



FEDERAL BUDGET 2009

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A STIMULATING BUDGET OVERALL

By Tim Cestnick and Leigh Vyn

All things considered, Jim Flaherty and the Department of Finance pulled together a federal budget in a very short period of time that may very well stimulate our economy, restore some confidence, and support Canadian families during the current global economic downturn. The federal budget – Canada's Economic Action Plan – will provide temporary economic stimulus in some ways, but also builds on Canada's long-term capacity so the country may emerge stronger when the economic recovery begins.

FROM THIRTY THOUSAND FEET

Let's take a look at a high-level overview of the stimulus plan put forth by the Department of Finance. The plan has been designed to:

- Improve access to financing for consumers and businesses with support of up to \$200 billion.
- Reduce income taxes for individuals and businesses by over \$20 billion over 2008-09 and the following five years.
- Undertake a significant investment in building projects with \$12 billion in new infrastructure funding and \$7.8 billion to build and renovate housing.
- Enhance benefits and training opportunities to protect Canadians affected by the global economic slowdown.
- Create or maintain up to 190,000 jobs for Canadians by the end of 2010.
- Provide total stimulus equal to 1.9 percent of GDP in 2009.

It should go without saying that providing economic stimulus is going to take some spending. After taking into account the 2009 budget measures, the government is projecting deficits of \$1.1 billion in 2008-09, \$15.7 billion in 2009-10, \$14.3 billion in 2010-11, \$8.3 billion in 2011-12, \$2.3 billion in 2012-13 and a surplus of \$5.5 billion in 2013-14. Most of the planned spending is targeted for 2009-10 and 2010-11 when the economy is expected to be the weakest.

Canada's debt-to-GDP ratio is expected to increase from 28.6 percent in 2008-09 to 32.1 percent by 2010-11 as a result of the deficits. Even still, this ratio is much better than the G7 average. The average debt-to-GDP ratio among G7 countries (excluding Canada) is currently 55.0 percent according to the OECD. Canada's ratio should return to levels below the current level by 2013-14. Finally, our federal debt is expected to grow from the current \$459 billion to \$542 billion in 2012-13, after which the debt should start to decline again.

PERSONAL TAX MEASURES

Thanks to many tax initiatives announced in the 2009 federal budget, all Canadians will have a little more money left in their pockets at the end of the day. Families with incomes of \$15,000 to \$30,000 will see annual savings of \$168 on average, while families with income in the \$80,000 to \$100,000 range will save, on average, \$614 annually. The following are personal tax changes introduced in the 2009 federal budget:

PERSONAL AMOUNTS AND INCOME TAX BRACKETS

The basic personal amount, the spousal and common law partner amount, and the eligible dependant amount, will all increase by 7.5 percent from their 2008 level of \$9,600 to \$10,320.

The upper threshold at which the first level of personal income tax (a 15 percent federal tax rate) is applied, will be increased from \$37,885 to \$40,726 for 2009. Similarly, the upper limit at which the second level of personal income tax (a 22 percent federal tax rate) is applied will be increased from \$75,769 to \$81,452 for 2009. As in previous years, all increased amounts and thresholds will be indexed to inflation in 2010 and subsequent years.

Strategy: Every Canadian taxpayer will now be entitled to earn more income on a no- or low-tax basis as a result of these changes. This will make income splitting even more beneficial. Moving capital gains to the hands of minor children, and investment and other income to the hands of a lower-income spouse will result in potentially significant tax savings over the course of time. Given the low current prescribed rate, a loan to a lower-income spouse is particularly attractive today to split income. Consideration should also be given to increasing salaries paid by the family business to family members. At WaterStreet, we help our client families to implement optimal income splitting strategies.

AGE CREDIT

The 2009 federal budget proposes to increase the amount on which the Age Credit is based by \$1,000 to \$6,408, effective January 1, 2009. The net income level at which the Age Credit begins to be phased out remains unchanged at \$32,312. The income level at which the Age Credit is fully phased out is increased by over \$6,600 to \$75,032.

CANADA CHILD TAX BENEFIT/NATIONAL CHILD BENEFIT SUPPLEMENT

The budget proposes to increase the income level on which eligibility for the Canada Child Tax Benefit (CCTB) and the National Child Tax Benefit supplement (NCBS) is based. For the 2009-10 benefit year, the income level at which the phase-out for the CCTB will begin is \$40,726. Likewise, the income level of the phase-out of the NCBS will be increased by \$1,894, and will be completely phased out for families with income in excess of \$40,726.

WORKING INCOME TAX BENEFIT

The government is prepared to enhance the tax relief provided by the Working Income Tax Benefit (WITB) by an additional \$580 million for 2009 and subsequent years. They are accepting comments and proposed design changes from provinces and territories, and will announce final changes following these consultations.

HOME RENOVATION TAX CREDIT

If you have been thinking about making good on those plans to renovate your home, now's the time to do it. In order to help stimulate growth in the economy, the budget proposes to introduce a temporary Home Renovation Tax Credit (HRTC). Individuals will be able to claim a 15 percent non refundable tax credit for eligible expenditures made to eligible dwellings. Here's how it works:

The 15 percent credit will apply to expenditures incurred in excess of \$1,000 up to \$10,000, for a maximum credit of \$1,350 (\$9,000 x 15 percent) to be claimed on the 2009 personal tax return. These expenses must have been incurred after January 27, 2009 and before February 1, 2010. Eligible expenditures do not include those incurred under an agreement that was entered into before January 28, 2009, even if the work was performed during the eligible period.

The maximum credit of \$1,350 is available to each family unit which generally consists of an individual, and if applicable his or her spouse, and any children who were under age 18 throughout 2009. Therefore, family members will be subject to a single limit based on total expenditures. Any unused portion of the \$1,350 credit can be shared with another family member to be used against that person's taxes otherwise payable.

Eligible expenditures include renovations or alterations made to any dwelling (or land that forms part of the dwelling) that could be considered your principal residence. Renovations or alterations made must be of an enduring nature, and would include the cost of labour and professional services, building materials, fixtures, equipment rentals and permits. Expenses that will not qualify include cost of routine maintenance and repairs, costs of appliances and audio-visual equipment and financing costs. Costs should be paid to a person dealing at arm's length unless that non-arm's length person is registered for GST.

Strategy: While this tax credit won't change your net worth much, the money is better in your pocket than the taxman's. If you've contemplated making home renovations, making this investment in 2009 will net you potentially \$1,350 from the government. Eligible expenditures can even include landscaping costs that are considered enduring in nature (i.e. the cost of annual flowers would not cut

it, but installing a brick patio would qualify). Since the window for this tax credit is short, making these renovations should be a priority over, say, contributing to a Tax Free Savings Account (TFSA) or perhaps even a Registered Education Savings Plan (RESP) in 2009.

HOME BUYER'S PLAN

The 2009 federal budget proposes to increase the amount that can be withdrawn under the Home Buyer's Plan from \$20,000 to \$25,000 for withdrawals made after January 27, 2009.

Strategy: The Home Buyer's Plan (HBP) has been around for many years. We've never been supporters of stealing from retirement assets to buy a home unless absolutely necessary – and only where there is the intention and ability to pay back that amount to the RRSP as quickly as possible. Our view doesn't change as a result of this most recent increase to the withdrawal limit under the HBP. Sorry, but we don't view this change as being much of an incentive, or valuable in any meaningful way.

FIRST-TIME HOME BUYER'S TAX CREDIT

First-time home buyers who acquire a qualifying home after January 27, 2009, will be eligible to claim a new non-refundable tax credit of \$5,000. An individual is considered to be a first-time home buyer provided neither the individual, nor the individual's spouse or common law partner owned and lived in a home in the calendar year the home is purchased or in any of the four preceding calendar years. In addition, to be eligible for the credit, the intention must be to occupy the home as the principal place of residence within one year after it is acquisition. The credit may be claimed by either the individual or his or her spouse. When a home is purchased in joint names, the total amount of the credits claimable in the year cannot exceed \$5,000.

The budget also proposes that this credit

be available for home acquisitions made by or for an individual who is eligible for the disability tax credit provided that the home is acquired to enable the individual to live in a more accessible dwelling or an environment better suited to his or her personal needs.

Strategy: This new tax credit won't make anyone wealthy either, but it's worth \$750 to a first-time homebuyer, and this is more than enough to buy the beer and pizza for any friends helping in the move, or to cover part of your legal fees or other moving costs. The strategy here is to simply ensure that any children or other family members claim the credit for a tax year in which they acquire a property that will qualify as a principal residence. This can include a cottage, or other vacation property. There may be other reasons to place a property in the name of an adult child, in which case the child may be entitled to this tax credit. At WaterStreet, we advise our clients on many strategies related to ownership structuring.

RRSP/RRIF LOSSES AFTER DEATH

Where RRSP/RRIF assets have declined after death, the budget proposes to allow the amount of post-death decreases in value to be carried back and deducted against the RRSP/RRIF income that was included in the deceased's final tax return. The amount of carry-back is calculated based on the difference between the value of the RRSP/RRIF assets that was included in the income at death of the annuitant, and the total of all amounts paid out of the RRSP or RRIF after the death of the annuitant. This measure applies where final distributions were made out of the RRSP or RRIF after 2008.

Strategy: If you're an executor of an estate that has not been fully wound-up, consider whether there is an opportunity to distribute the assets of the deceased's registered plans very soon, in order to take advantage of the accrued losses, if

any, on those assets. As a practical matter, the executor should file a T1 Adjustment Request to carry the losses back to the deceased's final tax return and recover some tax that might have been paid. It's possible to elect out of this carry-back opportunity so that the loss can be claimed by the inheritors of the RRSP/RRIF instead, but this will rarely be advantageous. That's because the loss will be a capital loss in the hands of those heirs, which will provide less in tax savings than carrying the loss back to the deceased's final tax return where the loss will be applied against the taxable RRSP amount at regular income rates.

MINERAL EXPLORATION TAX CREDIT

The mineral exploration tax credit, which provides investors in flow-through shares a benefit equal to 15 percent of specified mineral exploration expenses, was scheduled to expire at the end of March 2009. The budget proposes to extend eligibility for the credit one year – to March 31, 2010.

BUSINESS TAX MEASURES

The following measures will impact those who are business owners. There is some good news for those who own Canadian-controlled private corporations.

SMALL BUSINESS LIMIT

The 2009 federal budget proposes to increase the small business limit – the limit on which a Canadian-controlled private corporation (CCPC) can pay a reduced 11 percent federal rate on active business income – from \$400,000 to \$500,000. Companies with a non-calendar year-end must prorate the increased limit which is to be in effect January 1, 2009.

CCPCs that claim the small business deduction and have taxable income below the small business limit are able to pay any corporate taxes owing three months after their year-end, versus the standard two months. By in-

creasing the small business limit, corporations with taxable income in excess of \$400,000 but under the proposed \$500,000 may have the opportunity to defer paying their taxes by an additional one month.

Strategy: This increase in the small business limit provides an opportunity for business owners to reassess their compensation planning. It may make more sense to meet cash needs through paying out a different mix of salary, dividends and bonuses than in the past. There is no general rule that can be followed here, because the right mix will depend on other factors as well, such as the level of Refundable Dividend Tax on Hand (RDTOH) and the level of the company's capital dividend account (CDA). This change will also provide an opportunity for some small businesses

to make instalments to CRA less frequently (quarterly, rather than monthly). Finally, small business owners with corporate taxable income of \$500,000 or more will enjoy about \$14,000 in additional after-tax income annually as a result of this change, which could be reinvested in the business or paid up as a tax-free dividend to a holding company for investment there.

CCA FOR MANUFACTURING AND PROCESSING

The past two federal budgets have provided incentives for corporations purchasing machinery and equipment used primarily in Canada for manufacturing and processing goods through accelerated capital cost allowance (CCA) deductions. The 2009 Federal Budget proposes to further accelerate these deductions as follows:

YEAR	PRIOR TO 2009 BUDGET	PROPOSED 2009 BUDGET
2009	50 percent straight line	50 percent straight line
2010	Accelerated declining basis	50 percent straight line
2011	Accelerated declining basis	50 percent straight line

CCA FOR COMPUTERS

The 2009 budget proposes a temporary 100-percent CCA rate for eligible computers and system software purchased after January 27, 2009 and before February 2011. The CCA calculation will not be subject to the half-year rule which means that the cost of computers and software can be fully deducted in the year.

Strategy: There is a two-year window for business owners to accelerate the purchase of eligible computer equipment and software and gain the benefit of accelerated capital cost allowance (CCA) deductions for those costs. If you've been thinking of acquiring computer

equipment or software, consider making those acquisitions prior to February 2011. Also, consider deferring all or part of the deduction of CCA where your business income is not high enough to need the full deduction. CCA is a discretionary deduction, and can be claimed in any future year if you don't need it this year to reduce taxes.

MANDATORY ELECTRONIC FILING

Corporations with annual gross revenue in excess of \$1 million will have to file their income tax returns in electronic format commencing for taxation years that end after 2009. Penalties for non-compliance will commence in 2011.

PENALTY FOR FILING LATE INFORMATION RETURNS

The penalty for filing late information returns (such as T4 information summaries), will be reduced to be capped at between \$1,000 and \$7,500 depending on the number of returns required. Prior to this, the penalty could be as high as \$100 per failure or \$25 per day to a maximum of 100 days.

INTERNATIONAL MEASURES

The budget briefly touched on a number of outstanding international tax issues. First, it discussed section 18.2 of the Act which deals with interest deductibility in situations where a

Canadian corporation uses borrowed funds to finance a foreign affiliate. Due to the negative impact this may have on funding international expansion, the 2009 budget proposes that this section of the Act be repealed.

Also mentioned was the status of the non-resident trust (NRT) and foreign investment entity (FIE) rules which have been in draft form since 1999, as well as the foreign affiliate proposals from 2004. The government has received numerous submissions on these proposals and will review and evaluate these prior to proceeding with any final measures in this area.

ABOUT WATERSTREET

WaterStreet Family Wealth Counsel is Canada's leading Multi Family Office™ advisory firm. We are a team of professionals from multiple disciplines offering independent, objective advice on all matters related to the wealth of our clients. We work with wealthy families as a centre of stability and influence in helping them to make wise choices about their wealth and foster a family heritage that will endure across generations.

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