
Business Report

**2010 Federal Budget
March 2010**



2010 Federal Budget Overview

On Thursday, March 4, 2010, Federal Finance Minister Jim Flaherty delivered his fifth budget since assuming the finance portfolio. Although it completes the government's tax relief and spending provisions announced in last January's "Economic Action Plan" to help stimulate the economy, it is a more restrained Budget than the past few years. The Budget contains no major surprises or significant shifts in government economic or fiscal policy. Specifically, it does not propose to raise taxes or cut major transfers for health care, education or pensioners. Instead, the Budget relies on cuts to defense spending and foreign aid, along with future departmental spending freezes, to attempt to reduce the deficit by 2015.

While the Budget does not propose changes to corporate or personal tax *rates*, it does include proposals to offer targeted tax relief, and to close certain tax "loopholes," that will affect both businesses and individuals.

Personal Tax Measures

Employee Stock Options

Currently, a stock option deduction of 50% of the gross stock option benefit is available to employees where certain qualifying criteria are met. The employer is not allowed to claim a tax deduction for the issuance of its shares. However, where the employee "cashes out" their stock option rights without first acquiring the underlying shares, the employee may still qualify for the 50% deduction while the related payment by the employer is fully deductible by the employer.

For transactions occurring after 4:00 pm EST on March 4, 2010, the Budget proposes to limit the 50% employee stock option deduction to situations where the employee first acquires the shares. Consequently, this 50% deduction would not generally be available where the employee cashes out their stock option rights without first acquiring the shares. However, the employer can elect to forego the deduction for the cash payment and thereby allow the employee to claim the 50% stock option deduction.

Tax Deferral Election and Remittance Requirement

Currently, an employee of a non-CCPC (Canadian-controlled private corporation) can potentially elect to defer the tax liability on a stock option benefit where a stock option is exercised and the related shares are not sold until a later year. The deferral of this stock option benefit can result in financial difficulties for an individual where the value of the optioned securities subsequently decreases and the eventual proceeds from the sale of the shares are not sufficient to satisfy the tax obligation on the employment benefit.

The Budget proposes to repeal this tax deferral election for stock options exercised after 4:00 pm EST on March 4, 2010. In addition, the existing withholding tax requirements will be clarified to ensure that the applicable tax on the stock option benefit is required to be withheld and remitted by the employer at the time the stock option is exercised. These measures will prevent situations in which an employee is unable to meet his or her tax obligations as a result of the decrease in the value of these securities.

These amendments to the withholding and remittance requirements will apply to stock option benefits arising on the issuance of securities after 2010 to provide time for businesses to adjust their compensation arrangements and payroll systems. In addition, these proposals will not apply to options granted before 2011 pursuant to an agreement in writing entered into before 4:00 pm EST on March 4, 2010 where the agreement included restrictions on the disposition of the optioned shares.

Special Relief for Tax Deferral Elections

Where a taxpayer disposes of securities of a non-CCPC before 2015 and the related stock option benefit was deferred upon the exercise of the option, special tax relief will be provided. This special relief will ensure that the tax liability on a deferred stock option benefit will not exceed the sale proceeds from the optioned securities after taking into account the tax relief resulting from the use of the capital loss on the optioned securities to offset capital gains from other sources.

A taxpayer may elect to pay a special tax for the year equal to the proceeds from the sale of the optioned shares. This tax election will allow the taxpayer to claim an offsetting deduction equal to the amount of the stock option benefit. In addition, a capital gain equal to one-half of the lesser of the stock option benefit and the capital loss on the optioned shares will be included in income. This capital gain may be offset by the capital loss on the optioned shares, provided that this loss has not otherwise been utilized.

Individuals who disposed of their optioned securities before 2010 will have to make an election for this special tax treatment on or before the filing due-date for their 2010 tax return. In addition, individuals who have not disposed of their optioned shares before 2010 must do so before 2015 in order to qualify for this special tax treatment. The tax election will be required by the filing due-date for the year of disposition.

Note that this special tax treatment will only provide relief for federal income tax liabilities and for provincial and territorial income tax liabilities on those benefits for residents of provinces and territories participating in a Tax Collection Agreement. Residents of other provinces should consider their provincial income tax implications before disposing of non-CCPC option shares as a loss.

Also, where the option shares are still trading and have some value, there may be an opportunity to dispose of the shares by way of a donation, which can provide better income tax results than under the proposed rules.

Contact your D&H Advisor to see what planning makes sense in your circumstances.

Shared Custody Child Benefits

Currently, only one individual, usually the mother, may receive the Canada Child Tax Benefit, Universal Child Care Benefit and the child component of the refundable Goods and Services Tax/Harmonized Sales Tax Credit, even where there is shared custody of the eligible child. Effective for benefits payable commencing July, 2011, these payments may be shared equally between two individuals who live separately where the child lives approximately equally with each of them. Each will receive one-half of the amount to which they would be entitled if they were the sole recipient. These credits will still be able to be received by one individual if the two parties so agree.

Universal Child Care Benefit (UCCB)

In a two-parent family, the \$ 100 monthly UCCB for each child age five or under is included in the income of the lower income spouse. This potentially disadvantages a single parent since the tax on the UCCB could be significantly higher than for a two-parent family. Accordingly, for 2010 and subsequent years, a single parent receiving the UCCB will have the option of including the UCCB for all children in the income of the child for whom the eligible dependant (equivalent-to-married) credit is claimed. If no eligible dependant claim can be made, the parent will have the option of including the UCCB for all children in the income of any one of the children.

Medical Expense Credit

Expenses for medical or dental services, including related expenses such as travel, which are purely for cosmetic purposes will no longer qualify for the medical expense credit. This new restriction is effective for expenses incurred after March 4, 2010. Expenses necessary for medical or reconstructive purposes will continue to qualify for the credit.

U.S. Social Security Benefits

Prior to 1996, Canadian residents receiving US social security benefits were only required to include 50% of these benefits in income, pursuant to the Canada-United States Income Tax Convention. Tax changes in 1996 increased the inclusion rate for these benefits to 85%. The Budget proposes to reinstate the 50% inclusion rate for Canadian residents who have been in receipt of US social security benefits since before January 1, 1996 and for their spouses and common-law partners who are eligible to receive survivor benefits. This measure will apply to US social security benefits received on or after January 1, 2010.

Mineral Exploration Tax Credit

The Budget proposes to extend eligibility for the mineral exploration tax credit for one year to flow-through share agreements entered into on or before March 31, 2011.

Business Tax Measures

Accelerated Capital Cost Allowance

Budget 2010 proposes to expand Class 43.2 (50% declining-balance-CCA rate) to include heat recovery equipment used in a broader range of applications and distribution equipment used in district energy systems that rely primarily on ground source heat pumps, active solar systems or heat recovery equipment. These measures will apply to eligible assets acquired on or after March 4, 2010 that have not been used or acquired for use before that date.

Budget 2010 also proposes that satellite and cable set-top boxes that are acquired after March 4, 2010 and that have neither been used nor acquired for use before March 5, 2010 be eligible for a declining-balance-CCA rate of 40 per cent

Interest on Overpaid Corporate Taxes

To curb possible deliberate overpayments of tax by corporations to earn attractive rates of refund interest from the government, and to reduce its cost of borrowing funds, the prescribed quarterly rate of interest on amounts owing to corporations will no longer include the 2% premium above the prescribed quarterly rate of interest. This new lower interest rate for corporations will apply in respect of amounts including, but not limited to, income tax, Goods and Services Tax/Harmonized Sales Tax (GST/HST), employment insurance premiums and Canada Pension Plan contributions. The interest rates for non-corporate taxpayers will remain unchanged. This measure is effective July 1, 2010.

Taxation of Corporate Groups

The Budget indicates that the government intends to review the framework for the taxation of corporate groups to assess if changes could be made in this area to improve the functioning of the tax system. Potential new rules will be explored, including a formal system of loss transfer or consolidated reporting. The government intends to solicit stakeholders' views before introducing any new legislation

SIFT Conversions and Loss Trading

Currently, tax rules exist to facilitate the conversion of specified investment flow-through (SIFT) trusts and partnerships into corporate entities on a tax-deferred basis. Absent the conversion to corporate form, SIFT trusts and partnerships will be taxed on their distributions no later than 2011.

The Budget contains measures intended to curtail what it perceives to be inappropriate tax-loss trading using the SIFT conversion rules, where such loss trading would not otherwise be permitted between two corporations. The loss trading usually involves a reverse-takeover where an acquiring corporation's tax attributes, including its loss carryovers, are available without restriction to shelter future income earned by the acquired SIFT trust. Existing tax rules restrict the utilization of such losses if the acquired entity was instead a corporation. The Budget proposes to extend these restrictions to situations where units of a SIFT trust or SIFT partnership are exchanged for shares of a corporation. These measures will generally be applicable to transactions undertaken after 4:00 pm EST on March 4, 2010.

International Tax Measures

Section 116 and Taxable Canadian Property

Pursuant to Canadian tax rules, non-residents of Canada are subject to income tax in Canada on gains arising from the disposition of “taxable Canadian property”. However, many of Canada’s tax treaties with other countries contain an exemption from such tax in respect of taxable Canadian property, except for taxable Canadian property that is real estate or shares that derive their value principally from real estate.

The Budget proposes a relieving measure to amend the definition of “taxable Canadian property” to exclude shares of corporations (and certain other interests) that do not derive their value principally from real estate situated in Canada, Canadian resource property and timber resource property in order to reduce deterrents to foreign investors to invest in Canada. This measure will eliminate, in most cases, withholding tax and section 116 certificate compliance obligations on the sale of these types of properties. It will also eliminate the existing requirement of a vendor to file a Canadian tax return in instances where no Canadian tax liability exists in respect of the sale.

This measure will apply for determinations after March 4, 2010 of whether property owned by a taxpayer constitutes taxable Canadian property.

Refunds under Regulation 105 and Section 116

Regulation 105 imposes a withholding tax requirement on amounts paid to a non-resident of Canada who renders services in Canada. Also, section 116 imposes a withholding tax requirement on a purchase of taxable Canadian property from a non-resident. In both cases, the amounts are withheld and remitted to the CRA on account of the non-resident’s potential Canadian tax liability, and the responsibility of the payor/purchaser to withhold and remit such amounts exists even where the non-resident may be exempt from tax in Canada due to a tax treaty (subject to the ability to apply to the CRA for permission to reduce the amount of the withholding).

The ability of the non-resident to file a Canadian income tax return and claim a refund of any excess amounts withheld is subject to certain time limits. The Budget proposes to correct a technical anomaly that otherwise prevents a non-resident from recovering any such excess amounts withheld where the withholding tax is assessed some time after the year of the original transaction. Under the new rules, the tax return claiming the refund of the excess amounts withheld is required to be filed within two years of the assessment of the withholding tax. This measure is proposed to be effective for refunds claimed in tax returns filed after March 4, 2010.

Foreign Investment Entities and Non-Resident Trusts

The Budget contains new proposals to replace previous draft proposals pertaining to Foreign Investment Entities and Non-Resident Trusts. Taxpayers who voluntarily complied with the previous draft proposals for Foreign Investment Entities may choose either to have applicable previous years reassessed or may claim a deduction, in respect of any excess income previously reported, in its current year.

Other Tax Measures

Tax Avoidance Transactions

The government intends to hold public consultations on proposals for a formal reporting process for certain so-called tax avoidance transactions. Details of the proposals and the consultation process will be released at the “earliest opportunity.”

The purpose of the eventual legislation will be to institute a reporting mechanism in respect of potentially abusive transactions to enable the CRA to identify aggressive tax planning on a timely basis - existing anti-avoidance rules, such as the General Anti-Avoidance Rule (GAAR), can then be applied where warranted.

Reportable transactions will be avoidance transactions, as currently defined in the Income Tax Act, that meet at least two of the following three criteria:

1. A promoter or tax advisor is entitled to fees that are to any extent based on the amount of the tax benefit from the transaction, contingent on obtaining the tax benefit, or attributable to the number of taxpayers who participate in the transaction.
2. A promoter or advisor in respect of the transaction requires “confidential protection” about the transaction.
3. The taxpayer obtains “contractual protection” in respect of the transaction

Tax shelters and flow-through share arrangements will be exempted as they have existing reporting mechanisms.

Non-reporting will result in the denial of the tax benefit sought to be obtained. Alternatively, the taxpayer may elect to provide the information, pay a penalty, and still receive the tax benefit. The proposals are intended to apply to avoidance transactions entered into after 2010 and those that are part of a series of transactions completed after 2010. The Budget papers make it clear that reporting is not considered to be an admission that GAAR is applicable to the transaction or series of transactions.

Online Notices

Budget 2010 proposes that the Income Tax Act, Excise Tax Act, Excise Act, 2001, Air Travellers Security Charge Act, Canada Pension Plan and Employment Insurance Act be amended to allow for the electronic issuance of those notices that can currently be sent by ordinary mail. However, notices that are specifically required to be served personally or by registered or certified mail will not be eligible to be transmitted electronically

Aboriginal Tax Policy

The Budget is consistent with the government’s policy to enter into direct taxation arrangements with interested Aboriginal governments. Currently, 44 arrangements in respect of sales tax and personal income tax are in place with *Indian Act* bands and self-governing Aboriginal groups

D&H Group LLP continues to keep you informed of changes (and proposed changes) that can affect you and your business. D&H Group LLP is an eighty person firm with over 50 years experience in providing clients with sound professional advice. We are a member of IAPA which has over 130 offices located throughout the world, including major cities in Canada, the U.S., the Pacific Rim countries and Europe.

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