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Tax News: 2010 Federal Budget Highlights

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Budget Overview

In the afterglow of the Vancouver Olympics, federal Finance Minister Jim Flaherty mounted a podium in the House of Commons on Thursday, March 4, to table his fifth Budget, the second of the current minority Conservative government and the second in succession to follow a period of prorogation of the House.

The Minister described the Budget as a “jobs and growth budget” that completes the government’s Economic Action Plan announced last January and “will help solidify Canada’s economic recovery and sustain our economic advantage now and for the future.” The Budget is relatively cautious and 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.

The Budget projects a federal budgetary deficit of \$53.8 billion in fiscal 2009-10 and a further \$49.2 billion in 2010-11, but sharp declines thereafter leading to a deficit of only \$1.8 billion in 2014-15. This outlook reflects the government’s confidence in longer-term economic recovery as well as the intention to move away from stimulus spending to fiscal restraint.

Among proposed and continued spending programs aimed at stimulating and maintaining economic recovery are \$3.2 billion in personal income tax relief including upgrading the basic personal tax credit and raising child benefits; over \$4 billion in unemployment benefits including some EI premium relief; and \$7.7 billion to stimulate infrastructure and housing construction. The Budget also proposes investment of \$1.9 billion to “create the economy of tomorrow,” including \$600 million to strengthen research and development efforts in Canada.

The Minister pledged increased restraint on government spending, most notably by slowing the projected growth of spending on defense and foreign aid. There are, however, few proposed cuts to program spending. He also promised to freeze the total amount spent on government salaries, administration and overhead. This includes freezing the salaries of the Prime Minister, other ministers, members of parliament and senators, as well as the budgets of ministers’ offices.

While the Budget does not propose major fiscal policy shifts, it contains a number of fairly significant tax-related measures. For example, the government continues to be committed to cutting the corporate tax rate to 15 percent by 2012.

Other noteworthy tax-related proposals include closing some perceived tax loopholes to promote fairness, and the elimination of remaining tariffs on imported machinery and equipment.

These and other provisions are discussed below.

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Personal Income Tax Measures

Stock Options

The budget provided certain amendments to current rules relating to how employee stock options and the deferrals are treated. In general, the changes eliminate a loophole in the legislation and corrects the financial burden that could be caused by holding tax deferred shares received in an employee stock option plan that are underwater as follows:

- Situations where an employee may obtain the 50% deduction of the gross stock option benefit on exercise of a stock option, and the employer may obtain a deduction for the amount paid in cashing out situations will be eliminated. The amendment will allow either the 50% deduction to the employee or a deduction to the employer, but not both.
- The stock option deferral for shares other than a CCPC will be repealed. As a result of the repeal, withholding taxes will be required to be remitted at the time of exercise and no deferral will be required.

The elimination of the deferral should eliminate the financial burden taxpayers may have been exposed to where they held deferred shares which had declined in value from the exercise date by requiring tax to be paid at the time of exercise.

- Special relief will be available for dispositions of shares of non-CCPC corporation before 2015 to allow a taxpayer who has sold or who sells shares acquired as part of an employee stock option plan to treat the exercise price as the sales price.

The proposal offers temporary relief for those taxpayers who had tax deferred on non-CCPC employee stock option shares that have dropped below the fair market value.

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.

Measures for Disabled Taxpayers

Proposed changes to legislation have been made to clarify the rules surrounding Registered Disability Savings Plans (RDSP):

- A tax deferred “rollover” will be allowed where RRSP proceeds are transferred to a RDSP for the benefit of an infirm dependent child or grandchild, effective for deaths after March 4, 2010.

The amount rolled over cannot exceed the beneficiary’s RDSP contribution room, which currently has a lifetime maximum of \$200,000.

There may be the ability to retroactively transfer amount to an RDSP from an estate of a taxpayer whose death was after 2007.

- Canada Disability Savings Grants of up to \$3,500 per year and Canada Disability Savings Bonds of up to \$1,000 per year will have a 10 year carry forward (currently the grants expire at the end of a taxation year if no contribution was made) to the extent that no contributions are made to an RDSP in a particular taxation year.



Measures for Children

The budget proposes the following changes:

- 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.
- 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, for example if the children's income is too high, the parent will have the option of including the UCCB for all children in the income of one of the children for whom it is paid.
- The tax-free portion of a scholarship will be limited to the total of the fees paid to a designated educational institution for tuition and the cost of program-related materials where the taxpayer is enrolled in a part-time qualifying educational program. Scholarships awarded to disabled or infirm students enrolled in a part-time qualifying program will continue to be fully tax exempt.



A qualifying post-secondary school program, for the purpose of the education tax credit and the scholarship exemption, will not include a program which consists primarily of research unless the program leads to a diploma from a college or CEGEP or a bachelor, masters or doctoral degree or equivalent degree. Consequently, post-doctoral fellowships will be taxable.

Other Personal Changes

- Expenses for medical or dental services, including related expenses such as travel, which are purely for cosmetic purposes will not qualify for the medical expense credit effective for expenses incurred after March 4, 2010. Expenses necessary for medical or reconstructive purposes will continue to qualify for the credit.
- US Social Security benefits received by 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 will have an inclusion rate of 50% (reduced from 85%).
- Eligibility for the mineral exploration tax credit is extended for one year to flow-through share agreements entered into on or before March 31, 2011.

Corporate

There were no significant corporate changes in the budget. Some notable changes were:

- Taxpayers who acquire specified clean energy generation and conservation equipment after February 22, 2005 and before 2020 are permitted to treat these assets as Class 43.2 (50% declining balance CCA rate) property.



- 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.

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 legislation.

Charities

The Budget proposes to reform the disbursement quota for fiscal years that end on or after March 4, 2010 by the following measures:

- Repeal of the charitable expenditure rule.
- The capital accumulation rule will allow for accumulations of assets not used in charitable programs up to \$100,000 (formerly \$25,000).
- Amounts transferred between non-arm's length charities will not be able to be used to satisfy the disbursement quota of both charities. Penalties of 110% of the expenditure avoided or delayed can be imposed on both charities on a joint and several basis.

International Taxation

- 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, purchaser withholding and section 116 certificate compliance obligations for these types of properties. It will also eliminate the existing requirement of a vendor to file a related 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.

- Time limits for non-residents to file a Canadian tax return to claim a refund for Canadian withholding taxes have been clarified to require filing within two years.





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