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Federal Budget 2009: A Stimulating Budget in Uncertain Economic Times

Also in this issue:

In the midst of a deteriorating economic climate, on the heels of another inconclusive federal election, and following an extraordinary Parliamentary crisis that included the replacement of the Opposition Liberal Party leader, the political context and consequences of the 2009 Budget are as much the focus as its content.

After the 2008 election returned Stephen Harper's Conservative Party to power with an increased minority government, all eyes were focused on the federal government's response to a weakening global economic situation. The successful Conservative election campaign was based in large part on the premise that Canada's economy would weather the pending economic storm. The government asserted that the country was better positioned to face the collapse of the global financial system than other nations, and that there was little risk of returning the country's finances to deficit after a decade of surpluses.

With an increased standing in Parliament, a weakened opposition, and mindful of an incoming American administration rolling out various economic stimulus measures, Finance Minister Jim Flaherty was poised in November 2008 to deliver a fiscal update which would chart the new government's agenda for the turbulent years ahead. What followed instead was an unprecedented Parliamentary reaction which threatened to topple the government and supplant it with a coalition of opposition parties.

Unimpressed with the Conservative government's weak response to a growing economic crisis and cornered by the prospect of unpalatable changes to election financing rules, Canada's three Opposition parties refused to support the financial update and moved instead to defeat the government on a confidence motion, replacing it with a coalition government to be led, in the first instance, by the outgoing Liberal Leader Stephane Dion. His budget doomed, Prime Minister Harper sought and received the approval of the Governor General to prorogue Parliament for nearly two months, mere days after the Parliamentary session began.

In the intervening weeks, much has changed in the political arena and the economy. The Liberal Party leadership has passed to Michael Ignatieff and the status of the opposition coalition has become uncertain. Minister Flaherty has accepted that the federal government is

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is heading into deficit and has sought to redraft the budget with spending initiatives to stimulate the economy. His less confrontational budget plan reflects the reality of a minority government attempting to survive an ongoing economic downturn and the unpalatable possibility of being replaced by a coalition government, leaving the public optimistic that the government's second effort will garner enough Parliamentary support to succeed.

In the days leading up to the release of the 2009 Budget, many of the fiscal assumptions and some of the programs contained in it were made public. Most notably, after a decade of consecutive surplus budgets and in the wake of significant reductions in projected revenues, the federal government revealed that there will be a deficit of $1.1 billion for 2008-09, and deficits for at least the next four years: $33.7 billion in 2009-10; $29.8 billion in 2010-11; $13.0 billion in 2011-12; and, $7.3 billion in 2012-13 before the nation's finances return to a projected budgetary surplus of $0.7 billion in 2013-14.

This unprecedented federal budget has two primary components: The Extraordinary Financing Framework to address the credit crisis and The Economic Action Plan to stimulate the Canadian economy. The Financing Framework will provide $200 billion to correct market failures in segments of credit markets, mitigate against systemic risks and work to prevent competitive harm to Canadian firms as a result of policy decisions made by foreign governments.

The government's Economic Action Plan focuses new spending over the next two years, when it projects the economy to be at its weakest. On a cash-basis, the government's stimulus package will be just under $40 billion. Most of the areas targeted are directly or indirectly geared towards stimulating growth and the economy, whether through Skills Transition strategies, infrastructure investment and social housing development, favourable tax measures for businesses and homebuyers or the creation of Regional Development Agencies.

The fate of the minority Conservative government (as of this writing) now rests with Liberal leader Michael Ignatieff and the Liberal caucus. Whatever the outcome of the ensuing Parliamentary debate and confidence votes, this budget will be long remembered by students of the federal political game for the tumultuous drama which led to its inception.

Dan Brock
416 865 4513
dbrock@fasken.com

FINANCE

Response to the Global Financial Crisis

The Government has proposed a number of measures to help mitigate the impacts in Canada of highly risk averse global financial markets, which have limited the availability, and increased the cost, of credit.

Some of the measures and programs proposed in the 2009 Budget seek to improve wholesale borrowing costs for institutions, which should in turn improve access to financing for Canadian businesses and consumers. The measures to improve access to credit build on earlier initiatives taken in the fall of 2008.

The Canadian financial system has fared comparatively well in part because the banking sector in Canada is better capitalized and less leveraged than those in other countries. Nonetheless, some budget measures will give the federal government additional tools to safeguard the Canadian financial system should an institution become unviable or credit markets become more unstable. Many of the proposed measures mirror steps that other G7 governments have taken in recent months to support their financial institutions.

Extension of Insured Mortgage Purchase Program ("IMPP")

The Government will authorize the purchase of an additional $50 billion in insured mortgages under the IMPP to increase liquidity for financial institutions. Under the IMPP, Canada Mortgage and Housing Corporation purchases mortgage-backed securities. The extension of the IMPP will be financed through the issuance of treasury bills and bonds. The size of the original $25 billion program has increased to $125 billion.

New Flexibilities and Resources for Financial Crown Corporations

The Government will increase the authorized capital limits of Export Development Canada ("EDC") and Business Development Canada ("BDC") by $1.5 billion each. As well, the Government will also increase EDC's contingent liability limit to $45 billion and increase the Canada Account limit to $20 million. EDC and BDC will use these funds to participate in the Business Credit Availability Program. The Business Credit Availability Program is a new program designed to provide additional loans and credit support to businesses through enhanced cooperation between private sector financial institutions and the financial Crown corporations. The 2009 Budget also includes a shift in EDC's mandate to allow it to assist Canadian business in areas outside of trade finance.

Canada Small Business Financing Program

Through the Canada Small Business Financing Program, the Government guarantees 85% of loans made to small businesses under the limit. The current limit will be increased to $350,000 and to $500,000 for loans made to acquire real property. Institutions with a portfolio of eligible loans above $500,000 can claim reimbursement on losses of up to 12 percent of portfolio value.

Canadian Secured Credit Facility

In response to market disruption in the availability of consumer and business vehicle and equipment financing, the Government will create the Canadian Secured Credit Facility ("CSCF") with a funding allocation of $12 billion. The CSCF will purchase term asset-backed securities secured by vehicle and equipment loans and leases. The CSCF financing will be provided on commercial terms and, therefore, will be expected to generate a return for the government. Federally regulated financial institutions will be eligible to sell securities to the CSCF and provincially regulated financial institutions may participate with the approval of the Minister of Finance. Unregulated firms, presumably including the automobile finance companies, will be required to establish a plan approved by the Office of the Superintendent of Financial Institutions ("OSFI"), to become federally regulated in order to participate. The Government will also engage in a consultation process with market participants on opening the vehicle and equipment leasing market to banks.

Canadian Lenders Assurance Facility and Canadian Life Insurers Assurance Facility

The Canadian Lenders Assurance Facility ("CLAF"), which the Government announced in October 2008, provides voluntarily participating federal deposit-taking institutions with insurance on commercial terms for term debt they issue. The government guarantee, similar to what other countries are providing their banks, is intended to allow Canadian deposit-taking institutions greater access to global credit markets on competitive terms. The deadline for participating institutions to issue guaranteed debt instruments has been extended from April 30 to December 31, 2009.

The Government will create the Canadian Life Insurers Assurance Facility ("CLIAF") to permit federally regulated life insurers to participate in a debt guarantee program similar to CLAF, which will permit them greater access to global credit markets. Provincially regulated life insurers will be permitted to access CLIAF on the same commercial terms with the approval of the Minister of Finance and an indemnity from the provincial governments that regulate the institutions.

Further Safeguards for Financial Stability

The 2009 Budget contains a number of initiatives directed at providing the Government with additional tools to maintain financial stability and address problems in credit markets. The Government's intention is to create the framework for intervention in the financial system, should that prove necessary. The Government also appears to be motivated by a desire to ensure that the tools available to it are equivalent to those available to the governments of other G7 countries. While some of these tools would provide the Government with significant new powers, the 2009 Budget contains scant description about how and in what circumstances the Government would use these powers.

The 2009 Budget states that the Government will propose new authority for the Minister of Finance to enter into transactions that promote financial stability and maintain efficient and well-functioning markets. The 2009 Budget states that this will include providing loans, lines of credit, and the provision and payment of guarantees. It is not clear what the Government envisions beyond the CLAF and CLIAF facilities discussed above.

Proposals Relating to Canada Deposit Insurance Corporation ("CDIC")

The 2009 Budget contains a number of proposals relating to CDIC. They represent what appears to be significant expansion of CDIC's role in safeguarding financial stability. It is evident that the Government now sees CDIC not simply as a deposit insurer but as a tool for mitigating systemic risk. The following proposals are noteworthy in this regard:

- The Government proposes to be able to establish a bridge institution (a new bank, trust or loan company or retail cooperative credit association) to promote financial stability if a CDIC member is no longer viable. If the U.S. and U.K. approaches are a guide to the Government's thinking then, in the event of the failure of a CDIC member, the new institution would acquire assets and liabilities, including investments and deposits, from the troubled CDIC member as a transitional measure until the new institution, or its business, could be transferred to a viable institution.

- In order to provide CDIC with a broader range of options to respond to systemic risk concerns, the Government proposes to provide the authority to allow CDIC to take actions that may not result in a least-cost solution to CDIC. The 2009 Budget does not say how, or by whom, the cost of such exceptional actions would be funded.

- The Government proposes to grant the Minister of Finance the power to direct CDIC to take specific action to prevent adverse effects on financial stability. This is in addition to the existing power of the Governor in Council under the Financial Administration Act to give directives to CDIC on the recommendation of the Minister.

- The Government proposes that CDIC be allowed to own shares in a member institution, subject to the approval of the Minister of Finance, where that would promote the stability of the financial system in Canada. As discussed below, the Government is also proposing more generally that the Government be able to own shares in federally regulated financial institutions. Presumably, these exceptions to the prohibition on the Government or Crown corporations owing such shares will be temporary, but the 2009 Budget does not say so, nor does it say how such an initiative would be funded.

The Government also proposes the following changes relating to CDIC:

- The Government proposes to increase CDIC's borrowing limit from $6 billion to $15 billion and to escalate this borrowing limit in the future based on further growth in insured deposits.
- The Government proposes to designate deposits held in tax-free savings accounts as a category of deposits insurable by CDIC on a separate basis - that is, insuring deposits held in a TFSA separately, for up to $100,000, in the same manner as RRSP or RRIF deposits are separately insured.
- The Government proposes that CDIC be provided greater flexibility in the timing of preparatory examinations. The purpose of this presumably is to enable CDIC to examine a member institution's deposit systems at an earlier stage so that CDIC would be able to make deposit insurance payments more quickly in the event of a failure.

Government ownership of federally regulated financial institutions

The 2009 Budget states that the Government will propose an authority to allow it to inject capital into federally regulated financial institutions. Government ownership of shares of federally regulated financial institutions is currently prohibited under their governing legislation. The 2009 Budget states that this authority will only be exercised if the Minister of Finance, after consulting with the Superintendent of Financial Institutions, the Governor of the Bank of Canada and the Chair of CDIC, is of the view that this will promote the stability of Canada's financial system. Governments in other countries, most notably the U.S. and the U.K., have invested billions of dollars in their financial institutions. The Government wishes to have the power to take similar action. The 2009 Budget does not indicate what form a capital injection would take, whether the Government would attach conditions regarding how the capital is to be used or how much support would be available.

Legislation governing federally regulated financial institutions also prohibits shares in federally regulated financial institutions from being transferred or issued to foreign governments. This prohibition limits the ability of Canadian financial institutions to engage in transactions (such as acquiring assets being sold off by troubled foreign institutions) with foreign institutions in which foreign governments have an ownership stake and that involve share consideration. The 2009 Budget does not indicate that this prohibition will be removed.

A New Canadian Securities Regulator

The 2009 Budget states that the Government intends to proceed with willing provinces and territories to create a national securities regulator. This was previously announced and comes on the heels of the release on January 12, 2009 of the final report of the Expert Panel on Securities Regulation, Creating an Advantage in Global Capital Markets, and a draft securities act.

New Measures to Help Consumers of Financial Products

Credit Cards and Debt Collection

The Government intends to introduce legislation that will affect financial institutions offering credit cards by requiring more disclosure, including the provision of clear and simple summary information on credit card applications and contracts. As well, institutions will be mandated to provide advance notice of changes to rates and fees. The Government intends to improve the debt collection practices of federally regulated financial institutions. The means by which the Government will pursue these objectives is unclear.

Financial Literacy

The Government will establish an independent task force, which will make recommendations to the Minister of Finance for a cohesive national strategy to improve financial literacy. This task force is to include members of the business and education sectors, volunteer organizations and academics and will be supported by a federal secretariat.

Koker Christensen
416 868 3495
kchristensen@fasken.com

Robert Elliott
416 865 4382
relliott@fasken.com

Jared Gordon
416 865 4458
jgordon@fasken.com

INFRASTRUCTURE

In the intervening weeks between the prorogation of Parliament and today's budget, calls for short-term economic stimulus measures came from all corners. "Shovel-ready" became the catch phrase for immediate investment in projects that would drive short-term employment and material demand while producing lasting community benefits. Opposition politicians, economists, mayors and premiers were largely united in proposing an immediate boost to infrastructure spending to spur local economic activity. The federal government appears to have heeded their call.

Budget 2009 commits nearly $12 billion to renewing infrastructure across Canada. The government's desire for an immediate impact of such spending is reflected in the limited time availability of most of these funds: the money will be distributed over the next two years when the need for economic stimulus is deemed to be greatest. Combined with a commitment to streamline approvals, and an unprecedented singling out of specific projects already under consideration, these budgetary provisions will flow funding as quickly as possible.

Continued Collaboration with the Provinces and Municipalities

As in previous budgets, the majority of the infrastructure funding will be in partnership with other levels of government. In addition to providing local input and prioritization of projects, this partnership will leverage additional infrastructure spending from the provinces, municipalities and the private sector. Included in the federal government's commitment to fund cost-shared municipal and provincial infrastructure are the following measures:

- A $4 billion Infrastructure Stimulus Fund which will see the federal government approve provincial and municipal project plans based on merit and readiness, and cover up to 50% of the costs. This fund is structured to flow all of its funding for construction in 2009 and 2010.

- A five-year, $1 billion Green Infrastructure Fund to support projects related to such things as sustainable energy.

- A two-year, $500 million fund to build and renew community recreation facilities, including sports fields, hockey rinks and swimming pools in smaller communities.

- A $25 million national initiative to create, upgrade and sustain snowmobile and all-terrain vehicle trails.

- A $60 million targeted two-year fund to support cultural infrastructure such as local theatres, community museums and libraries.

- An acceleration of $1 billion under the Provincial/Territorial Base Funding Initiative over two years, for infrastructure projects which are ready to commence. Payments originally planned under this program for the fiscal years 2011-12 through 2013-14 will be made in 2009-10 and 2010-11 to those provinces and territories that can demonstrate the ability to put these funds to work quickly.

The federal government has also announced a two-year, $515 million investment to fund First Nations infrastructure projects, on a cost-shared basis, with the federal government providing up to 50% of the cost. This program will focus on infrastructure related to schools, water, and critical community services, in partnership with municipalities or community groups.

Federal Infrastructure Investment

Budget 2009 lists numerous federal public infrastructure projects slated for investment and renewal, including an expanded VIA rail service in the Toronto-Montreal corridor, at a cost of $407 million; the allocation of $212 million for renewing the Champlain Bridge in Montreal; and $130 million to twin a section of the Trans-Canada Highway through Banff National Park. Other projects include smaller First Nations railways, bridges at U.S. border crossings, federal bridges, small craft harbors, remediation of federal contaminated sites and the restoration of numerous federally-owned buildings.

The Budget commits $2 billion to address deferred maintenance at Canadian universities, colleges and training centres, and identifies a number of large scale investments in specific research facilities and laboratories. It provides $150 million in new funds to the Canada Foundation for Innovation to support leading edge research infrastructure, and an additional $600 million to support future Foundation activities in areas consistent with its mandate.

Other highlighted federal infrastructure spending will include:

- $250 million invested over the next two years to accelerate a Treasury Board-managed process to address deferred maintenance at federal laboratories.
- $500 million committed to continue the work of the Canada Health Infoway, with a goal of having 50 per cent of Canadians with an electronic health record by 2011.
- $282 million spent over two years for aviation security, including measures to improve operations of the Canada Air Transportation Security Agency and the implementation of a new passenger assessment system.
- A further $225 million over three years through Industry Canada to expand broadband coverage to all rural communities which do not currently have broadband internet access.
- Consistent with its northern strategy, $2 million to study the feasibility of a High Arctic Research station, and up to $85 million to upgrade key existing Arctic research facilities.

The federal government has committed to streamlining its regulatory process, and expediting its approval process in order to encourage many of these municipal and provincial infrastructure projects to start in the coming construction season. It has set as a goal the shortening of approval processes by as much as 12 months. Regulatory efficiencies will be achieved through amendments to the Navigable Waters Act, and the Fisheries Act. The government appears poised to curtail current regulatory requirements for projects normally subject to review under the Canadian Environmental Assessment Act.

Despite their commitment to expediting approval, some constitutional and jurisdictional questions remain. The Budget makes specific reference to the government’s commitment to its legal obligation to consult and accommodate with respect to Aboriginal rights and title. This is a challenging proposition, given the government’s desired timelines. Furthermore, it remains to be seen how the government will set into action its Budget commitment to require only one level of government to perform environmental assessments where two are currently required.

Housing Construction

Budget 2009 will provide immediate investment in much-needed social housing across Canada.

It contains a one-time, $1 billion investment over two years to address renovation and energy retrofits in social housing across the country. The funding will flow from the Canada Mortgage and Housing Corporation (CMHC) on a 50-50 cost shared basis with the provinces.

Under the Affordable Housing Initiative, the Budget provides an additional $400 million over two years targeted toward the construction of housing units for low-income seniors and $75 million over two years targeted to housing units for persons with disabilities to be cost-shared with the provinces and territories. Other measures include:

- $400 million over two years to support on-reserve housing for First Nations, with funding to flow from CMHC and Indian and Northern Affairs Canada.
- A further investment in social housing in the North will be funded through CMHC, with $50 million each for the Yukon and Northwest Territories and $100 million for Nunavut.

In addition, the federal government will make $2 billion available in direct, low-cost loans to municipalities through CMHC. These loans can be used by municipal governments to fund their contribution for cost-shared federal infrastructure projects.

Beyond the commitment to public infrastructure, a temporary Home Renovation Tax Credit has been introduced to provide tax relief for home renovation costs, in hopes of spurring demand for building labour and materials, and encouraging homeowners to invest in their property. Families will be entitled to a 15% non-refundable tax credit on qualifying expenditures between $1,000 and $10,000 for a maximum credit of $1,350.

Budget 2009 also contains measures to encourage home ownership, and to stimulate new home construction. The Home Buyers' Plan withdrawal limit will be increased for the first time since 1992 from $20,000 to $25,000. This is the amount that can be withdrawn from an RRSP to purchase a home without being included as income, and must be repaid within fifteen years.

The budget also calls for the creation of a first-time home buyers' non-refundable tax credit of $5000 for eligible costs associated with the purchase of a new home, or for the benefit of an individual eligible for the Disability Tax Credit for the purchase of a more accessible home,

"Shovel ready" infrastructure investment was perhaps the most popular and most widely accepted form of stimulus proposed by economists and politicians alike. Budget 2009 appears to deliver it in spades. In the midst of an unpredictable political context, the political nature and necessity of this significant short-term infrastructure spending is obvious. In addition to leveraging economic commitments from municipal and provincial partners, it will likely leverage the requisite political support of these same leaders, something the governing Conservatives will likely need should the government's economic plan be unsatisfactory to the Opposition.

Tom Barlow
416 868 3403
tbarlow@fasken.com

Sean Morley
416 865 4362
smorley@fasken.com

AUTO INDUSTRY

One of the sectors hardest hit by the global economic crisis is the auto industry. As sources of financing evaporated and credit markets froze, many automobile manufacturers, some of which were already highly leveraged, found themselves in significant financial difficulties. The U.S. automotive industry, in particular, was especially hard hit by the global downturn. General Motors and Chrysler, fearing insolvency, aggressively lobbied both the Canadian and U.S. governments in a highly publicised series of events for an emergency bail-out package commencing in late 2008. The other member of the Detroit "Big 3", Ford, did not request emergency government loans despite sales for its light trucks dropping 18% in 2008.

This is not to say, however, that the only players impacted by the global financial recession are GM, Chrysler and Ford. Japanese, European and Korean automobile manufacturers and auto parts suppliers and dealers, regardless of affiliation, have all been impacted by the financial downturn. For example, in January, 2009, Toyota Motor Corp., in response to the dramatic rise in the value of the yen, was forced to lay off thousands of its contract workers in Japan and, in fact, forecasted its first-ever annual operating loss for 2009.

Regardless, in advance of the 2009 Budget announcement, with over 219,000 Canadians employed in the automobile sector and automobile parts industries, many pundits agreed that swift and decisive attention by the federal government was necessary.

Recent Automotive Initiatives and the 2009 Budget

The 2009 Budget did not provide for specific initiatives relating to the automotive sector except for the Canadian Secured Credit Facility discussed below. It summarizes other initiatives that have recently been announced and states that the Minister of Industry, Tony Clement, will develop a further strategy to be announced as noted below.

The Bailout of Chrysler and GM

As announced on December 20, 2007, the federal government reaffirmed its pledge to provide up to $2,700,000,000 as support for GM and Chrysler; such amounts to be made available in conjunction with the $1,300,000,000 pledged by the Ontario government as part of a $4,000,000,000 aid package (the "Aid Package"). However, at the time of publishing, these funds, although available, have yet to be drawn on by either GM or Chrysler.

It is a term of the Aid Package being made available that each of GM and Chrysler are to provide the federal and Ontario governments with a comprehensive restructuring plan by February 20, 2009. Part of the reason for the choice of this date is likely attributable to the various conditions attached to the Aid Package required by the federal and provincial government. As described by Industry Minister Tony Clement in December of 2008, the Aid Package is contingent on the automobile manufacturers working together with parts suppliers and unions to create a long term viable solution. As such, it is a condition of the Aid Package that either company seeking to draw down on the funds must reduce its labour costs to a level competitive with the U.S. operations of Japanese automobile makers. This condition, in particular, remains unresolved and subject of much discussion.

Furthermore, and perhaps more importantly, GM and Chrysler are also in the process of negotiating the terms of the U.S. government's massive $17,400,000,000 bailout, which may also explain the inability to finalize the terms and conditions of the Aid Package.

Automotive Parts Suppliers

Automotive Parts Suppliers (the "Suppliers") have been significantly impacted by the concurrent freezing of credit markets and downturn in the automotive industry. In advance of the 2009

Budget, Gerry Fedchun, head of the Automotive Parts Manufacturers Association, explained that bankruptcies and insolvencies were a serious concern unless the ongoing issue of access to funding was resolved in a timely manner. Not surprisingly, the federal government has focused resources to ameliorating the credit crunch and easing financing restrictions.

The federal government has developed programs which will provide assistance to Suppliers. First, as announced on January 19, 2009, the federal government has agreed to provide $350,000,000 in investment funding to the Business Development Bank of Canada (the "BDC"), which will enable the BDC to offer up to $1,500,000,000 in new financing for small and medium sized businesses. As explained by Industry Minister Tony Clement in announcing the initiative, these investment funds will be used to support those businesses affected by the financial crisis and, in particular, Suppliers that may be suffering due to the reduced demand for new vehicles. The funding will provide for a $250,000,000 capital investment to increase the BDC's term lending abilities and a further $100,000,000 to top up lines of credit for small and medium sized businesses.

Second, the federal government recently announced that it will be improving Suppliers' access to credit via accounts receivable insurance to be offered by Export Development Canada (the "EDC"). By way of background, accounts receivable insurance insures a company's book of business for up to 90% of any losses incurred against commercial risks. It is the intention of the federal government that this measure will further encourage and facilitate the flow of credit and access to financing for Suppliers.

Stimulating Spending

Prior to Chrysler and GM suspending their respective leasing programs in September of 2008, due to an insufficient amount of available financing, leasing represented approximately 43% of new vehicle sales in Canada. For 2008, the value of Canadian new vehicle leasing fell to $13,700,000,000 from $18,800,000,000 the previous year. This precipitous decline was seen as a result of the collapse of the asset backed commercial paper market, which was the main source of funding for auto financing companies. In Canada, vehicle financing is made primarily through the following companies: GMAC, Ford Credit, Chrysler Credit, Toyota Motor Credit and Honda Credit.

Although details remain forthcoming, the 2009 Budget announced the creation of a $12,000,000,000 Canadian Secured Credit Facility (the "CSCF"). It is intended that this credit facility encourage access to credit for Canadians and, thereby, enabling consumers to purchase and lease new vehicles.

As described in the 2009 Budget, the CSCF will allocate up to $12,000,000,000 to purchase term asset-backed securities that are secured by loans and leases on vehicles and equipment. Federally regulated financial institutions will be eligible to sell into the facility and provincially regulated financial institutions may be eligible on the approval of the Minister of Finance.

Discussion remains ongoing as to whether additional legislative and regulatory amendments will be necessary to provide for the leasing of depreciable assets by federally regulated financial institutions. Currently, Canadian banks are forbidden from holding depreciating assets such as automobiles, although banks are permitted to offer lease financing and administration. It should be noted that banks in the U.S. are permitted to hold depreciating assets, however some commentators have suggested that the involvement of banks in this industry exacerbated the banking crisis in the U.S. as individuals became unable to service their loans.

One More Surprise?

The 2009 Budget also suggests that the measures, as described above, are not the extent of the support programs to be made available to the automobile industry. Sometime in the coming months Industry Minister Tony Clement will announce a broader strategy dealing with the state of the Canadian automotive industry, which will be based on a defined set of principles. The 2009 Budget describes the guiding principles behind this yet to be published strategy as the following:

1. Long-term planning: Strategic investment in specific technologies/areas of the automotive industry in which Canada may have a competitive advantage in the future;

2. Protecting taxpayers: Ensuring government lending related to the automotive industry is sufficiently secured;

3. Maintaining a business analysis: Encouraging private sector lenders and participants to assist the automotive industry's reform process and ensure its sustainability;

4. Broad range of support: Support will be available for Canadian based assemblers, Suppliers and, also, for those contemplating a Canadian investment;

5. Recognizing the global economy: Consideration will paid to the global nature of the automotive industry and Canada's role therein; and

6. Engage all stakeholders: The federal government will not unilaterally support the automotive industry, all interested parties, for example the province of Ontario, will be expected to assist in the restructuring of the automotive industry.

However, with the inauguration of Barack Obama complete and his staff now able to fully concentrate on the U.S. domestic auto sector crisis, it would seem likely that any further announcement from the Canadian federal government will only be made subsequent to, or in tandem with, any U.S. statements on this issue.

Peter Armstrong	**Mark Stinson**
416 868 3454	*416 868 3444*
parmstrong@fasken.com	*mstinson@fasken.com*

HEALTH

Health spending in the 2009 Budget focuses on three areas: health infrastructure, health technology and aboriginal health. The total envelope for health spending across these three priority areas is almost $2 billion over two years.

Health Infrastructure

The 2009 Budget identifies and targets a number of large scale investments in specific research facilities and laboratories, such as Canada Food Inspection Agency laboratories in Quebec and Nova Scotia and Health Canada's regional laboratory in Manitoba. Through the Canada Foundation for Innovation, $150 million in new funds will be provided to support leading edge research infrastructure, and $600 million for future Foundation activities in areas consistent with its mandate. A further $250 million will also be invested over the next two years to accelerate a Treasury Board-managed process to address deferred maintenance at federal laboratories.

Canada Health Infoway

Infoway is a not-for-profit organization that collaborates with the provinces and territories, health care providers and technology solution providers to accelerate the use of electronic health records (EHRs) in Canada. Together, these funders and providers are contributing to the development of a network of EHR systems, enabling efficient communication between health care professionals with the goal of reducing wait times, advancing patient safety and creating better access to quality health care. The federal government is underscoring its ongoing commitment to the Canada Health Infoway by allocating $500 million towards e-health development, with a goal of having 50% of Canadians with an electronic health record by 2011.

Aboriginal Canadians

Budget 2008 provided $147 million over two years to lay the groundwork for a strategy based on greater integration of First Nations health programs with provincial and territorial health systems. Progress has also been made in addressing systemic issues, such as ensuring that severely disabled children receive adequate health services. The federal government is seeking to continue and strengthen its partnership with Aboriginal Canadians by committing an additional $305 million over the next two years to improve health outcomes for First Nations and Inuit people, as well as $20 million to extend partnerships with provinces to further improve child and family services on reserves.

Lynne Golding
416 865 5166
lgolding@fasken.com

TAXATION

International

The 2009 Budget proposes to repeal section 18.2 of the Income Tax Act, which was scheduled to come into force in 2012. Briefly, section 18.2 restricted the deductibility of interest in certain cases where a Canadian corporation used borrowed funds to finance a foreign affiliate and a second deduction for that interest is available in the foreign jurisdiction (i.e. double-dip financing). The proposed repeal is stated to be in response to the report of the Advisory Panel on Canada's System of International Taxation of the potentially negative impact of section 18.2 on foreign investment by Canadian companies. By originally enacting section 18.2, Canada was taking the lead in eliminating double-dip financing. However, section 18.2 has the potential for putting Canadian companies at a competitive disadvantage. Therefore the repeal of section 18.2 will be welcomed by the Canadian business community.

The government is continuing to review the existing proposals regarding non-resident trusts, foreign investment entities and foreign affiliates.

Business

With the goal of providing tax relief to small business, the 2009 Budget proposed to increase the annual amount of active business income of a Canadian-controlled private corporation eligible for the reduced corporate tax rate from $400,000 to $500,000, effective January 1, 2009. This increase will be pro-rated for corporations with taxation years that do not coincide with the calendar year.

The 2009 Budget proposes the extension of the 50% straight-line accelerated capital cost allowance (CCA) for manufacturing and processing equipment acquired in 2010 and 2011. The "half-year rule," which ordinarily restricts CCA which can be claimed in the year an acquired asset is first available for use, will apply to such manufacturing and processing equipment. As well the 2009 Budget proposes to introduce a temporary 100% CCA rate for eligible computer equipment (including systems software) acquired after January 27, 2009 and before February 2011. The "half-year rule" will not apply to eligible computer equipment subject to the 100% CCA rate.

In addition, the 2009 Budget proposes the extension of the Mineral Exploration Tax Credit (i.e. 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors) for one year.

Personal

The 2009 Budget also introduces measures intended to provide tax relief for lower and middle income families. The personal tax measures proposed included an increase of 7.5% in the basic personal amount, the spousal and common-law partner amount and the eligible dependant amount, effective 2009. As well, an increase in the upper limit of the first and second personal income tax brackets for 2009 to $40,726 and $81,452, respectively, is proposed which would result in a reduction in personal tax payable for individuals in these brackets. The increased amounts and tax bracket threshholds will be indexed to account for inflation starting in 2010 and in subsequent years.

The 2009 Budget proposes that the income levels at which entitlement to the Canada Child Tax Benefit and the National Child Benefit supplement is phased-out will be increased for the 2009-2010 benefit year and that the Age Credit (i.e. the federal income tax credit for Canadians 65 years of age or older) is proposed to be increased by $150 for 2009 and subsequent taxation years.

In an effort to promote home ownership, the 2009 Budget proposes an increase in the Home Buyers' Plan withdrawal limit from $20,000 to $25,000. This would permit first-time home buyers to withdraw $25,000 from their RRSPs (without penalty or income inclusion) to assist in the purchase or construction of their first home. As before, amounts withdrawn under this plan must be repaid within 15 years. As well, the 2009 Budget proposes to introduce a new non-refundable tax credit for first-time home-buyers who acquire qualifying homes after January 27, 2009. As proposed, the credit will be $750.

With the goal of encouraging spending on home improvement and to stimulate economic growth, the 2009 Budget proposes the introduction of the temporary Home Renovation Tax Credit. This credit will permit individuals to claim a 15% non-refundable tax credit for eligible expenditures (in excess of $1,000, but not more than $10,000) made in respect of eligible dwellings. This tax credit will apply only to the 2009 taxation year (on expenditures for work performed or goods acquired after January 27, 2009 and before February 1, 2010) in respect of dwellings which are eligible during the period to be a principal residence under the existing tax law.

Finally, the 2009 Budget proposes to allow decreases in the value of RRSPs and RRIFs, following the death of the annuitant of the plan and prior to the distribution of the plan property to the beneficiaries, to be carried back and deducted against the income inclusion in respect of the RRSP or RRIF in the annuitant's year of death.

GST/HST

The 2009 Budget calls for only one change to the Excise Tax Act in respect of the GST/HST - the simplification of the operation of the GST/HST for those businesses engaged in the direct-selling industry. There are two general types of business model employed in the direct selling industry and while one of these models already enjoys a simplified GST/HST accounting method under the Excise Tax Act, the other model does not. The 2009 Budget proposes to implement a special accounting method for those direct sellers using this other business model if certain conditions are satisfied. It is proposed that this special accounting method be available in respect of fiscal years beginning after 2009.

Paul Casuccio
416 868 3491
pcasuccio@fasken.com

Ronald Nobrega
416 865 4399
rnobrega@fasken.com

Mitchell Thaw
416 865 4461
mthaw@fasken.com

RETIREMENT SAVINGS

Defined Benefit Pension Plans

The 2009 Budget recognizes that the funding of defined benefit pension plans has become a significant issue for employers and plan members and sets the stage for more meaningful changes outside the budget process. Of note:

- The funding rules for defined benefit pension plans under the Pension Benefits Standards Act (1985) permit the use of asset smoothing over a period up to five years. However, OSFI currently does not permit the use of an asset value that is in excess of 110% of market value. The 110% limit will be increased to an unstated amount and will be the subject of further guidance by OSFI. Any deferral in funding that results from using an asset value in excess of 110% of market will be subject to a deemed trust.
- The consultation process set out in the government's paper dated January 9, 2009 will be completed within 90 days due to the importance of some of the issues. The government intends to make permanent changes before the end of the year.

These are in addition to solvency funding relief in the form of 10 year solvency amortization that was announced in November, 2008. Details of the Regulation to implement that relief were not included in the 2009 Budget.

Registered Retirement Savings Plans and Registered Retirement Income Funds

If an RRSP or RRIF loses value after the death of the annuitant, the losses may be carried back and applied against the income inclusion in the terminal return of the annuitant. This complements the existing provision that includes in the income of beneficiaries of the RRSP or RRIF any gains in the plan's asset value after the death of the annuitant.

Home Buyers Plan

Since 1992, the Home Buyers Plan has permitted an eligible first time buyer to withdraw up to $20,000 from his or her RRSP. The limit on withdrawals is being increased to $25,000.

Tax-Free Savings Accounts

TFSAs will be a separate category of deposits for the purposes of insurance coverage from the Canada Deposit Insurance Corporation.

Solvency Funding Relief

Having released a comprehensive consultation paper earlier in the month and having previously announced (but not implemented) solvency funding relief, it seems that there was little more that the federal government could offer in the 2009 Budget. The good news in this is that the responses to the consultation will take into account the dismal performance of many asset markets in 2008 and the continued decrease in long term interest rates that are used in determining valuation rates. These have not been reflected in the consultations that some provinces have been holding. With a more current set of responses to work with, it is conceivable that meaningful pension reform could occur at the federal level before it does in the provinces.

Ross Gascho
416 865 5447
rgascho@fasken.com

For more information on the topics discussed in this report, please contact any of the authors of the individual articles or the following key contacts in our Government Relations Group:

Daniel Brock, Toronto
416 865 4513
dbrock@fasken.com

Jean Masson, Montréal
514 397 7493
jmasson@fasken.com

or one of the following members of our team:

Vancouver:

Peter H. Stafford, Q.C
604 631 4721
pstafford@fasken.com

Calgary:

Gary Rose
403 261 6159
grose@fasken.com

Toronto:

W. Thomas Barlow
416 868 3403
tbarlow@fasken.com

Sean L. Morley
416 865 4362
smorley@fasken.com

Ottawa:

Robert J. Buchan
613 236 3882
rbuchan@fasken.com

Joel R. Fortune
613 236 3882
jfortune@fasken.com

Montréal:

Raymond Chrétien
514 397 5230
rchretien@fasken.com

Pierre B. Meunier
514 397 4380
pmeunier@fasken.com

André Turmel
514 397 5141
aturmel@fasken.com

Christian Leblanc
514 397 7545
cleblanc@fasken.com

Québec City:

Pierre Lamontagne
418 640 2040
plamontagne@fasken.com

London:

James Lisson
+44 20 7917 8677
jlisson@fasken.com

Robert Paydon
+44 20 7917 8570
rpaydon@fasken.com

Johannesburg:

Louise Vaillancourt-Châtillon
+27 11 685 0805
lchatillon@jnb.fasken.com