FTR Now

Federal Budget 2008

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INTRODUCTION

The Budget Plan 2008, “Responsible Leadership” was tabled in the House of Commons on February 26, 2008 by the Honourable James M. Flaherty, Minister of Finance. The two primary themes of the Budget are Leadership at Home and Abroad and Economic Leadership. Economic Leadership is reflected in three main initiatives:

- Maintaining Strong Fiscal Management;
- Strengthening Canada’s Tax Advantage; and
- Investing in the Future

This Client Update highlights select Budget measures that are of interest to employers, human resources professionals and pension plan administrators.

TAX-ASSISTED SAVINGS AND RETIREMENT

Tax-Free Savings Accounts

Calling it one of the most significant initiatives since the introduction of the RRSP, the Government introduced a new tax-assisted savings vehicle, the Tax-Free Savings Account (TFSA). Available beginning in 2009 to residents of Canada aged 18 and over, the TFSA will be a registered vehicle in which individuals can invest contributed amounts. While contributions are not tax-deductible, investment earnings on the contributions can accumulate tax-free, and there will be no tax on withdrawals. Available investment options for this account will be similar to those for RRSPs, and a spousal account option will be offered.

Contributions will initially be limited to $5,000 per year, with a monthly 1% penalty tax applied on excess contributions. Unused contribution room can be carried forward indefinitely. The contribution limit will increase by inflation each year (in $500 increments). Unlike RRSP contribution limits, the TFSA limit is not linked to “earned income” or some other income test. This may make the TFSA attractive to retirees who are in receipt of a pension or are required to make minimum withdrawals from their RRIFs or Life Income Funds, but who wish to continue saving and are unable to make RRSP contributions.

Withdrawals can be made at any time and, if a withdrawal is made, the contributor’s contribution limit is increased by the amount of the withdrawal. This means that a withdrawal does not result in lost contribution room. Withdrawals also do not impact income-tested benefits, such as Old Age Security. These features may make the TFSA attractive as a shorter-term savings vehicle, such as for the down payment on a home. There will also be rules allowing the transfer of the account to a spouse or common-law partner’s TFSA when the contributor dies, and on marriage breakdown.

Employers sponsoring Group RSPs and other tax-deferred savings vehicles may wish to consider including the new TFSA in their plan in addition to any after-tax savings vehicle already in place, although as with other types of plans, the application of withdrawal restrictions will need to be carefully considered.

LIFE INCOME FUNDS (LIF)

Following the lead of several provinces that have, in recent years, relaxed the withdrawal rules governing locked-in retirement savings vehicles, the Budget proposes to amend the federal *Pension Benefits Standards Act* to allow individuals to withdraw amounts from federally regulated LIFs in three situations:

- individuals who are 55 years of age or older with LIF holdings of up to $22,450 will be able to wind up their accounts and convert them to an unlocked tax-deferred savings vehicle;
- individuals who are 55 years of age or older will be able to convert, on a one-time basis, up to 50% of their LIF holdings into an unlocked tax-deferred savings vehicle; and
- individuals of any age who are facing financial hardship (due to low income or high disability- or medical-related costs) will be able to unlock a portion of their LIF funds, up to a maximum of $22,450.

The $22,450 threshold/maximum will be indexed with increases in the average industrial wage. The Budget does not specify an effective date for these changes.

REGISTERED EDUCATION SAVINGS PLANS (RESP)

Continuing reform that began with the 2007 Budget, the 2008 Budget proposes to further facilitate the use of RESPs by increasing the period during which contributions can be made and extending the deadline for terminating the plan. RESPs may now remain open for 35 years instead of 25 years. The maximum contribution period will also be extended by 10 years, from 21 years to 31 years. For RESPs where the beneficiary is disabled and receiving the Disability Tax Credit, corresponding increases will be applied and those RESPs may now remain open for 40 years instead of 35 years and contributions can be made for up to 35 years. These changes will apply for the 2008 and subsequent taxation years to all existing and future RESPs.

In addition, the Budget proposes a 6-month grace period, starting after a beneficiary ceases to be enrolled in a qualifying program, during which the beneficiary could to continue to withdraw Educational Assistance Payments. The grace period will apply to any RESP beneficiary who ceases to be enrolled in a qualifying program after December 31, 2007.

REGISTERED DISABILITY SAVINGS PROGRAM (RDSP)

Introduced in the 2007 Budget as a mechanism to facilitate long-term savings for a disabled child, the Government announced that it expects financial institutions will be able to begin offering RDSP’s in 2008. The Budget also clarified the rules surrounding the collapse of an established RDSP. The RDSP Program itself will be subject to triennial reviews.

GUARANTEED INCOME SUPPLEMENT (GIS)

The GIS is an income-tested monthly benefit paid to low-income seniors (aged 65 years of age and older). In an effort to facilitate the employment of older individuals, the Budget proposes to increase the employment income exemption from its current limit of $500. The new limit would allow seniors to earn up to $3,500 a year without affecting the amount of the GIS that they receive.

EMPLOYMENT INSURANCE REFORM

It is estimated that, since 1995, EI premiums paid by employers and employees have exceeded program costs by a staggering $54 billion in the aggregate. Many employers have long criticized the use of notional EI “surplus” to fund other government priorities. The Budget contains several proposals to respond to these criticisms.

The 2008 Budget proposes the creation of the Canada Employment Insurance Financing Board (CEIFB), an independent Crown corporation. Starting January 1, 2009, the CEIFB will maintain a separate fund to hold and invest any future EI surplus. In good economic times, surplus beyond a certain threshold (to be determined) would be used to lower EI premiums in future years. In the event of an economic downturn, money held by the CEIFB would act as a reserve to buffer any necessary hike to EI premiums.

The CEIFB will also be responsible for setting EI premium rates for employers and employees. Premium rates will take into consideration any surplus or deficit in the EI program, with the objective of operating the EI program on a “break even” basis over the long run.

To prevent wild fluctuations in EI premiums from year to year, the Budget proposes that the maximum annual premium change will be capped at 15 cents per $100 of insurable earnings. The Budget also infuses the CEIFB with an initial $2 billion reserve, which would be used to fund any EI premium increase beyond the 15 cent cap.

BENEFITS

MOTOR VEHICLE EXPENSES

The Budget announced that the Canada Revenue Agency will consult with key stakeholders in 2008 on reducing the tax compliance burden associated with having to demonstrate the business use of a motor vehicle. The Budget proposes that a representative sample logbook be maintained, covering only a limited period of time, instead of a detailed logbook covering the entire year. The Canada Revenue Agency will implement a revised administrative policy on the treatment of this taxable benefit in 2009.

MEDICAL EXPENSE TAX CREDIT (METC)

The Budget announced changes to the list of eligible medical-related expenses that qualify for the METC, including:

- the addition of a number of new devices for treatment of speech, balance and mobility impairments;
- the addition of service animals for assistance to individuals affected by autism and epilepsy; and
- in response to recent court decisions, a clarification that only drugs and medications that require a prescription will be eligible.

The additions to the list of eligible METCs will be made effective for 2008, and the clarification respecting eligible drugs and medications will be effective for expenses incurred after February 26, 2008. Employers should consider what impact, if any, these adjustments will have on their medical plans.

APPLICATION OF GST/HST TO HEALTH CARE SERVICES AND PRODUCTS

The list of medical and assistive devices which are exempt from GST/HST has been expanded to include: nursing services provided outside of a Hospital; training to assist individuals coping with a disorder or disability; and drugs prescribed by health practitioners who are not medical practitioners, such as nurse practitioners and midwives. Depending on the nature of expenses covered by a group benefits plan, the elimination of GST on these services may result in some cost reductions.

CONTINUED SUPPORT FOR COMMON SECURITIES REGULATOR

The Budget reiterates the Government's commitment to work with the provinces to create a common securities regulator that will provide proportionate, more principles-based regulation and strong enforcement to Canadian capital markets. The Budget refers to the Government's earlier announcement, made on February 21, 2008, respecting the establishment of the Expert Panel on Securities Regulation to advise on ways to enhance the effectiveness, content and structure of securities regulation. The Expert Panel will prepare and present its report by the end of 2008.

DIVIDEND TAX CREDIT

The Budget proposes to adjust the tax treatment of dividends to reflect the corporate income tax reductions announced in the 2007 Economic Statement. The dividend gross-up will be reduced from 45% to 44% on January 1, 2010, and then further reduced to 41% and 38% in 2011 and 2012, respectively. The Dividend Tax Credit calculation will also be adjusted in a corresponding manner. The result of these adjustments will be that tax treatment of dividend income will remain in line with the general corporate income tax rate of 18% in 2010, 16.5% in 2011 and 15% in 2012.

PAYROLL REMITTANCES

Under the current rules, employers must withhold and remit various source deductions and are subject to a basic late remittance penalty of 10%. Employers with large payrolls must remit payment directly to a financial institution instead of to the Receiver General. Effective for remittances that are due on or after February 26, 2008, the Budget proposes to introduce a graduated penalty varying between 3% to 10% of amounts due, increasing with the lateness of the remittance and reaching 10% for a remittance that is 8 days late. To simplify remittances, a large remitter who remits to a financial institution at least one full day before the due date, would be deemed to have remitted to the Receiver General on time, even if the transfer of funds from the financial institution to the Government takes place after the remitter's remittance due date.

If you have any questions arising out this Client Update, please contact one of the members of our Pensions & Benefits Group or your regular Hicks Morley lawyer.