



Summary of the 2010 Federal Budget

March 4, 2010

On March 4, 2010, the honorable Jim Flaherty, minister of Finance, tabled a budget focused on the recovery of the Canadian economy. More specifically, the Government's actions target the creation of employment and job growth that will maintain our national economic advantage, with a view of returning to a balanced budget.

The present budget proposes the following measures:

Personal Income Tax Measures

Benefits Entitlement – Shared Custody

The Budget proposes to allow two eligible individuals to receive Canada Child Tax Benefit and Universal Child Care Benefit amounts in a particular month, and two eligible individuals to receive GST/HST credit amounts in respect of a particular quarter, in respect of a child if the recipients would be eligible to receive amounts under the Canada Revenue Agency's existing shared eligibility policy. This policy applies when a child lives more or less equally with two individuals who live separately.

This measure will apply to benefits payable commencing July 2011.

Universal Child Care Benefit for Single Parents

The Budget proposes to allow a single parent the option of including the aggregate Universal Child Care Benefit amount received, in respect of all of his or her children, in the parent's income or in the income of the dependant for whom an Eligible Dependant Credit is claimed. If a single parent is unable to claim an Eligible Dependant Credit, he or she will have the option of including the aggregate Universal Child Care Benefit amount in the income of one of the children for whom the Universal Child Care Benefit is paid.

This measure will apply to the 2010 and subsequent taxation years.

Medical Expense Tax Credit – Purely Cosmetic Procedures

The Budget proposes that expenses incurred for purely cosmetic procedures (including related services and other expenses such as travel) be ineligible to be claimed under the Medical Expense Tax Credit.

This measure will apply to expenses incurred after March 4, 2010.

Rollover of RRSP Proceeds to an RDSP

The Budget proposes to extend the existing RRSP rollover rules to allow a rollover of a deceased individual's RRSP proceeds to the RDSP of a financially dependent infirm child or grandchild.

The amount of RRSP proceeds rolled over into an RDSP will not be permitted to exceed the beneficiary's available RDSP contribution room (the maximum lifetime contribution limit is \$200,000). The rolled-over proceeds will reduce the beneficiary's RDSP contribution room, but will not attract Canada Disability Savings Grants. Since the amount of RRSP proceeds rolled over to an RDSP will not have been subject to income tax, the amount will form part of the portion of a disability assistance payment that is included in the beneficiary's income when withdrawn from the RDSP.

These measures will be effective for deaths occurring on or after March 4, 2010.

Where the death of an RRSP annuitant occurs after 2007 and before 2011, special transitional rules will allow a contribution to be made to the RDSP of a financially dependent infirm child or

grandchild of the annuitant that would provide a result that is generally equivalent to the proposed measures.

Carry Forward of RDSP Grants and Bonds

The Budget proposes to amend the Canada Disability Savings Act to allow a 10-year carry forward of CDSG and CDSB entitlements.

Upon opening an RDSP, CDSB entitlements will be determined and paid into the plan for the preceding 10 years (not before 2008, the year RDSPs became available), based on the beneficiary's family income in those years. Balances of unused CDSG entitlements will also be determined and maintained for the same period. CDSGs will be paid on unused entitlements, up to an annual maximum of \$10,500.

The carry forward will be available starting in 2011.

Charities: Disbursement Quota Reform

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

- Repeal the charitable expenditure rule;
- Modify the capital accumulation rule (the threshold for an exemption will increase from \$25,000 to \$100,000 for charitable organizations); and
- Strengthen related anti-avoidance rules for charities (notably where it can reasonably be considered that a purpose of a transaction was to delay unduly or avoid the application of the disbursement quota).

Employee Stock Options

Stock Option Cash Outs

It is possible to structure employee stock option agreements so that, if employees dispose of ("cash out") their stock option rights for a cash payment from the employer (or other in-kind benefit), the employment benefit is eligible for the stock option deduction while the cash payment is fully deductible by the employer.

The Budget proposes to prevent both the stock option deduction and a deduction by the employer from being claimed for the same employment benefit. To this effect, the stock option deduction will generally be available to employees only in situations where they exercise their options by acquiring securities of their employer. An employer may continue to allow employees to cash out their stock option rights to the corporation without affecting their eligibility for the stock option deduction provided the employer makes an election to forgo the deduction for the cash payment.

These measures will apply to dispositions of employee stock options that occur after 4:00 p.m. Eastern Standard Time on March 4, 2010.

Tax Deferral Election and Remittance Requirement

The Budget proposes to repeal the tax deferral election and to clarify existing withholding requirements to ensure that an amount in respect of tax on the value of the employment benefit associated with the issuance of a security is required to be remitted to the government by the employer.

The repeal of the tax deferral election will apply to employee stock options exercised after 4:00 p.m. Eastern Standard Time on March 4, 2010.

The clarifications to remittance requirements will apply to benefits arising on the issuance of securities after 2010, to provide time for businesses to adjust their compensation arrangements and payroll systems.

The proposed tax remittance measure will not apply in respect of options granted before 2011 pursuant to an agreement in writing entered into before 4:00 p.m. Eastern Standard Time on March 4, 2010 where the agreement included, at that time, restrictions on the disposition of the optioned securities.

Special Relief for Tax Deferral Elections

The Budget proposes to introduce a special elective tax treatment for taxpayers who elected under the current rules to defer taxation of their stock option benefits until the disposition of the optioned securities.

The taxpayer may elect to pay a special tax for the year equal to the taxpayer's proceeds of disposition, if any, from the sale or other disposition of the optioned securities (for Quebec residents, the special tax will equal two-thirds of the proceeds of disposition).

Where such an election is made:

- The taxpayer will be able to claim an offsetting deduction equal to the amount of the stock option benefit; and
- An amount equal to one half of the lesser of the stock option benefit and the capital loss on the optioned securities will be included in the taxpayer's income as a taxable capital gain. That gain may be offset by the allowable capital loss on the optioned securities, provided this loss has not been otherwise used.

Only stock option benefits for which an election to defer taxation has been made will qualify for this special elective tax treatment. In addition:

- Individuals who disposed of their optioned securities before 2010 will have to make an election for this special treatment on or before their filing due date for the 2010 taxation year; and
- Individuals who have not disposed of their optioned securities before 2010 must do so before 2015. They will then have until their filing due date for the taxation year of disposition to make an election for this special treatment.

U.S. Social Security Benefits

The Budget proposes to reinstate the 50-per-cent inclusion rate for Canadian residents who have been in receipt of U.S. 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 U.S. Social Security benefits received on or after January 1, 2010.

Business Income Tax Measures

Accelerated Capital Cost Allowance for Clean Energy Generation

The Budget proposes to expand Class 43.2 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.

Canadian Renewable and Conservation Expenses – Principal-Business Corporations

The Budget proposes that the definition “principal-business corporation” be amended to clarify that flow-through share eligibility extends to corporations the principal business of which is one, or any combination, of:

- Producing fuel;
- Generating energy; or
- Distributing energy

using Class 43.1 or Class 43.2 property.

This measure will apply in respect of taxation years ending after 2004.

Television Set-top Boxes – Capital Cost Allowance

The Budget 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 Taxes

The Budget proposes that, effective July 1, 2010, the interest rate payable by the Minister of National Revenue to corporations will be set at the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point. The interest rate calculations in respect of non-corporate taxpayers will not change.

Specified investment flow-through (SIFT) Conversions and Loss Trading

In the case of a “reverse takeover” of a public corporation, an existing rule in the Income Tax Act generally deems there to be an acquisition of control of the public corporation in situations where shares of the public corporation are exchanged for shares of another corporation. The Budget proposes to extend this rule to ensure that it also applies to impose restrictions on the use of losses in situations where units of a SIFT trust or SIFT partnership are exchanged for shares of a corporation.

The Budget also proposes to amend the acquisition-of-control rules in the Income Tax Act to ensure that they do not inappropriately restrict the use of losses where a SIFT trust is wound up and distributes the shares of a corporation it holds.

These amendments apply to transactions undertaken after 4:00 p.m. Eastern Standard Time on March 4, 2010, other than transactions that the parties are obligated to complete pursuant to the terms of an agreement in writing between the parties entered into before that time.

International Taxation

Section 116 and Taxable Canadian Property

The Budget proposes that the definition of taxable Canadian property be amended to exclude shares of corporations, and certain other interests, that do not derive their value principally from

real or immovable property situated in Canada, Canadian resource property, or timber resource property.

This measure will apply in determining after March 4, 2010 whether a property is taxable Canadian property of a taxpayer.

Refunds under Regulation 105 and Section 116

The Budget proposes an amendment to section 164 of the Income Tax Act to permit the issuance of a refund of an overpayment of tax under Part I of the Income Tax Act if the overpayment is related to an assessment of the payer or purchaser in respect of a required withholding under section 105 of the Income Tax Regulations (services rendered by a non-resident) or section 116 of the Income Tax Act (disposition of taxable Canadian property by a non-resident) and the taxpayer files a return no more than two years after the date of that assessment.

This measure will be effective for applications for refunds claimed in returns filed after March 4, 2010.

Foreign Tax Credit (FTC) Generators

The Budget proposes measures that will deny claims for FTCs, and foreign accrual tax (FAT) and underlying foreign tax (UFT) deductions, in circumstances in which the income tax law of the jurisdiction levying the foreign income tax, or another relevant jurisdiction, considers the Canadian corporation to have a lesser direct or indirect interest in the foreign special purpose entity than the Canadian corporation is considered to have for the purposes of the Income Tax Act. This measure should generally put the Canadian corporation in the same tax position as if it had made a simple loan to the foreign corporation.

This measure is proposed to be effective for foreign taxes incurred in respect of taxation years that end after March 4, 2010.

Foreign Investment Entities and Non-Resident Trusts

The Budget contains revised proposals with respect to Foreign Investment Entities and Non-Resident Trusts, which will be subject to a public consultation process.

It is proposed that the new measures regarding foreign investment entities apply for taxation years that end after March 4, 2010. A taxpayer who voluntarily complied with the outstanding proposals in previous years will have the option of having those years reassessed.

It is proposed that the measures regarding non-resident trusts apply for the 2007 and subsequent taxation years. An election allowing a trust to be deemed resident for the 2001 and subsequent taxation years will be available.

Sales Tax Measures

GST/HST and Purely Cosmetic Procedures

The Budget proposes to clarify that GST/HST applies to all purely cosmetic procedures, to devices or other goods used or provided with cosmetic procedures, and to services related to cosmetic procedures. Taxable procedures would generally include surgical and non-surgical procedures aimed at enhancing one's appearance such as liposuction, hair replacement procedures, botulinum toxin injections, and teeth whitening.

The proposed clarifying measures will apply to supplies made after March 4, 2010 and to supplies made on or before March 4, 2010 if the supplier charged, collected or remitted GST/HST in respect of the supply.

Other Tax Measures

Specified Leasing Property Rules

The Budget proposes to extend the application of the Specified Leasing Property rules to otherwise exempt property that is the subject of a lease to a government or other tax-exempt entity, or to a non-resident. However, such a lease will continue to be exempt if the total value of the property that is the subject of the lease is less than \$1 million. In this regard, an anti-avoidance rule will apply if it may reasonably be considered that one of the purposes of dividing property (or a class of property) among separate leases is to meet the \$1 million exception.

These measures will apply to leases entered into after 4:00 p.m. Eastern Standard Time March 4, 2010.

Information Reporting of Tax Avoidance Transactions – Public Consultation

The Budget announces a public consultation on proposals to require the reporting of certain tax avoidance transactions.

For this purpose, a reportable transaction would be an avoidance transaction, as currently defined in the *Income Tax Act*, that is entered into by or for the benefit of a taxpayer that bears at least two of the following three hallmarks:

1. A promoter or tax advisor in respect of the transaction is entitled to fees that are to any extent
 - Attributable to the amount of the tax benefit from the transaction,
 - Contingent upon the obtaining of a tax benefit from the transaction, or
 - Attributable to the number of taxpayers who participate in the transaction or who have been provided access to advice given by the promoter or advisor regarding the tax consequences from the transaction.
2. A promoter or tax advisor in respect of the transaction requires “confidential protection” about the transaction.
3. The taxpayer or the person who entered into the transaction for the benefit of the taxpayer obtains “contractual protection” in respect of the transaction (otherwise than as a result of a fee described in the first hallmark).

A transaction that is a tax shelter or a flow-through share arrangement will not be impacted by these proposals.

Upon discovery of a reportable transaction that has not been reported when required, the Canada Revenue Agency could deny the tax benefit resulting from the transaction. If the taxpayer still wanted to claim the tax benefit, it would be required to file with the Canada Revenue Agency any required information and to pay a penalty.

These proposals, as modified to take into account the consultations, would apply to avoidance transactions entered into after 2010, as well as those that are part of a series of transactions completed after 2010.

Online Notices

The Budget 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.

The necessary legislative amendments will be effective as of the date of Royal Assent of the implementing legislation. However, the application of these measures will commence at such time as will be announced by the Minister of National Revenue.

Taxation of Corporate Groups

Going forward, the Government will explore whether new rules for the taxation of corporate groups - such as the introduction of a formal system of loss transfers or consolidated reporting – could improve the functioning of the tax system. Stakeholder views will be sought prior to the introduction of any changes.