FEDERAL BUDGET 2009

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An Insurance Professional's Guide

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CANADIAN Insurance

by DON BISCH

OVERVIEW

INSURANCE INDUSTRY OPTIMISTIC

Representatives from Canada's property and casualty insurance industry reacted positively to the 2009 federal budget, particularly to the Harper government's proposed investments in renewing Canada's outdated roads and sewers.

The 2009 budget, announced by Finance Minister Jim Flaherty in Ottawa yesterday, was the most important budget in recent years as it signalled the federal government's response to the current economic downturn. Despite the fact that the budget will put the country into deficit for the first time in 13 years, reaction from the P&C insurance industry was largely positive.

"There's one thing that really jumps out as a tremendous positive and that is the spending on infrastructure that is specifically targeted at restoring aging infrastructure," said Dennis Prouse, director of federal government relations with the Insurance Bureau of Canada (IBC). He said the IBC has been telling the federal government to make investments in infrastructure for years, so it was encouraging to see that the budget included a two-year, $4 billion dollar Infrastructure Stimulus Fund targeted at restoring aging infrastructure. Under the proposed fund, provinces, municipalities and territories can apply to have up to 50% of eligible project costs covered for "shovel-ready" projects.

"It was heartening to hear [Finance Minister Jim Flaherty] specifically mention sewer and water in the budget speech," said Prouse. "Sewer backup claims have continued to increase tremendously over the last number of years. That's [due to] a combination of greater extreme weather events and aging infrastructure. To the extent that this will provide greater stability and predictability, that's always a good thing."

"ALL THOSE PROJECTS WILL REQUIRE INSURANCE-RELATED CONTRACTS."

George Cooke agreed that the infrastructure investments proposed by the Harper government will be good for the property and casualty insurance industry. "That's going to create premium income for somebody," said Cooke, president and CEO of The Dominion in Toronto. "There's going to be the need for all those participants to continue to be insured. And all those projects will require insurance-related contracts." He added that the infrastructure spending, if done wisely, should result in safer roads and better storm sewers, which would help mitigate losses.

Insurance brokers could also benefit from the government's proposed infrastructure investment. "That's the biggest thing from the broker's perspective because it's new business," said Eric Walker, a partner with Cookson Walker Group, a consulting firm in Toronto, noting that it will create significant opportunities for those selling bonding insurance. "It's going to add a lot of commission income into the system. Whatever projects need bonding, multiply that by 4%."

However, it may be large, rather than small brokerages that benefit from the proposed infrastructure funding, points out Bob King, CMA, CIP, president of GNK Insurance Brokers in Vancouver. King cites his experience with Vancouver's 2010 Olympics as an example of how a massive project rarely involves any more than large brokers.

"The Olympic contracts went exclusively to Aon, and a lot of smaller brokers were shut out of the bonding contracts because of this; the announcements on large infrastructure spending [in this budget] will do little to benefit the majority of brokers [in Canada]," he said.

Nick Leadbetter, president of Halpenny Insurance in Ottawa was even less impressed with the government's proposed infrastructure funding. "If you look at the budget, there really was nothing about major infrastructure," continued on page 3 continued from page 2 said Leadbetter. "We do have to fix roads and bridges, but the budget only talked about short-term money and two-year timeframes. I hate quick fixes, but almost every government around the world is saying we need quick fixes because the global economy is such a mess."

But infrastructure wasn't the only proposal in Minister Flaherty's budget with implications for the P&C insurance industry. Cooke cited a number of potential benefits, including tax relief for small businesses, which will provide "a much needed lift" for brokers and their clients. As well, the budget included a temporary 100% capital cost allowance rate for computers acquired after Jan. 27, 2009 and before Feb. 1, 2011. "That will be a benefit to many in this industry and will provide a much-needed incentive for people to upgrade and move forward," said Cooke.

Another potential boon to the industry is the $12 billion Canadian Secured Credit Facility to improve credit availability for consumers to purchase and lease new vehicles. "We insure cars. That ought to make it a little bit easier for people to be driving newer vehicles or to be driving period. And that's got to have a benefit to our industry," said Cooke.

He added that the P&C insurance industry can't help but benefit from the government's proposed incentives for home renovations. The budget would implement a temporary Home Renovation Tax Credit to provide up to $1,350 in tax relief for homeowners, as well as an additional $300 million over two years to the ecoENERGY Retrofit Program. "Those features should actually improve the quality of the continued on page 4

BUDGET HIGHLIGHTS

Finance Minister Jim Flaherty delivered a much anticipated federal budget on Tuesday in Ottawa. This budget has many items that could affect your business and present additional savings and opportunities.

SMALL BUSINESS

• **Small business tax relief:** The budget increases the amount of small business income eligible for the reduced federal tax rate of 11% to $500,000 from the current limit of $400,000 as of January 1, 2009.

• **Increased access to credit** for small business through proposed amendments to the Canada Small Business Financing Program and the Business Development Bank of Canada.

• **Funding for small business:** The budget proposes $30 million over two years for the Canada Business Network and $10 million to the Canadian Youth Business Foundation. It would also allocate $200 million over two years to the National Research Council's Industrial Research Assistance Program to enable it to temporarily expand its initiatives for small and medium-sized businesses.

PERSONAL LINES

• **Increase in home premiums:** Homeowners will get a 15% tax credit–up to $1,350 in tax relief–on home improvement projects undertaken in the next 12 months. The client can claim the tax credit on their home, cottage or condo unit as long as the property is owned and used for personal use. However, the renovation cannot exceed the maximum of $10,000 per family. Your client will need to undertake and complete these renovations before Feb. 1, 2010, keep their receipts and claim the credit on their 2009 tax return, but remind them that the renovation will add value to their home.

• **Potential increase in home policies:** The budget offered tax relief for first-time home buyers. They can borrow up to $25,000 per person from a registered retirement savings plan without paying tax or interest and as long as the money is repaid within 15 years. This is the first time the Home Buyers Plan's withdrawal limit was increased since it was first introduced in 1992 (with the $20,000 per person limit).

• **New home tax credit:** First-time buyers will get a tax credit, which could amount to $750 worth of savings on closing costs for anyone purchasing a new home.

• **A new $12 billion Canadian Secured Credit Facility** initiative

continued on page 4

continued from page 3 risks that we otherwise insure."

Fraser Lyle, president of the Insurance Brokers Association of BC, agreed that brokers, particularly those in his province, will benefit from the proposed home renovation incentive. "So many other industries are hooked up with the construction industry in B.C., right down to forestry. These companies also need insurance. And, if they're vibrant and getting business because of these activities, then that bodes well for brokers in B.C."

Just as important as the proposed spending, incentives and tax relief set out in the federal budget, was the important message it sent to Canadian business about the need to pitch in and help boost the economy, said Cooke. "If we all looked at our operations and jumped on board in terms of extra things that we could do, we might be able to actually find a way to leverage off some of these initiatives and add some extra value not only to our policyholders and business partners, but also to the economy in general."

What specifically should P&C stakeholders do to help? "As people are sitting out there talking about layoffs and stepping back from investments in technology, there are incentives in here that say, 'Don't do that.' Maybe some should re-think their plan," said Cooke. "Similarly, some of these initiatives are going to require insurance capacity. And we better make sure we adjust our business plans to make sure that we provide it." ■

(with files from Romana King)

BUDGET HIGHLIGHTS

continued from page 3

will help to improve credit availability for consumers to purchase and lease new vehicles.

COMMERCIAL LINES:

• **A new $4 billion Infrastructure Stimulus Fund** to provide funding to provincial, territorial and municipal infrastructure rehabilitation projects. Funding will be available for two years for projects that will begin construction during the 2009 and 2010 construction seasons. Under the proposed fund, provinces, municipalities and territories can apply to have up to 50% of eligible project costs covered for "shovel-ready" projects.

• **Employment insurance premium rates** will be frozen in 2009 and 2010. A reduction in Employment Insurance premium rates to $1.73 per $100 of insurable earnings, their lowest level since 1982.

• **Computer hardware and systems software** purchases will get a temporary 100% capital cost allowance rate for acquisitions after January 27, 2009 and before February 1, 2011.

• **For manufacturers,** the budget proposes to extend measures announced in the 2007 and 2008 budgets; these prior measures gave business in manufacturing and processing sectors a 50% straight line accelerated rate for eligible assets acquired during a certain period of time. Budget 2009 proposes to extend the rate to investment in machinery and equipment undertaken in 2010 and 2011 as well.

• **A repeal of section 18.2** of the *Income Tax Act,* scheduled to come in to force in 2012 will affect businesses by constraining the deductibility of interest in certain situations where a Canadian corporation uses borrowed funds to finance a foreign affiliate.

• **Energy and mining businesses** will get a break with a new extension to exploration tax credits, the establishment of a new Clean Energy Fund to support research, development and demonstration projects, possibly in areas of interest to "green" investors.

• **Brokers involved in solvency protection** may be pleased at plans to extend the Wage Earner Protection Program to cover severance and termination pay. The program currently provides guaranteed and timely payment of wages and vacation pay owed to eligible workers if employers fail to pay after declaring bankruptcy. Currently the assistance is worth $3,254. ■

FEDERAL BUDGET 2009

by ROMANA KING & PHILIP PORADO


BUDGET.SMALLBIZ

BUSINESS BENEFITS FROM BUDGET

Go out and buy computers. That was the Tory government's clearest message to business owners in its 2009 budget released yesterday in Ottawa. Included in the specifics is a 100% capital cost allowance (CCA) for computers bought between January 27 of this year and February 1, 2011.

Debbie Meloche, Canadian private company services tax leader at Price Waterhouse Coopers says that goodie was a pleasant surprise. "Those [expenditures] were the types of things companies may have been putting off," she says. "So this may have some stimulus."

For many brokers, however, technology investment is not a zero-sum game and this announcement will simply be a bonus to an already existing plan to spend.

"We purchased new computers and servers last year so this acceleration in capital cost allowances won't make a big difference to us," explains Nick Leadbetter, president of Halpenny Insurance Brokers in Ottawa. "But, like most businesses, we are buying bits of technology all the time—particularly since technology really makes a big difference [in this industry]."

Given the continued pressure to innovate, he thinks that many brokerages will welcome the feds temporary 100% CCA for computers, but doubts this will fuel any major spending in the industry.

The budget also extended CCA adjustments to a 50% straight-line accelerated rate for equipment purchased by manufacturers during 2010 and 2011. In theory, the changes will benefit the manufacturing sector, notes Michael Templeton, a senior tax partner McMillan LLP.

"These incentives will help bring more confidence to the economy and help sectors such as manufacturing, retail and transportation—all sectors that buy insurance," says Philomena Comerford, CIP, president of Baird MacGregor Insurance Brokers, based out of Toronto. In her three decades within the industry, Comerford has noticed that, "When the economy is strong the P&C industry is strong."

The problem, says Templeton, is that the manufacturing sector is already hurting, which means most firms will likely have enough write-offs to see them through. It's also limited in terms of who can qualify, he notes.

Meloche agrees: "The problem with this budget is you have to be taxable to benefit from some of this. They have to be profitable," she says. "And as we know a lot of companies aren't in that position. So they don't get anything out of this, ie: no cash."

Of more interest, though, are plans to increase the amount of small business income eligible for a reduced 11% federal tax rate from the current $400,000 to a clean half million retroactive to this January 1. Leadbetter, a self-proclaimed fiscal conservative, says the change is welcome. Budget documents estimate the $100,000 shift will cost $45 million in fiscal 2009-2010 and $80 million in 2010-2011.

"It's a measure that builds on small business, and that's good for the economy," says Leadbetter. "What we agonize over [as a nation] is supporting big business."

Dan Danyluk, CEO, IBAC agrees. "Income eligible for the small business tax rate being increased from $400,000 to $500,000 is a very good thing. It will certainly touch brokers…There are very few brokers, even if they're dealing primarily with auto and home, that aren't also doing small business. So anything that makes it easier for small businesses to survive and encourages them to prosper is going to impact every brokerage."

Bob King, CMA, CIP and president of Vancouver-based GNK Insurance Services, sees potential changes in the broker landscape based continued on page 6 continued from page 5 on these budget announcements.

"Measures which increase the small business tax deduction and the acceleration of write-offs for computer software and equipment, combined with a weakened economy, will promote consolidation in the broker sector," says King. "Brokers will now be able to take advantage of economies of scale and still stay within the small business earnings cap," providing them incentive to go after bigger contracts to compete in different markets.

Big businesses also benefit, despite no further capital tax exemptions. A repeal of rules under section 18.2 of the *Income Tax Act* aimed at preventing double-dipping on interest deductions will help businesses, particularly those that operate outside of Canada's borders. "There are going to be a lot of big businesses cheering on that one," says Kim Moody, CA, TEP, at Moodys LLP Tax Advisors in Calgary.

Rules scheduled to take effect in 2012 were designed to prevent scenarios in which a Canadian company borrowed money to fund a business venture overseas, and then took both a Canadian interest deduction and a foreign interest deduction. "The Canadian authorities looked at this practice and said it was improper," says Templeton, "so they made an anti avoidance rule that was so broad that it would make problems for many multi-jurisdictional operations."

Templeton notes Canadian corporations have a "tough enough time competing internationally" and it's a good move on the part of Parliament to repeal rules that would have made it worse.

continued on page 7

MORE POWER FOR FEDS: BUDGET

by DOUG WATT

In an effort to keep Canada financially stable and avoid future problems in credit markets, such as the recent asset-backed commercial paper crisis, Ottawa plans to give the Department of Finance increased powers to act quickly to protect the financial system in times of stress.

Under today's budget proposals, the finance minister will have the authority to provide loans and lines of credit and to authorize the provision and payment of guarantees, as well as to inject capital directly into federal financial institutions.

"We do not foresee the need to use this authority," said Finance Minister Jim Flaherty in the budget speech, "but we have a duty to be prepared should the unforeseen suddenly emerge."

In related measures, the Canada Deposit Insurance Corporation's (CDIC) borrowing limit will be increased to $15 billion from $6 billion, and the CDIC will be permitted to establish a bridge institution to help maintain stability in the event a CDIC member is no longer viable. Flaherty will be granted the power to direct the CDIC to take specific action to prevent adverse effects on financial stability.

Ottawa also plans to purchase $50 billion of insured mortgage pools in the first half of 2009-2010, in addition to the $75 billion already authorized, bringing the total amount of the program to $125 billion. According to budget documents, this will provide long-term stable funding to lenders.

Flaherty says his government will support the most recent effort to create a national securities regulator, which the minister called a "glaring weakness" in Canada's financial system—pointing out that the current patchwork system of 13 separate regulators across the country causes uncertainty for investors and unnecessary red tape.

Ottawa will establish and fund a transition office for willing provinces and territories, with an eye to tabling a new securities act later this year based on the recommendations of an expert panel chaired by Tom Hockin. Earlier this month, that panel stated that the feds should create a single securities regulator administering a single securities act.

However, Flaherty says Ottawa will respect constitutional jurisdiction, and participation in the new Canadian Securities Regulator will be voluntary. Alberta and Quebec have already indicated that they would not participate in such a program. ■

continued from page 6

Moody adds another good fix is a change in the rules related to the selling of a Canadian Controlled Private Corporation. The existing rules place the sale of a corporation in the beginning of the day the sale takes place, but that created a timing glitch for the disposition of the company; which could put at risk utilization of the capital gains deduction.

That's a big downside, notes Meloche, because being out of control can mean an owner's not eligible for a $750,000 tax deduction. "It could make a very big difference for someone," she says. "If you had two or three owners and this happens, each person is losing that. So it's a good change."

King also sees hope for brokers in the Finance Minister's announcement to promote home buying and home renovations.

• Homeowners will get a 15% tax credit, up to $1,350 in tax relief, on home improvement projects undertaken in the next 12 months. The tax credit can be claimed on the home, cottage or condo unit as long as the property is owned and used for personal use. The renovation cannot exceed the maximum of $10,000 per family and homeowners will need to undertake and complete these renovations before Feb. 1, 2010, keeping all receipts and claiming the credit on their 2009 tax return.

• The budget also allows first-time home buyers to borrow up to $25,000 per person from a registered retirement savings plan, without paying tax or interest, as long as the money is repaid within 15 years. This is the first increase in limit to the RRSP home buyers plan since it was first introduced in 1992 with the $20,000 per person limit.

• Finally, first-time buyers will get a tax, which could amount to $750 worth of savings on closing costs for anyone purchasing a new home.

"This will help the small broker as more buyers are qualified and values improve with renovation."

The one incentive that is missing, according to Dan Danyluk, CEO, IBAC, is tax relief in terms of transfers of business within families. ■

DEFICIT UPDATE

by DOUG WATT

Finance Minister Jim Flaherty says the federal government has no choice but to run a massive deficit over the next five years in an attempt to spend its way out of the current recession. And there's no question the measures in this year's budget are going to put a severe dent in the federal government's coffers.

This year's deficit will be a relatively small $1.1 billion, but is expected to jump to $33.7 billion in the next fiscal year and $29.8 billion in 2010-2011. The deficit is projected at $13 billion in 2011-2012 and $7.3 billion in 2012-2013, for a grand total of $84.9 billion. Ottawa doesn't expect to be back in the black until 2013-2014, when it projects a modest surplus of $700 million.

"A temporary deficit cannot be avoided," Flaherty said in the budget speech. "As a result of the global recession, we expect the Canadian economy to contract by 0.8% over the next year. This means tax revenues will be reduced."

Personal income tax revenues are expected to be about $12 billion lower over the next five years, while corporate tax revenues will drop an estimated $13 billion.

Still, Flaherty insists the deficit won't be permanent or long-running. "As the economy recovers, we fully expect to emerge from deficit and return to surplus within five years. We will use future surpluses first to pay off the debt incurred during the recession."

However, there are some questions about the government's budgetary projections. Although revenues are expected to drop nearly 5% in the current fiscal year, future numbers are more rosy: +6.7% in 2010-2011, +8.1% in 2011-2012, +6.6% in 2012-2013 and +6.5% in 2013-2014.

Dave Clarke, a principal with tax firm Collins Barrow in Ottawa, calls those predictions optimistic. "If these projections don't pan out, we'll be seeing deficits beyond 2014," Clarke warns. ■

CANADIAN Insurance

CUSTOMIZABLE TEMPLATE LETTER

TO CLIENTS/PROSPECTS

Dear [Client/Prospect name],

As you know, Finance Minister Jim Flaherty delivered a much anticipated federal budget on Tuesday in Ottawa.

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

• Homeowners will get a 15% tax credit–up to $1,350 in tax relief–on home improvement projects undertaken in the next 12 months. You can claim the tax credit on your home, cottage or condo unit as long as the property is owned and used for personal use. The renovation cannot exceed the maximum of $10,000 per family and you will need to undertake and complete these renovations before Feb. 1, 2010. Remember to keep all your receipts and claim the credit on your 2009 tax return.

• If you are looking to move from being a tenant to home-ownership, the budget offers first-time homebuyers incentives. First-time home buyers can borrow up to $25,000 per person from a registered retirement savings plan without paying tax or interest and as long as the money is repaid within 15 years. This is the first increase in limit to the RRSP home buyers plan since it was first introduced in 1992 with the $20,000 per person limit.

• Finally, if you are looking to purchase a new home, there is a new tax credit to offset the closing costs that could amount to $750 worth of savings.

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

Sincerely,
Your signature
Your name
(01/27/09)