



2010 Federal Budget Commentary

"Leading the Way on Jobs and Growth"

March 4, 2010

Introduction

The Honourable Jim Flaherty, Minister of Finance, today tabled a budget plan that builds on Canada's economic recovery with action to create jobs and growth, sustains our nation's economic advantages and includes a disciplined plan to return to balanced budgets.

Budget 2010 will help solidify Canada's economic recovery and sustain our economic advantage now and for the future. The budget plan has three key objectives.

First, it confirms \$19 billion in new federal stimulus under Year 2 of Canada's Economic Action Plan to create and protect jobs. This new stimulus will be complemented by \$6 billion from provinces, territories, municipalities and other partners.

Second, Budget 2010 invests in a limited number of new, targeted initiatives to build jobs and growth for the economy of tomorrow, harness Canadian innovation, and make Canada a destination of choice for new business investment.

Third, Budget 2010 charts a course to bring Canada's finances back to balance over the medium term and well before any other Group of Seven (G7) country.

Personal Tax Measures

Benefits Entitlement – Shared Custody

Under existing rules, only one eligible individual can receive the Canada Child Tax Benefit and Universal Child Care Benefit in respect of a qualified dependant each month.

To improve the allocation of child benefits between parents who share custody of a child, Budget 2010 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

Budget 2010 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

To ensure consistency with the intent of the Medical Expense Tax Credit, Budget 2010 proposes that expenses incurred for purely cosmetic procedures be ineligible to be claimed under the Medical Expense Tax Credit. A cosmetic procedure will continue to qualify for the Medical Expense Tax Credit if it is required for medical or reconstructive purposes. This measure will apply to expenses incurred after March 4, 2010.

Rollover of RRSP Proceeds to an RDSP

When the annuitant under a Registered Retirement Savings Plan (RRSP) dies, the existing income tax rules generally provide that the value of the RRSP is included in computing the deceased's income for the year of death. However, preferential tax treatment is provided on RRSP distributions made after death to the deceased's surviving spouse or common-law partner, or to children or grandchildren who were financially dependent on the deceased RRSP annuitant.

Budget 2010 proposes to extend the existing RRSP rollover rules to allow a rollover of a deceased individual's RRSP proceeds to the Registered Disability Savings Plan (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. These measures will be effective for deaths occurring on or after March 4, 2010.

Please note that transitional rules exist where the death of an RRSP annuitant occurs after 2007 and before 2011.

Carry Forward of RDSP Grants and Bonds

In recognition of the fact that families of children with disabilities may not be able to contribute regularly to their plans, Budget 2010 proposes to amend the *Canada Disability Savings Act* to allow a 10-year carry forward of Canada Disability Savings Grants (CDSG) and Canada Disability Savings Bonds (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. The carry forward will be available starting in 2011.

Scholarship Exemption and Education Tax Credit

Budget 2010 proposes to clarify that a post-secondary program that consists principally of research will be eligible for the Education Tax Credit, and the scholarship exemption, only if it leads to a college or CEGEP diploma, or a bachelor, masters or doctoral degree (or an equivalent degree). Accordingly, post-doctoral fellowships will be taxable.

Budget 2010 also proposes that an amount will be eligible for the scholarship exemption only to the extent it can reasonably be considered to be received in connection with enrolment in an eligible educational program for the duration of the period of study related to the scholarship. The measures will apply to the 2010 and subsequent taxation years.

Employee Stock Options

Stock Option Cash Outs

The tax rules currently ensure that, when an employee acquires securities under a stock option agreement, only one deduction (at the employee level) is provided. This is because employers are, in this context, prevented from claiming a tax deduction for the issuance of a security.

It is possible, however, 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.

Budget 2010 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

Budget 2010 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. This amount will be added to the employer's remittances of tax withheld at source in respect of all employee salary and benefits, including other in-kind benefits, for the period that includes the date on which the security was issued or sold. These measures will prevent situations in which an employee is unable to meet his or her tax obligation as a result of a decrease in the value of these securities.

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.

Special Relief for Tax Deferral Elections

Some taxpayers who took advantage of the tax deferral election on stock options introduced in Budget 2000 have experienced financial difficulties as a result of a decline in the value of the optioned securities to the point that the value of the securities is less than the deferred tax liability on the underlying stock option benefit.

To provide relief for taxpayers in these situations, Budget 2010 proposes to introduce a special elective tax treatment for affected taxpayers who elected under the current rules to defer taxation of their stock option benefits until the disposition of the optioned securities. In effect, the special elective treatment will ensure that the tax liability on a deferred stock option benefit does not exceed the proceeds of disposition of the optioned securities, taking into account tax relief resulting from the use of capital losses on the optioned securities against capital gains from other sources.

In any year in which a taxpayer is required to include in income a qualifying deferred stock option benefit, 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. 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 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 (generally April 30, 2011); 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

Budget 2010 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.

Mineral Exploration Tax Credit

The eligibility for the mineral exploration tax credit which was scheduled to expire March 31, 2010 will be extended to flow-through share agreements entered into on or before March 31, 2011.

Charity Income Tax Measures

Disbursement Quota Reform

The Canada Revenue Agency may impose sanctions or revoke the registration of a charity in situations where charities use their funds inappropriately, such as in cases where there is undue private benefit. These tools provide a more effective and direct means to fulfill the objectives of the charitable expenditure rule of the disbursement quota.

Budget 2010 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 and strengthen related anti-avoidance rules for charities.

Charitable Expenditure Rule

Provisions relating to enduring property, the capital gains reduction and the capital gains pool, specified gifts and exclusions from the calculation of the base to which the 3.5-per-cent disbursement rate is applied will no longer be required to calculate the disbursement quota.

Capital Accumulation Rule

There is currently an exemption from the capital accumulation rule for charities having \$25,000 or less in assets not used in charitable programs or administration. Budget 2010 proposes to increase this threshold to \$100,000 for charitable organizations. The threshold for charitable foundations will remain at \$25,000.

Anti-Avoidance Rules for Charities

Budget 2010 proposes provisions to ensure that amounts transferred between non-arm's length charities will be used to satisfy the disbursement quota of only one charity. It is proposed that a recipient charity, in such circumstances, be required to spend the full amount transferred on its own charitable activities, or to transfer the amount to a qualified donee with which it deals at arm's length, in the current or subsequent taxation year.

Business Income Tax Measures

Accelerated Capital Cost Allowance

Budget 2010 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.

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.

Canadian Renewable and Conservation Expenses – Principal-Business Corporations

In order to transfer or “renounce” Canadian Renewable and Conservation Expenses to an investor using flow-through shares, a corporation must be a “principal-business corporation”. Currently, the definition “principal-business corporation” includes a corporation the principal business of which is the generation of energy using Class 43.2 property or the development of Class 43.2 projects. Recent expansions of Class 43.2, however, have provided Class 43.2 treatment for certain assets related to energy generation even in cases where the taxpayer is not the party generating the energy.

Budget 2010 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.

Interest on Overpaid Taxes

Budget 2010 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. This new rate for corporations will apply in respect of income tax, Goods and Services Tax / Harmonized Sales Tax (GST/HST), employment insurance premiums, Canada Pension Plan contributions, excise tax and duty (except in respect of excise duty on beer), the Air Travellers Security Charge and the softwood lumber products export charge. The interest rate calculations in respect of non-corporate taxpayers will not change.

Federal Credit Unions

Consequential to the Budget 2010 proposal to allow for the establishment of federal credit unions, certain amendments may be required to the *Income Tax Act* to provide that federal credit unions that satisfy the existing definition “credit union” in the *Income Tax Act* will be subject to the same income tax rules as other credit unions.

SIFT Conversions and Loss Trading

The *Income Tax Act* includes provisions intended to allow specified investment flow-through (SIFT) trusts and partnerships – commonly referred to as income trusts and partnerships – to convert their structures into corporate form on a tax-deferred basis. Aggressive schemes have been designed to use these provisions to achieve inappropriate tax loss trading that would not be allowed as between two corporations.

In particular, the ability of a corporation to utilize its tax losses is constrained where control of the corporation has been acquired. 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. Budget 2010 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.

Budget 2010 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. The rules will be amended to provide that where a SIFT trust, the sole beneficiary of which is a corporation, owns shares of another corporation, the wind-up of the trust will not cause an acquisition of control of the other corporation and restrict the subsequent use of that corporation's losses.

It is proposed that 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 Tax Measures

Section 116 and Taxable Canadian Property

Building upon the measures introduced in Budget 2008, Budget 2010 proposes that the definition of taxable Canadian property in the *Income Tax Act* be amended to exclude shares of corporations, and certain other interests, that within the previous 60 months did not derive their value principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property. This measure will eliminate section 116 compliance obligations for these types of properties and will also bring Canada's domestic tax rules more in line with our tax treaties and the tax laws of our major trading partners. 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

Budget 2010 proposes an amendment to section 164 of the *Income Tax Act* to also 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 payor or purchaser in respect of a required withholding under section 105 of the *Income Tax Regulations* or section 116 of the *Income Tax Act* 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 Generators

In order to avoid tax abuse, Budget 2010 proposes measures that will deny claims for foreign tax credits (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. The Government will be accepting comments in the finalization of the legislation to implement this measure and encourages stakeholders to submit any such comments before May 4, 2010.

Foreign Investment Entities and Non-Resident Trusts

Budget 2009 stated that the Government would review the outstanding proposals before proceeding with measures in this area. As a result of this review, the Government has developed revised proposals to replace the outstanding proposals for public consultation with a view to developing revised legislation, which will then also be released for comment.

Sales and Excise Tax Measures

GST/HST and Purely Cosmetic Procedures

Budget 2010 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. A cosmetic procedure will continue to be exempt if it is required for medical or reconstructive purposes. 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.

Simplification of the GST/HST for the Direct Selling Industry

Budget 2010 confirms the Government's intention to implement the Budget 2009 proposals for simplification of the GST/HST for the direct selling industry and proposes the following enhancements and clarifications to the previously announced measure:

- a clarification that new entrants in the direct selling industry, who meet the qualification criteria and who have never before made a supply of a select product, may apply to the Minister of National Revenue at any time during a fiscal year for approval to use the special GST/HST accounting method for network sellers;
- a clarification that the supply of host gifts by a network seller to hosts would not be subject to the GST/HST; and
- a "safety mechanism" for a network seller that does not meet the qualification criterion concerning the commissions paid by the network seller to its sales representatives for a particular fiscal year.

Budget 2010 proposes that these enhancements apply in respect of fiscal years of a network seller that begin after 2009, matching the timing of the Budget 2009 proposals. A network seller, other than a new entrant, will be required to apply for approval to use the special GST/HST accounting method before the first day of the fiscal year of the network seller in respect of which that method is to begin applying. However, for a fiscal year of the network seller beginning in 2010, it is also proposed that a transitional measure allow a network seller to apply in 2010 for approval to start using the special GST/HST accounting method in 2010 in respect of the remaining part of that fiscal year.

Administrative and Other Tax Measures

Specified Leasing Property Rules

Budget 2010 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

Budget 2010 announces a public consultation on proposals to require the reporting of certain tax avoidance transactions. The Government will undertake consultations with stakeholders on these proposals, with a view to improving the fairness of the Canadian tax system. The proposed regime is similar to, but less strict than, the reporting regimes of other jurisdictions that use hallmarks as a means of identifying aggressive tax planning, such as those of the United States, the United Kingdom and most recently, the Province of Québec.

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.

Taxation of Corporate Groups

The Government has heard various concerns from the business community and from the provinces regarding the utilization of tax losses within 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.

Tariff Reductions on Manufacturing Inputs and Machinery and Equipment

Budget 2010 proposes to eliminate the remaining tariffs on manufacturing inputs and machinery and equipment. The tariff reductions will be given effect by amendments to the *Customs Tariff* and will be effective in respect of goods imported into Canada on or after March 5, 2010.

Disclaimer

The information contained herein is for information purposes only and is not intended to be complete in all respects. It is a summary of budget materials released by the Department of Finance Canada. It is not certain if all or parts of these materials will become law. We recommend that you consult with a Collins Barrow tax professional before acting on the basis of material contained herein.