March 4, 2010

FINANCIAL ADVISORY SUPPORT

The 2010 Federal Budget – March 4, 2010

A summary of the key tax measures that have a direct impact on you

Prior to implementing any strategies contained in this article individuals should consult with a qualified tax advisor, accountant, legal professional or other professional to discuss implications specific to their situation.

On March 4, 2010, Federal Finance Minister Jim Flaherty delivered the Conservative government's latest budget. In view of the challenging world economy and current budget deficits, there are only a limited number of changes proposed in the budget that are likely to have a financial impact on tax paying Canadians and their businesses.

Key highlights of the budget that have a direct impact on you include:

- The government's plan to go forward with previously announced measures that will lower the federal corporate tax rate to 15% by 2012;
- No increases in personal tax rates, or changes in planned indexation of tax brackets and tax credits;
- Elimination of the tax deferral rules for employee stock options exercised after March 4, 2010; and
- Limited new spending measures, with a focus on making technical adjustments to address a number of tax issues.

Please note: There is an element of risk in proceeding with a tax planning strategy that is based on any proposals contained in the budget that have not yet been enacted into law. Historically, the process through which budget proposals become law is a multi-step process that may take a few months to a few years to complete. It is also possible that a budget proposal will never become law. If the opposition parties feel the budget does not provide appropriate measures to improve the Canadian economy, there is a possibility that the minority Conservative government may fall.

While it has been the long-standing practice of Canada Revenue Agency (CRA) to allow taxpayers to file their tax returns based on proposed legislation, a taxpayer remains potentially liable for taxes under the current law in the event that a budget proposal is not ultimately passed. Therefore, if proposed legislation does not become law, it is possible that CRA may assess or re-assess your tax return based on existing legislation. It is recommended that you consult a professional tax advisor to assist you in assessing the costs and benefits of proceeding with specific budget proposals as they relate to you.

Personal Income Tax Changes

Employee Stock Options

Employee stock options have been a popular way for many businesses to remunerate key employees. The budget proposes to eliminate the ability to defer the recognition of employee stock option income for the exercise of employee stock options that occur after March 4, 2010. Previously, this deferral allowed an employee of a publicly traded company to defer recognition of the employment benefit on options exercised until a future sale, to a limit of $100,000 of cost of qualifying stock options vesting in any calendar year. Starting in 2011 employers will also be required to withhold and remit tax on the amount of the benefit along with their regular payroll.

In situations where the value of the securities acquired through the exercise of an employee stock option is less than the deferred tax liability, a special tax election is proposed that will limit the tax liability to the proceeds on the sale, taking into account the tax benefit of the capital loss of the securities acquired through the exercise of the employee stock option. This measure will provide significant tax relief to employees of companies that have had significant reductions in their share price over the last number of years, provided they dispose of their optioned securities before 2015. This measure will also apply to employees who sold their optioned securities in prior years.

Changes are also proposed for situations where an employee accepts a stock option cash out. Prior to proposals in the budget, it was possible for the employee to benefit from preferential tax treatment through the stock option deduction and for their employer to benefit from a corporate deduction. A new proposal will only allow for a choice to be made by the employer of whether the employee or employer receives preferential tax treatment.

Registered Disability Savings Plan (RDSP)

The RDSP is a savings program created by the federal government to assist individuals with disabilities and their families in saving for their long-term financial needs in a tax-deferred environment. The budget proposes to enhance the ability to fund the needs of an individual with a disability by permitting RRSP or RRIF proceeds from a deceased individual to be rolled over to an RDSP held for a child or grandchild of any age who is financially dependent on the deceased because of physical or mental infirmity. The amount of the rollover will not be permitted to exceed the beneficiary’s available RDSP room, with the lifetime contribution limit for an RDSP of $200,000. The rollover will not be eligible for the Canada Disability Savings Grant (CDSG) or Canada Disability Savings Bond (CDSB).

The budget proposes to enhance the ability to receive CDSG and CDSB in situations where regular annual contributions that maximize the amount of these two benefits are not made. The ability to receive the CDSG and CDSB is proposed to be extended by allowing for a 10-year carryforward to these benefits.

Child Benefits

The budget proposes to potentially reduce the taxation of the Universal Child Care Benefit (UCCB) for single-parent families by allowing single parents (or other eligible individuals) to choose to include UCCB payments in their own income, or in the income of the child for whom they are claiming the credit. In most cases, the child would not be subject to tax and this measure could result in tax savings of up to $168 for single parents with one child under six in 2010. This measure will apply to the 2010 and subsequent taxation years.

The budget also proposes to improve the allocation of benefits between individuals who share custody of a child. When a child lives more or less equally with two eligible individuals who live separately, the budget proposes they may receive the Canada Child Tax Benefit (CCTB), UCCB, and the child component of the GST/HST credit. The CCTB / UCCB payments will be equivalent to each eligible individual receiving one-half of the annual entitlement that they would receive if they were the sole eligible individual, paid in monthly instalments over the year. This measure will apply to benefits payable commencing July 2011.

Medical Expense Tax Credit

The budget proposes to remove a number of purely cosmetic medical procedures from the list of eligible expenses for the Medical Expense Tax Credit, such as liposuction, hair replacement, botox injections, and teeth whitening. Cosmetic procedures that are medically required or are for reconstructive purposes will continue to qualify for the credit.

U.S. Social Social Security Benefits

The budget proposes a reduction in the inclusion rate for U.S. Social Security benefits from the current level of 85% to 50% 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. Therefore, taxpayers will include only 50% of the benefits received instead of 85%.

Renewal of The Mineral Exploration Tax Credit

Investors who enter into an agreement to purchase qualifying flow-through shares on or before March 31, 2011, where specified mineral exploration expenses incurred are renounced to the investors, will continue to be eligible to receive a tax credit of 15%. The budget proposes to extend the availability of this temporary tax credit, which was set to expire at the end of March 2010, by an additional year.

Home Renovation Tax Credit Not Renewed

Prior to the release of the budget, the government stated that the hugely popular Home Renovation Tax Credit would not be renewed. This was confirmed in the budget.

Business Income Tax Changes

Income Trust Conversions and Loss Trading

The budget proposes to ensure that income trust and partnership conversions into corporations are subject to the same loss utilization rules that currently apply to similar transactions involving only corporations. The budget proposes to impose restrictions on the use of losses in situations where units of an income trust or partnership are exchanged for shares of a corporation. This measure will apply to transactions undertaken after March 4, 2010, other than transactions that the parties are required to complete pursuant to the terms of a pre-existing written agreement.

Interest on Overpaid Taxes

The government currently pays interest on the overpayment of most taxes at a rate that is more than 2% greater than the average yield available on Government of Canada Treasury Bills sold in the first month of the preceding calendar quarter (T-bill rate rounded up to the nearest percentage point, plus 2 percentage points). Currently this rate is 3%. The budget proposes that effective July 1, 2010 the interest rate payable to corporations will be lowered to equal the relevant T-bill rate, rounded up to the nearest percentage point. This change does not apply to non-corporate taxpayers.

Employment Insurance Premium Rates

The budget proposes to freeze the Employment Insurance premium rate for employees and employers at $1.73 per $100 of insurable earnings to the end of 2010. The maximum annual employee/employer premium for 2010 is $747.36 ($587.52 in Quebec due to separate maternity and parental benefits).

Enhanced Capital Cost Allowance for Clean Energy Generation

Capital Cost Allowance (CCA) allows for deductions to be taken for tax purposes related to the cost of machinery and equipment used for business purposes. The budget proposes to provide the ability to accelerate the recognition of CCA for the purchase of specific equipment that generates or conserves energy. Additional improvements are also proposed to the CCA rules regarding heat recovery equipment.

Tariffs on Manufacturing Equipment

The budget provides for the reduction on tariffs for Canadian manufacturers on the purchase of manufacturing machinery and equipment. The reduction will apply to over 1,500 tariff items – some effective immediately and others to be phased in from March 4, 2010 to the end of 2014.

Other Proposed Measures

Disbursement Quota Reform for Charities

The budget proposes to eliminate the rule that requires charities to spend 80% of their previous-year's tax-receipted donations and certain other amounts (known as the charitable expenditure rule). The 3.5% disbursement quota threshold has been raised to $100,000 from $25,000 for charitable organizations. The threshold for charitable foundations will remain at $25,000.

These new rules will apply to charities for fiscal years ending on or after March 4, 2010.

Non-Resident Tax Reporting for Certain Investments

The budget proposes to narrow the definition of Canadian taxable property to eliminate the need for non-resident withholding tax for shares of corporations resident in Canada that do not derive their value principally from real or immovable property situated in Canada. This measure may make investments by non-residents in Canadian equity investments, in particular, venture capital and private equity funds, more attractive.

Encouraging Participation in Amateur Sports

The budget proposes to provide $44 million for Canada's high performance athletes. This includes $10 million over two years to renew funding for the identification and development of elite athletes, and $34 million over two years to renew and enhance programs that support training and preparation for competition for both winter and summer elite athletes.