

2007 FEDERAL BUDGET HIGHLIGHTS

On March 19, Finance Minister Jim Flaherty tabled the Conservative Government's second Federal Budget in the House of Commons. As expected, the government has delivered an election-ready Budget, with an increase in spending over the next three years and further measures to reduce taxes. However, total government program expenses as a percentage of GDP will remain stable over the next two years.

Tax Changes Affecting Credit Union Products

Age Limit for Maturing RRSPs and RPPs

In 1997, the age at which RRSPs and RPPs must mature was dropped from 71 to 69. The budget restores to age 71 the conversion age for these plans, effective for 2007. This extends the number of years in which RRSP and RPP contributions can be made as well as delaying the start of payments received from maturity options. Existing registered plan annuities will be permitted to be amended to reflect the later conversion age. Employers will be able to amend their RPPs to allow their employees to accrue benefits and make contributions to age 71.

Registered Education Savings Plan (RESP)

Currently, up to \$4,000 per year, and \$42,000 in total, can be contributed per beneficiary. After 2006, the annual limit is eliminated and the maximum contribution becomes \$50,000. Therefore, a family that can afford to can fully fund a \$50,000 RESP for an infant child.

The Canada Education Saving Grant (CESG) provides a 20% federal grant with a \$400 annual maximum grant, except \$800 if there is unused grant room from a previous year. (There is additional assistance to low and middle income families). These amounts will increase to



\$500 and \$1,000 respectively. The lifetime limit will remain unchanged at \$7,200.

It is interesting to note that a family that decides to pre-fund an RESP to take advantage of the elimination of annual contribution limits will forego most of the CESG. For this reason, it is expected that the marketplace will continue to see many more annual contributions than one-time payments.

Part-time studies will be recognized for the first time. Current eligibility to withdraw Education Assistance Payments requires at least 10 hours course time per week. Effective for 2007, this is relaxed to 12 hours per month.

Registered Disability Savings Plan (RDSP)

Credit unions will be able to offer a new product. To help parents and others save for the long-term financial security of a child with a severe disability, the budget introduces a new RDSP, designed much like an RESP. The lifetime contribution limit will be \$200,000, which will be permitted until the beneficiary reaches age 59. Government grants, with a lifetime limit of \$70,000, will be available to match, and in some cases exceed, annual contributions. Payments from an RDSP must commence by the year the beneficiary reaches 60 years of age. Contributors will not be entitled to receive a refund of contributions. It is worth noting that Canadian Central recommended the creation of this plan in October 2005 as part of a submission to government.

Canada-U.S. Tax Treaty: Elimination of Withholding Tax on Interest

Currently a financial institution must withhold 10% tax on cross-border interest payments to a U.S. resident. Impending changes to the Canada-U.S. tax treaty will phase this out over three years.

After the revisions to the treaty are ratified by both countries, the withholding rate will become:

- First year following entry into force 7%
- Second year following entry into force 4%
- Third and subsequent years 0%

After this implementation, the federal government pledges to eliminate all Canadian withholding tax on interest paid to arm's length non-residents, regardless of their country of residence.

RRSP Qualified Investments

Currently, qualified investments include publicly-listed securities and many types of debt obligations. Eligibility is extended to any debt obligation that has an investment grade rating and that is part of a minimum \$25 million issuance and any security that is listed on a designated stock exchange.

Tax Changes Affecting Credit Unions

There are no changes to the income tax rates paid by credit unions. However, a couple of tax changes are noted.

Computers: Currently, computer equipment is eligible for a capital cost allowance (CCA) rate of 45%. For computer equipment acquired after March 19, 2007, the rate is increased to 55%.

Non-residential buildings: Currently, non-residential buildings are eligible for a CCA rate of 4%. This is increased to 6% for buildings acquired after March 19, 2007, where at least 90% of the building is used for non-residential purposes. This will assist in writing off new premises for credit union branches, for example.

Other Announcements of Interest to Credit Unions

Instalments: The required frequency for income tax and GST instalment payments will be reduced for many small taxpayers, including some credit unions and many of our members.

The annual personal instalment threshold – the annual tax liability at which quarterly payments are required - is increased from \$2,000 to \$3,000, beginning with the 2008 taxation year.

The **corporate** threshold at which any instalments are required is increased from \$1,000 to \$3,000, effective for tax years beginning after 2007. Small businesses will be able to reduce the frequency of their monthly instalments to quarterly if taxable income is less than \$400,000, they qualify for the small business deduction, and taxable capital is less than \$10 million.

For **GST/HST**, the taxable supplies threshold at which registrants can file annually instead of quarterly is increased to \$1.5 million from \$500,000. The net tax threshold below which filers can make only one annual tax remittance is increased from \$1,500 to \$3,000. These changes impact fiscal years beginning after 2007.

For **source deductions**, employers can move to quarterly from monthly remittances if the monthly amount is \$3,000, instead of the current \$1,000, for calendar years beginning in 2008.

Other Announcements of General Interest

Review of Competition Policy

The government has committed to establish an expert independent panel to undertake a comprehensive review of Canada's competition policy and report its findings to the Minister of Industry on options for future legislative amendments before Budget 2008. Canadian Central will ensure that this review considers the credit union system's long standing concern regarding the flat fee of \$50,000 to review mergers among credit unions.

Agricultural Support

As announced on March 9 in Saskatoon, two new commitments to farmers will cost \$1 billion for 2006-07. There is an intention to replace the current Canadian Agricultural Income Stabilization (CAIS) program with a new savings account program. In order to help build these new savings accounts, a one-time payment of \$600 million will be made into the accounts, after

agreement is reached with the provinces. In future years, up to \$100 million in additional contributions will be made in years when costs of production for the sector as a whole are rising. More details will follow discussions with the provinces. To help address rising costs of production over the last four years, there will be an “immediate payment” of \$400 million to farmers.

Enhancing Regulatory Efficiency

The government has pledged \$9 million over two years to develop a performance based regulatory system that aims to ensure efficiency and effectiveness are key considerations in the development and implementation of regulations. Of particular interest to the financial services sector is the government pledge to consider a principles-based legislative framework to guide regulatory departments and agencies in measuring the impact of regulations and to improve their efficiency. This approach is being pioneered by the Financial Services Authority in the United Kingdom and is being actively considered by OSFI.

Lifetime Capital Gains Exemption

For dispositions after March 19, 2007, the exemption increases from \$500,000 to \$750,000 for qualified farm and fishing property and qualified small business corporation shares.

“Green Levy” on Gas Guzzler Vehicles

Purchasers of passenger vehicles, but not pick-up trucks, will pay hefty new excise taxes. Based on 2007 Vehicle EnerGuide ratings, the tax will be:

- at least 13 but less than 14 litres per 100 km - \$1,000
- at least 14 but less than 15 litres per 100 km - \$2,000
- at least 15 but less than 16 litres per 100 km - \$3,000
- 16 or more litres per 100 km - \$4,000

The Green Levy will increase the cost of new vehicles delivered or imported after March 19, 2007.

Rebate for Fuel-efficient Vehicles

Fuel-efficient vehicles will be eligible for a rebate payment from the federal government.

New automobiles with a combined fuel consumption rating of 6.5 L/100 km or less and minivans, SUVs and light trucks with fuel consumption of 8.3 L/100 km or less will qualify. The basic rebate will be \$1,000 and an additional \$500 will be added for each half litre per 100 km improvement. The maximum rebate will be \$2,000. Purchases or leases as of March 20, 2007 will qualify. Cheques are planned to flow beginning in fall 2007.

New Personal Income Tax Relief

\$2,000 Child Tax Credit: A new non-refundable tax credit can be claimed for each child under age 18. The tax relief is $\$2,000 \times 15.5\% = \310 per child, effective for 2007.

Spousal and other dependant amounts: The non-refundable credits for low-income spouses, and dependants of single individuals, are raised to provide up to \$209 of tax relief, effective for 2007.

Working Income Tax Benefit (WITB): The WITB is a new refundable tax credit equal to 20% earned income greater than \$3,000 to a maximum credit of \$500 for single individuals and \$1,000 for families. To target the assistance to those with low income, the credit is reduced by 15% of net family income greater than \$9,500 for singles and \$14,500 for families. Net family income will be calculated as for the GST credit and the Child Tax Benefit. Payments will begin in 2008.

Economic Assumptions

The 2007 budget is based on the following economic assumptions:

	2006	2007	2008
Real GDP growth	2.7	2.3	2.9
GDP inflation	2.2	1.5	2.0
Nominal GDP growth	4.9	3.9	5.0
3-month Treasury bill rate	4.0	4.2	4.2
10-year government bond rate	4.2	4.1	4.5

All proposals contained in the Federal Budget are subject to passage of appropriate legislation. The Budget debate in the House of Commons will get underway on March 20. Opposition party amendments to the proposed budget will be tabled in the coming days. The final of four debate days on the budget will not come earlier than next week, followed by a confidence vote on the budget.

The Ottawa Update is published by the Government Relations Department of Credit Union Central of Canada.

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