

TAX FLASH

New Stock Option Rules Requiring Mandatory Withholding on Exercise

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On September 1, 2010 the Department of Finance issued draft legislation to implement certain proposals announced in the March 4, 2010 budget. Specifically, new subsection 153(1.01) will consider stock option benefits, and benefits relating to units of a mutual fund trust issued to employees, to be remuneration and subject to the same withholding and remittance rules as salary or remuneration. The 50% deduction available to employees under paragraph 110(1)(d) of the Act, where the exercise price is at least equal to the FMV of the share at the time of granting the option, will reduce the stock option benefit on which the withholding tax will apply. However, stock option benefits relating to shares of a Canadian controlled private corporation will not be subject to these new rules.

The withholding requirements under new subsection 153(1.01) will apply for stock options exercised after 2010.

New subsection 153(1.01) will also not apply to stock option benefits arising from options which existed before 4:00 pm EST on March 4, 2010 and which included at that time a written condition prohibiting the employee from selling shares acquired under the agreement for a period of time after exercise. There is no mention as to the length of this time period.

The legislative proposals offer no guidance on how employers are to satisfy the withholding tax obligation. While existing legislation under subsection 153(1.1) gives the Minister of National Revenue discretion to reduce required withholding amounts that would cause undue hardship, new legislation has been introduced specifically stating that relief will not be granted with regards to stock options solely because it is received as a non-cash benefit.

We will continue to do research to determine if the Department of Finance will provide guidance to employers on how to fund the withholding tax obligation.

Prior to the introduction of the draft legislation there was an element of uncertainty as to whether the existing rules required withholdings on stock option benefits. The uncertainty was irrelevant as Canada Revenue Agency ("CRA") had an administrative policy to not require withholdings on these benefits.

Certain steps can be taken to mitigate the impact of these rules and in many cases the stock option agreements will need to be reworded to permit a sale of a portion of the shares or alter the number of shares awarded.

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Registered Disability Savings Plan and the Accident Victim

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What is an RDSP?

The Registered Disability Savings Plan (RDSP) is intended to assist eligible Canadians with disabilities and their families in saving for their long-term financial security.

The RDSP is a new government initiative which was launched effective for 2008 and later taxation years.

Individuals who are disabled or have become disabled as a result of an accident may be in a position to take advantage of the RDSP.

Key Features of the RDSP

- The government will contribute to the RDSP in the form of the Canada Disability Savings Grant (CDSG) and the Canada Disability Savings Bond (CDSB) for a total annual benefit of up to \$4,500.
- Investment income and capital gains remain tax deferred while in the RDSP, but are taxable to the beneficiary when paid.
- Anyone can contribute, with written permission, to an RDSP on behalf of the disabled beneficiary. Contributions are not tax deductible. A beneficiary may only have one RDSP.
- To be eligible as a beneficiary of an RDSP, an individual must qualify for the disability amount on his or her income tax return. To qualify for the disability amount, a doctor or appropriate medical practitioner must certify that the individual has a prolonged physical or mental impairment.
- RDSP's can be opened with most major financial institutions.

Canada Disability Savings Grant

Annual RDSP contributions will qualify for matching government grants based on the following limits and family net income. Family net income is based on the income of the parents and the beneficiary when the beneficiary is less than 19 years of age and on the income of the beneficiary (and spouse, if applicable) for legal adults.

Family Net Income	Contributions	Grant	Maximum
\$81,941 or less	On the first \$500	\$3 for every \$1 contributed	\$1,500
	On the next \$1,000	\$2 for every \$1 contributed Bond	\$2,000
Greater than \$81,941 (or no income tax return)	On the first \$1,000	\$1 for every \$1 contributed	\$1,000

The CDSG is only available when the beneficiary is under age 50 at December 31 and subject to a \$70,000 lifetime maximum grant. Lifetime contributions to an RDSP are limited to \$200,000. There is no annual contribution limit.

Canada Disability Savings Bond

On an annual basis the government will assist beneficiaries in the form of a bond. The assistance is as follows:

Family Net Income	Bond
\$23,855 or less	\$1,000
Between \$23,855 and \$40,970	\$1,000 is reduced on a prorated basis
More than \$40,970 (or no income tax return)	No bond is paid

There is a lifetime maximum benefit of \$20,000. For both the CDSB and CDSG, family net income brackets are to be indexed to inflation. As with the CDSG, the bond is only available if the beneficiary is under age 50 at December 31.

Contributions must remain within the fund for 10 years, or else the CDSG and CDSB must be repaid.

Maximizing the RDSP Benefit and the Accident Victim

One should consider opening an RDSP if the beneficiary is:

- Under 50 years of age
- Canadian resident with a social insurance number
- Eligible for the disability amount
- Looking for long term savings

As the grant and bond are linked to family net income, we will consider two scenarios:

- Family net income exceeds \$81,941
- Family net income is less than \$23,855

Income > \$81,941

An annual contribution of \$1,000 will receive the maximum grant of \$1,000 and the beneficiary is not eligible for any CDSB. The return on the investment is 100% and growth is tax deferred. The benefit of making additional contributions is that funds are tax sheltered until paid to the beneficiary, who may be in a lower tax bracket than the contributor.

In most cases, the appropriate course of action once an individual is certified as disabled is to open up an RDSP and put in the \$1,000 annual contribution. Contributions beyond that amount can be made to an RDSP to take advantage of the tax deferral and the transfer of income to the lower income beneficiary. However, one should consider the beneficiary's tax free savings account first, as it allows investments to grow tax free as compared to the RDSP, which is tax deferred.

Income < \$23,855

An annual contribution of \$1,500 will generate a combined grant and bond of \$4,500 - a return of 300%. As families in this income level may not have surplus funds for investment, they may not be in a position to contribute further amounts, nor may they be concerned with long term savings. In cases with an adult beneficiary, the family net income of the beneficiary may be low, but economic reasons to contribute greater amounts may exist where parents or other family members have surplus funds to invest for the benefit of the disabled person.

A \$1,500 contribution for ten years invested at 3% will grow to approximately \$58,000 in an RDSP as compared to \$17,500, or less depending on the individual's marginal tax rate, in a similar investment outside of an RDSP. There is a significant financial advantage to invest in an RDSP. In situations where funds are unavailable for annual cash contributions the beneficiary can still qualify for the \$1,000 bond.

As families in this situation may not have disposable cash flow, appropriate planning for an accident victim may be to set aside \$1,500, from any insurance or settlement award, for each year until the beneficiary turns 49 to fund annual contributions to an RDSP. This plan will ensure that the funds are available to maximize the government grants. §

Collins Barrow periodically publishes a Tax Flash for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada. While Tax Flash suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.

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