changes will promote the growth of the Canadian venture capital and private equity markets at no cost to Canadian taxpayers."

Rick Nathan, President Canada's Venture Capital and Private Equity Association (CVCA), and Managing Director, Kensington Capital Partners Ltd.

Grants for Students

"It's an investment in human capital which will generate higher tax revenues for the government down the road. You pump them up, make these kids smarter, they'll make more money and pay you more taxes tomorrow."

Amin Mawani, MA, LL.M, PhD, FCMA, CFP, associate professor of taxation, Schulich School of Business, York University

BY

MARK NOBLE



FOCUS ON WORKING FAMILIES

TFSA CHANGES GAME PLAN FOR INVESTORS

It doesn't rival the RRSP yet, but the newly proposed Tax Free Savings Account might be just as important an investment vehicle down the road for working families, experts say.

The 2008 Federal Budget, proposes that starting in 2009, Canadian investors will be able to put in \$5,000 a year in a TFSA. Contributions to the TFSA will not be tax-deductible as they are for an RRSP, but investment income, including capital gains will not be taxed as income. In addition, investors can withdraw money from the TFSA at any time – tax-free – without reducing their contribution room. For example, they withdraw \$5,000, and that \$5,000 can be put back into the plan later.

Larry Chapman, a tax specialist and spokesperson for the Canadian Institute of Chartered Accountants, says once the contribution room on the plans has had time to grow, the TFSA will be very valuable. He notes the TFSA's ability to turn any RRSP-eligible investment's growth into tax-free income gives it a huge flexibility in how it can be used and what can be invested in.

For young investors the benefits are obvious: tax-free compounding over their lifetime. A 25-year-old investor in 2009 will have more than \$150,000 contribution room by the time they are 55. Because the contribution room accumulates and can't be removed, it will still be valuable to older investors, who may be in their 40s and have missed contributions.

"I did a calculation for if you're in your 40s and you don't start contributing until then. If you contribute regularly from then on until you're in your 60s with an annualized investment return 7% over that period of time, you have \$200,000 at the end of that period," he says. "That's very significant compared to if you were in a taxable account, where it would be \$140,000. This will make a huge difference if you can manage to get a high rate of return."

Myron Knodel, a tax and estate planning specialist with

Investors Group, says the TFSA is really going to motivate lower-income earners to get into investing, because they won't take a tax hit on withdrawals. They can use it as a savings vehicle for large-ticket items like purchasing a home.

Also, he notes unlike the RRSP, lower-income earners won't be deterred from investing in the TFSP, because they won't have to worry about having their government benefits being rolled back in retirement if they take out investment income.

"There aren't the usual restrictions you have with RRSPs. There is no requirement to take the contributions and necessarily use them for retirement, it gives you a lot of flexibility," he says.

Advisor Trevor Daigle, a partner with Halifax-based Stephenson Daigle Financial, says the TFSA is a "huge win" for the modest investor, particularly younger ones. He'd suggest these clients opt for investing the available \$5000 in a TFSA over the RRSP while they are starting their careers.

"From a planning perspective it certainly gives us a whole new vehicle to help clients save money on a short- to medium-term basis," he says. "Especially for younger investors since most tend to be in a relatively low tax bracket and have a much more significant tax issue down the road as they advance in their career and make more money."

Daigle says this strategy would effectively allow younger investors to utilize a big tax deduction on their RRSP when they get older and find themselves paying a higher tax rate. Unlike before, they won't have to worry about missing out on the tax-deferred growth by not putting the money in the RRSP.

Harry Perler, CEO of Perler Financial Group in Coquitlam, B.C., says he's also going to be using the TFSA as a complement to the RRSP. In particular, for the first few years after it's introduced, he's going to suggest clients take money from their RRSP tax refund and invest it in the TFSA. +

TFSA CHANGES GAME PLAN FOR INVESTORS

He also notes it will be appealing for conservative investors who may have high interest savings accounts or GICs outside their RRSP. They can now move that money into the TFSA and not worry about paying tax on the interest distributions.

Perler also says the government’s decision to extend the life of RESPs by 10 years will spark more interest in that investment vehicle. Under the current rules an RESP must be terminated on its 21st year or 25th year if the beneficiary qualifies for the Disability Tax Credit. Under the 2008 Budget, these termination deadlines would be extended to 31 and 35 years respectively.

“That’s definitely a huge benefit. A lot of our clients were concerned whether they could utilize those funds to that point,” he says. “Age 25 is not that old if you’re looking at becoming a doctor – this gives them that extra time to finish their education.”

Daigle believes this makes the RESP more useful for today’s worker, who generally has to upgrade their education mid-career to stay competitive.

Peter Ficek, an independent advisor and CFP based in

Calgary, agrees the TFSA and RESP extension are very positive developments, but he believes future budgets can do more to improve these vehicles for working investors.

For example, Ficek says older investors who are nearing retirement now are not going to get the boost from the TFSA that younger investors will. He would like to see a one-time large contribution allowed, so that older investors could catch up to the contribution levels future investors are going to enjoy when they are the same age.

“What about a 60-year-old investor right now who has grown their investment portfolio and will be having taxation immediately. What’s the harm of allowing them to do a \$25,000 contribution? One could argue this would be fair to everyone,” he says.

Ficek also believes a 10-year extension of the Canada Educational Savings Grant to match the new extension for the RESP would also maximize that product’s appeal for more investors.

A.C.A

Mark Noble is a news reporter for Advisor.ca.
mark.noble@advisor.rogers.com

PROPOSED CHANGES TO RESP TIME LIMITS

| TIME LIMIT | CURRENT | PROPOSED |
|--|---|---|
| Number of contribution years after plan entered into | <ul style="list-style-type: none"> • 21 years • For DTC beneficiary plans, 25 years | <ul style="list-style-type: none"> • 31 years • For DTC beneficiary plans, 35 years |
| Deadline for plan termination | <ul style="list-style-type: none"> • Year that includes the 25th anniversary of the plan • For DTC beneficiary plans, year that includes the 30th anniversary of the plan | <ul style="list-style-type: none"> • Year that includes the 35th anniversary of the plan • For DTC beneficiary plans, year that includes the 40th anniversary of the plan |
| Contribution age limit for family plan | <ul style="list-style-type: none"> • No contributions for beneficiary who is 21 years of age or older | <ul style="list-style-type: none"> • No contribution for beneficiary who is 31 years of age or older |

BY

ROMANA KING & PHILIP PORADO

FOCUS ON BUSINESS OWNERS



CAPITAL INVESTMENT WILL GARNER WRITEDOWNS

Canadian business owners shopping for capital equipment south of the border got an additional boost from the federal government today. However, entrepreneurs outside of manufacturing found little in terms of direct aid in the Conservative budget.

A strong loonie has already been boosting business owners' purchasing power, and now a proposal to implement three years of accelerated capital cost allowance (CCA) treatment will let those buying manufacturing and processing equipment between 2009 and 2011 write off that equipment at an accelerated rate over a three-year period.

"There are some good things for capital cost allowances for manufacturers, railway companies, and anybody who buys clean energy generation equipment," says Marc Lamontagne, a principal at Ryan Lamontagne Inc. in Ottawa. "But, as a business owner, there's no reason to revise your financial plan tomorrow."

Last October's goodie-laden mini-budget got the ball rolling when it unveiled a temporary, two-year, 50% straight-line accelerated CCA rate for those buying new equipment before next year. This budget extends the treatment for three more years. "This will include a one-year extension of the 50% straight-line accelerated CCA treatment, followed by a two-year period during which the accelerated treatment will be provided on a declining basis," according to budget documents.

The hope is that by extending the breaks until 2011, businesses will be able to retool, boost productivity and add value to production processes at a time when the surging dollar has made Canadian goods expensive for importers. The budget further proposes to increase the CCA on the purchase of rail equipment to 30% from 15% with an eye toward encouraging operators to switch to more fuel-efficient locomotives.

"Step back to 1999, during Y2K, when we had to replace all

our technology. The government offered an incentive that allowed businesses to write off the purchase of computers in one year; computer sales went through the roof," says Peter Merrick, president of MerrickWealth.com. "So, in essence, our antiquated industries are being given the incentive to make those large purchases. Because it's such a fast write-down, businesses that purchase, write off and then sell their equipment may also be able to recapture some of those expenses."

Of course, notes Lamontagne, whether businesses bite is another matter. "The fact that the government is signalling a slower economy could get a business owner to say, 'Well I'm not sure if I should have a big spending spree. Maybe I shouldn't hire those extra bodies,'" he says. "It kind of telegraphs a slowdown of the economy."

Mark McNulty, author of *The Canadian Small Business Guide to Financial Independence*, disagrees. He believes that by acknowledging the uncertain economy and opting for fiscal prudence, the budget will benefit entrepreneurs in the long-run. "We didn't get direct money into the pockets [of entrepreneurs]. This government did that in the last budget and in October's mini-budget," said McNulty, a Markham, Ont.-based CFP and the youngest half of the father-son McNulty team, a fee-only financial planning firm that caters to dentists. "I'm glad the government decided to pay down the debt and build up reserves. That's a lot of money that went into building another cushion [for entrepreneurs] and this helps avoid a recession. Nothing hurts entrepreneurs more than a recession."

While McNulty maintains this budget really has no significant impact on Canadian businesses, he is hopeful the long-term strategy of the Conservatives will offer boomer-entrepreneurs a chance to realize their potential.

"The amount of money funnelled into education is very promising," he says "The Canadian Federation of Independent +

CAPITAL INVESTMENT WILL GARNER WRITEDOWNS

Business has conducted countless studies that show the landscape of businesses will dramatically change when the boomers start to retire. By funnelling money into education the government is [grooming] potential purchasers for boomers selling their businesses and about to retire.”

More direct benefits will come from a promise to improve processing of a tax incentive program tied to Scientific Research and Experimental Development (SR&ED), says Lamontagne. While the program has provided significant tax assistance, he says the application process can be ponderous to the point where he’s told applicants not to hold their breath.

The budget will “increase the expenditure limit from \$2 million to \$3 million [and] increase the upper limit for the taxable capital phase-out range from \$15 million to \$50 million,” the documents say, and the upper limit of the taxable income phase-out range will also be increased, from \$600,000 to \$700,000. The changes will be effective for tax years ending on or after February 26, 2008. “They’re giving you a bit more a bit more headroom before you bump into the caps,” notes Jason Safar, a tax partner at PricewaterhouseCoopers.

Adds Lamontagne: “What they’ve announced in this budget is that they’re going to make the forms simpler and actually hire more people to read the applications and qualify people. That will be an improvement.”

Entrepreneurs with large numbers of employees will benefit from a reduction in penalties if they’re late disbursing

withholding payments to the government. Currently, a business owner who is as little as one hour late with a payment can be penalized 10%. Under the budget proposal, the penalties will be stratified so that it takes one week to reach that level. “It’s quite punitive,” says Safar. “It’s 10% of whatever holdings you were supposed to remit. So if you have a large payroll, or you’re paying a big bonus, that 10% can be quite painful.”

And, if you have to drive for work, the budget will simplify the current system that now requires the keeping of detailed log books indicating the number of kilometres driven, whom was met and what the business purpose was. Under the new arrangement, a taxpayer who provides a sampling of auto use will be given the benefit of the doubt regarding legitimacy of the business travel. “We do tax preparation for a number of clients and we find they just hate to keep log books, so the fact that they made it easier will make a big difference,” says Lamontagne.

Safar notes that a huge percentage of taxpayers don’t actually maintain log books, and that becomes an issue in the event the CRA audits. “I’ve always been successful saying, ‘Can we give you the typical month?’ and they agree,” he says. “So they’ve formalized what I have experienced as their internal administrative process.”

A.CA

*Romana King is associate editor of Advisor's Edge Report.
romana.king@advisor.rogers.com*

*Philip Porado is editor of Advisor's Edge.
philip.porado@advisor.rogers.com*

WORTH REPEATING

Sick Kids

“Today’s budget announcement will make an important difference for a large number of children with chronic or potentially serious medical conditions... Children with medical conditions are more at risk whenever they leave home; parents are concerned about how their child will be able to communicate their medical condition in a crisis. No Child Without addresses that concern. The government of Canada’s support again this year will help significantly expand the No Child Without program to a growing list of schools across the country.”

Robert Ridge, acting president and CEO, MedicAlert



WORTH REPEATING

Missing in Action

“The one thing that was needed was more of an incentive for mid-sized companies to raise risk capital. We’ve been pushing for those incentives for some time. These are the companies that provide a lot of the employment and activity in the Canadian economy. We do a good job in starting small businesses; we don’t do as good a job in growing them. Access to capital is an important reason... We were looking for capital gains tax relief for shares in smaller companies – that wouldn’t [have been] expensive – [but] we didn’t get it.”

Ian Russell, president and CEO, Investment Industry Association of Canada (IIAC)

Closing Words from Honourable Ralph Goodale, Member of Parliament for Wascana, Official Opposition House Leader

“In many ways this budget is pretty thin; it’s ‘a mile-wide and an inch deep,’ as Stéphane Dion said earlier today. It touches on a lot of things but accomplishes very little. You’re kind of hard-pressed to find a coherent theme running through it. To the extent that there is some real substance in the budget, it’s mostly borrowed from things that Liberals have been proposing over the last year or so, as we either prepared for the House of Commons, or prepared for the upcoming platform in an election campaign. Making the gas tax permanent – the rebate to municipalities – that was a Liberal proposal.

We obviously will be very watching closely as the government goes forward. Are they in fact going to do what they say? There have been some big discrepancies in the past...and also the issue of how close they’ve come to deficit financing. This is getting to be a bit of a frightening scenario. Not so much for what’s in this budget, because, in fact, there’s not much in this budget. But it’s what they did with the fiscal framework in the previous two budgets. They’ve become the biggest spending government in Canadian history. Spending, by their projections, will be up by about \$40 billion – which makes Mr. Harper the biggest spending Prime Minister, which I’m not sure he or others would have expected.

[If] you ask the average Canadian, ‘What have you got for that \$40 billion?’ most of them would be pretty hard-pressed to think of anything specifically... On the other side of the equation, [the government] has eroded the tax space in a very serious way. They had the choice of a number of tax reductions that they could have made; they chose to put virtually all of their eggs in the basket of cutting the GST. That confers a benefit on the average Canadian of about \$15 a month; so 50 cents a day. Whereas, it takes about \$12- or \$14 billion out of the fiscal framework. They chose to cut the wrong taxes. We would not argue against tax cuts – but we’d say ‘cut the income tax.’ – And they chose to cut the GST. Because of mistakes that they’ve made on tax cuts, and because of this huge level of spending that they’ve established, there’s no fiscal room left.

When they came into office, I was the previous Finance Minister. I left them the strongest economy, the best fiscal situation, and the cleanest set of books in Canadian history. They had \$100 billion worth of flexibility when they came into office on the fourth of February 2006. And now that’s been reduced to \$1.3 billion. They had \$100 billion to work with and they’ve whittled it down to \$1 [billion]. That’s bad management. That’s how serious their erosion of the fiscal capacity of the country has been.

The shock absorbers that we had built into the system to protect against unpleasant surprises when it comes to the country’s fiscal situation – the contingency reserve, the extra prudence, all of those things that we had built into our planning to make sure that...they would never push us back into deficit again – that’s how we managed to get past 9-11, that’s how we managed to get past SARS and BSC, and the Pesos crisis in Mexico – because we had that prudence factor built in. That’s all gone now. When you get down to the end of the fiscal year next year, the \$2.3 billion will be absolutely all there is left. There’s no cushion. There’s no margin for error. And that \$2.3 billion is quite literally a rounding error on a total spending level of \$240 billion. A mistake of 1% revenue going in or expenditures going out – 1% error – and this country’s back in deficit. So that’s how serious their erosion of the fiscal security is.”

A.C.A.

CUSTOMIZABLE TEMPLATE LETTER

TO CLIENTS/PROPECTS:
THE 2008 FEDERAL BUDGET AND
YOUR FINANCIAL PLAN

Dear [Client/Prospect name],

As you know, Finance Minister Jim Flaherty delivered his third federal budget on Tuesday in Ottawa.

This budget has many items that could affect your financial plan and present additional savings and investment opportunities. In case you haven't had a chance to review the media coverage, I thought you would appreciate a quick overview of the federal budget.

Tax-free Savings Account: Beginning in 2009, Canadians over the age of 18 can contribute \$5,000 each year to a TFSA and investment income, including capital gains, will accumulate tax-free. Withdrawals will also be, as the name implies, tax-free. Unused contribution room carries forward to subsequent years.

Registered Education Savings Plan (RESP): The RESP contribution period has been extended from 21 years to 31 years. The life of the plan has been extended from 25 to 35 years.

Guaranteed Income Supplement: The GIS earnings clawback will kick in at \$3,500 instead of \$500.

Dividend Tax Credit: A reduced gross-up and dividend tax credit will reflect lower corporate income tax rates, effective in 2010.

I hope you find these highlights useful. If you'd like to discuss these and other federal budget initiatives and how they affect your financial plan, please don't hesitate to contact me.

Sincerely,
Your signature
Your name
(02/26/08)