

## 2008 FEDERAL BUDGET HIGHLIGHTS

On February 26, Finance Minister Flaherty tabled the Conservative Government's third Federal Budget in the House of Commons. As expected, the government has delivered a politically safe Budget with no tax increases or measures likely to offend taxpayers.

### Tax Changes Affecting Credit Union Products

#### Tax-Free Savings Accounts

The most significant announcement in the Budget for credit unions and their members is the creation of the new "Tax-Free Savings Account" (TFSA). Financial institutions currently eligible to issue RRSPs will be permitted to issue TFSA's. This includes credit unions, banks and life insurance companies.

Starting in 2009, individuals 18 years of age and older will acquire \$5,000 of TFSA contribution room each year. He or she will be able to make total TFSA contributions up to the accumulated contribution room available. Unused contribution room will be carried forward to future years. The \$5,000 annual limit will eventually be indexed to inflation.

There is no deduction from taxable income for contributions and no tax payable on amounts withdrawn from the account, either capital or earnings. This means that interest, dividends or capital gains earned within a TFSA are truly tax-free. In contrast, contributions to an RRSP are tax-deductible and amounts withdrawn are taxed i.e. it is a tax deferral account. Also in contrast, contributions to an RESP are not tax-deductible, but earnings within the RESP are taxable when withdrawn, but in the hands of the student who is not necessarily the contributor.

Any amounts withdrawn from a TFSA in a year will be added back to the individual's contribution room for the following year. Therefore, individuals who withdraw money from their account can restore it later. This is

different than an RRSP where amounts withdrawn cannot be put back without using new contribution room. Withdrawals from a TFSA will not impact federal income-tested credits or programs, such as Old Age Security, Guaranteed Income Supplement, EI, Child Tax Benefit, GST credit, etc.

A TFSA will generally be permitted to hold the same investments as a RRSP. However to prevent situations where unreasonably large amounts of income could be directed to an account, investments in entities with which the account holder does not deal at arm's length will be prohibited. Excess contributions will be subject to a tax of 1% per month.

Spouses and common-law partners can each have a TFSA and contribute to either one. Therefore, within a family, there can be more than one TFSA, even if there is only one spouse with income. At death, a TFSA can be transferred to the surviving spouse or partner's TFSA without reducing the survivor's existing room.

Interest on money borrowed to invest in a TFSA will not be deductible. There will be no prohibition on an individual's ability to use their account as collateral for a loan.

As with any new tax measure, there will be more paperwork for financial institutions. TFSA issuers, such as credit unions, will have to provide annual information returns to the Canada Revenue Agency (CRA). The information required to be reported is expected to include the amount of contributions, withdrawals and transfers made in the year. As an individual may hold more than one TFSA, CRA will aggregate this information and determine accumulated contribution room, much as it does for RRSP contribution room.

The budget documents also indicate that information will be required from FIs to report the value of an account's assets at the beginning and end of the year. This is information not required for RRSP accounts. Credit

Union Central of Canada was informed by officials from the Department of Finance that this new data will be used to monitor unusual increases in accounts that may indicate abusive direction of income into these tax-free accounts. Credit unions will need to consider how computer systems may have to be adapted to capture these new fields of information.

The TFSA is not a new concept. It has been strongly advocated by the C.D. Howe Institute, among others, for a number of years. Budget documents several years ago outlined how a similar plan called Tax-Paid Savings Plans might operate. Credit Union Central of Canada and other stakeholders participated in consultations with the Department of Finance in 2003. The concept was subsequently dropped for a number of reasons. Chief among them was a perception that the real beneficiaries would be the high income earners that had already maximized their RRSP and RPP contributions.

It is expected that most depositors and investors outside of RRSPs will open TFSAs to avail themselves of tax-free earnings. Over time, at \$5,000 per year, substantial tax-free accounts can accumulate. The budget documents suggest that the foregone tax revenue to the government will be \$50 million in 2009-10, increasing to \$385 million by 2012-13 and eventually to \$3 billion annually. Indeed, the documents suggest that as TFSAs mature over the next 20 years, it is estimated that, in combination with existing registered plans, over 90% of Canadians will hold all their financial assets in tax-efficient savings vehicles.

Will taxpayers shift some of their contributions from RRSPs to TFSAs? It is expected that the immediate tax savings from RRSPs will remain a powerful factor in favour of RRSPs. Those low income taxpayers with economic means may prefer TFSAs to avoid the harsh result of losing entitlements to low income credits and programs that they face with RRSP withdrawals. And seniors are expected to be heavy users, realizing one-half of the tax benefits provided by the new TFSA.

For some time, credit unions have been requesting the federal government to examine the relative taxation of interest, which is fully taxed immediately, compared to capital gains and dividends, which are tax-favoured and

often on a deferred basis. These tax differences will become neutralized for savings within a TFSA.

### Life Income Funds (LIFs)

Three changes will provide greater flexibility for amounts held in LIFs which arise from retirement savings from federally regulated registered pension plans. Currently, LIFs are subject to strict annual withdrawal limits.

- Individuals 55 or older with small holdings of up to \$22,450 will be able to wind up their LIF with the option to transfer to a tax-deferred account, such as an RRSP.
- Individuals 55 or older may convert up to 50% of their LIF to a tax-deferred savings vehicle, such as a RRIF or RRSP, but such a conversion may occur one time only.
- Anyone facing financial hardship will be entitled to unlock up to \$22,450 regardless of age.

### Registered Education Savings Plans (RESP)

Currently, an RESP must be terminated by the end of the year that is 25 years after its origin. This is increased to 35 years, beginning in 2008.

No contributions may be made to a family plan for a beneficiary who is 21 years of age or older. This is increased to age 31, beginning in 2008.

### Tax Changes Affecting Credit Unions

#### Tax Rates

There are no changes to previously announced income tax rates. Effective January 1, 2008 the federal small business income tax rate decreased to 11%, from 13.12% in 2007. Most credit unions pay this rate. The general tax rate, paid by some credit unions, decreased to 19.5%, from 22.12% in 2007.

#### Annual GST Information Schedule for Financial Institutions

A number of months ago, CRA and the Department of Finance jointly announced a requirement for GST registrant financial institutions to file an annual 7-page information schedule - Form GST111 - to report an abundance of GST-related data not currently required on

GST returns. Only FIs that are not GST registrants or whose annual financial statement revenue (not net income!) is less than \$1 million are exempt from filing. The first Schedules are required for December 31, 2007 year-ends, due June 30, 2008. Despite requests from credit unions and other small financial institutions to increase the exemption and shorten the form, the budget papers confirm that it will proceed unchanged.

A 16-page guide to preparation of the new form has just been posted on the CRA website.

Officials told Credit Union Central of Canada in the Budget Day lock-up that no changes to the requirements are contemplated within the first couple of years. However, based on information gleaned from initial filings, changes are likely to be made in future.

### Other Information of General Interest

#### Management and Governance of Employment Insurance (EI)

Currently, the surplus in the EI program is used for general revenue purposes. It is likely that this framework has resulted in higher premiums than necessary to support the EI program.

A new independent Crown corporation will be created for EI with its own board of directors. EI surpluses will be minimized and used only for EI purposes. The Crown corporation will implement a new rate-setting mechanism to ensure revenues and expenditures break even over time. The new Crown corporation will begin with a \$2 billion reserve account.

#### Provincial Sales Tax Harmonization

The federal government committed once again to its goal of a single harmonized sales tax in Canada. The budget documents state, without specifics, an intention to work with the five provincial governments that have their own retail sales taxes – British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island.

#### Canada Student Loans Program

A four year program will expand online services and enable students to manage their loans online from application through repayment.

#### Strengthening Financial Systems Resilience

The budget documents refer to the global markets turbulence of 2007 and state:

“Against this background, the Government is committed to enhancing its core instruments for promoting financial system resilience and stability within a framework founded on open and competitive markets. It proposes to modernize the statutory authorities of the Bank of Canada to support the stability of the financial system and the conduct of monetary policy. It will also ensure that responsible federal agencies have continued capacity to safeguard financial stability through diligent oversight of financial institutions and a range of flexible and up-to-date regulatory tools.”

#### Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)

Administrative savings of \$2.2 million a year will be directed towards increased compliance activities and enforcement.

#### Economic Assumptions

The 2008 budget is based on the following economic assumptions:

	2007	2008	2009
Real GDP growth	2.6	1.7	2.4
GDP inflation	3.1	1.8	1.9
Nominal GDP growth	5.7	3.5	4.3
3-month Treasury bill rate	4.2	3.2	3.8
10-year government bond rate	4.3	3.6	4.2

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