

# MNP Tax Alert



## 2010 Federal Budget Summary – Leading the Way on Jobs and Growth

### **British Columbia Region Tax Leaders**

#### **FRASER VALLEY**

**David Cesmystruk**  
604-870-7404

#### **LOWER MAINLAND**

**Ken Robinson**  
604-949-2103

#### **OKANAGAN**

**Derek Johnson**  
250-979-2573

#### **VANCOUVER**

**Eric Feilden**  
604-637-1504

#### **VANCOUVER ISLAND**

**Alladin Versi**  
250-734-4305

Federal Minister of Finance James M. Flaherty delivered the Conservative government's Federal budget on March 4, 2010. Budget 2010 continues to build on last year's Economic Action Plan with a focus on creating jobs and growth, sustaining the nation's economic advantages and planning to return to a balanced budget.

No new personal or corporate income tax rate changes have been announced in this year's Budget and the Government reiterates its commitment to have the lowest corporate income tax rate in the G7 by 2012. The Budget proposals also address the progress of a number of corporate tax measures announced in prior years.

Highlights of the key tax measures announced in Budget 2010 are summarized below.

### **I. Corporate Income Tax Measures**

#### **CORPORATE TAX RATES**

No new corporate tax rate changes were announced this year, however the government confirms that Canada remains on course to have the lowest statutory corporate income tax rate in the G7 by 2012. Budget 2010 also reiterates the government's intent to achieve its goal of a 25% combined federal-provincial corporate income tax rate in collaboration with the provinces. Below is a summary of the current federal corporate tax rates for general and small business corporations:

	General Corporate Rate	Small Business Corporate Rate	Small Business Threshold
2010	18.00%	11.00%	\$500,000
2011	16.50%	11.00%	\$500,000
2012	15.00%	11.00%	\$500,000

#### **INTEREST ON OVERPAID TAXES**

Effective July 1, 2010 the interest rate payable by the government to corporations in respect of overpaid income tax, GST/HST, EI, CPP, excise tax and duty will be reduced by 2%. Currently, the interest rate is equal to the average yield of three month Government of Canada T-Bills sold in the first month of the preceding quarter, plus 2%. The 2% reduction is in response to the Auditor General's report on interest paid on tax overpayments.



**Alberta  
Regional Tax  
Leaders**

**CALGARY**  
**Doug Ng**  
403-537-7682

**CENTRAL  
ALBERTA**  
**Graham Heron**  
403-356-1255

**EDMONTON**  
**Les Creasy**  
780-453-5386

**PEACE**  
**Kim Drever**  
780-832-4287

**SOUTHERN  
ALBERTA**  
**Deidre Jensen**  
403-502-8467

**LETHBRIDGE**  
**Michael Unick**  
403-536-5517

### **EMPLOYMENT INSURANCE PREMIUMS**

Budget 2010 proposes to freeze EI premiums until the end of 2010 at \$1.73 per \$100 of insurable earnings. This is the lowest rate since 1982.

### **SPECIFIED LEASING PROPERTY RULES**

Budget 2010 proposes to extend the application of the specified leasing property rules to otherwise exempt property with value in excess of \$1,000,000 that is the subject of a lease to a government or other tax- exempt entity, or to a non-resident. This proposal applies for leases entered into after 4:00 p.m. EST March 4, 2010.

### **CORPORATE GROUPS - LOSS CONSOLIDATION**

The Government announced that it will explore whether new rules for the taxation of corporate groups could improve the tax system. This is in response to concerns raised by the business community regarding the transfer of losses within a corporate group. Measures to be examined include the introduction of a formal system of loss transfers or consolidated reporting.

### **SIFT CONVERSIONS AND LOSS TRADING**

As a result of the introduction of the specified investment flow-through (SIFT) rules in 2006, many SIFT trusts and partnerships have decided to convert to a corporate structure on a tax-deferred basis using transitional rules. In some cases they have used a reverse takeover strategy to obtain access to loss carryforwards and other tax attributes.

Budget 2010 proposes measures to restrict the utilization of tax losses where units of a SIFT trust or partnership are exchanged for shares of a corporation.

These proposals will apply to transactions undertaken after 4:00pm EST on March 4, 2010, other than transactions that parties are obligated to complete pursuant to a written agreement.

## **II. Personal Income Tax Measures**

### **EMPLOYEE STOCK OPTIONS**

Budget 2010 proposes significant changes to the taxation of stock option benefits:

- **Stock Option Cash Outs** – Budget 2010 proposes to prevent both a stock option deduction for employees and a deduction by the employer from being claimed for the same employment benefit. Under current legislation, this situation occurs when employees dispose of their stock option rights to their employer for cash (or other in-kind benefit). Budget 2010 introduces measures which will allow employees to claim the stock option deduction when they cash out their stock options to their employer but only if the employer elects to forgo the deduction for the cash payment. If the employer does not make the election, the employee will not be entitled to the stock option deduction.



## Saskatchewan Regional Tax Leaders

### NORTH SASK

**Dave Boyko**

306-664-8301

### SOUTH SASK

**Carol Hanney**

306-790-7930

## Manitoba Regional Tax Leaders

### EASTERN

#### MANITOBA

**Terry Speiss**

204-788-6059

### WESTERN

#### MANITOBA

**Shawn de Delley**

204-571-7672

## Ontario Regional Tax Leaders

### TORONTO

**Stella Gasparro**

416-260-3515

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

- **Stock Option Tax Deferral Election and Remittances** – Budget 2010 proposes to repeal the tax deferral election introduced in Budget 2000 which allows an employee of a publicly traded company to defer the recognition of a stock option benefit until the disposition of the securities. The repeal of the tax deferral election will apply to employee stock options exercised after 4:00 p.m. EST on March 4, 2010.

In addition to the repeal of the tax deferral election, Budget 2010 proposes to clarify withholding requirements to ensure employers remit the required withholdings on stock option benefits in the period that the security is issued or sold.

- **Special Relief for Tax Deferral Elections** – Budget 2010 proposes to provide relief for taxpayers who hold securities subject to a prior year stock option tax deferral election where, at the time of disposal, the securities have a value less than the deferred tax liability. Budget 2010 proposes special elective treatment that will ensure the tax liability on a deferred stock option benefit does not exceed the proceeds of disposition of the optioned securities. The securities must be disposed of before 2015. The election is also retroactive for securities disposed of before 2010.

### ROLLOVER OF RRSP PROCEEDS TO A RDSP

Budget 2010 proposes to allow a rollover of the proceeds of a deceased individual's RRSP to the Registered Disability Savings Plan (RDSP) of a financially dependent infirm child or grandchild. This is an extension of the existing RRSP rollover rules. Special transitional rules apply for deaths of RRSP annuitants after 2007 and before 2011.

### TAX CREDITS


#### ***Medical Expense Tax Credit – Cosmetic Procedures***

Effective for expenses incurred after March 4, 2010, the Budget proposes that expenses incurred for purely cosmetic procedures will not be eligible for the Medical Expense Tax Credit.

#### ***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 the program leads to a college diploma, or a bachelor, masters or doctoral degree.

In addition, the amount eligible for scholarship exemption must 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.



If a scholarship, fellowship or bursary amount is provided in connection with a part-time program, the exemption will generally be limited to the amount of tuition paid for the program plus the costs of program-related materials.

#### ***Mineral Exploration Tax Credit***

Budget 2010 proposes to extend the eligibility for the mineral exploration tax credit to flow-through shares agreements that are entered into on or before March 31, 2011. The existing program was scheduled to expire on March 31, 2010.

#### **CHILD TAX BENEFITS**

##### ***CCTB and UCCB - Shared Custody***

Where a child lives with two eligible individuals who live separately, Budget 2010 proposes to allow the two individuals to share the monthly Canada Child Tax Benefit (CCTB) and Universal Child Care Benefit (UCCB) amounts and the quarterly GST/HST credit. This measure applies for benefits payable commencing July 2011.

##### ***UCCB - Single Parent***

Beginning 2010, a single parent will have the option of including the total Universal Child Care Benefit (UCCB) received in his/her income or in the income of the child for whom the Eligible Dependant Credit is claimed or in the income of one of the children for whom the UCCB was paid.

### **III. International Taxation**


#### **SECTION 116 AND TAXABLE CANADIAN PROPERTY**

Budget 2010 proposes to amend the definition of taxable Canadian property to exclude shares of corporations, and certain other interests, that (within the previous 60 months) do not derive their value principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property.

This proposal will eliminate section 116 compliance and tax reporting requirements for most share investments in Canadian corporations. This proposal will apply to determinations of taxable Canadian property after March 4, 2010.

#### **REFUNDS UNDER REGULATION 105 AND SECTION 116**

Budget 2010 proposes to fix a technical inconsistency in the Income Tax Act (the "Act") relating to non-resident taxpayers applying for refunds of overpayments of tax under Regulation 105 and Section 116 of the Act. Currently these provisions of the Act require payors of funds to non-resident service providers and purchasers of taxable Canadian property to withhold and remit to the CRA an amount on account of the non-resident's potential Canadian tax liability. Provided that the non-resident files an income tax return on a timely basis, there are provisions in the Act for the taxpayer to



receive a refund of any overpaid taxes. An anomaly exists in the Act which currently results in a non-resident being unable to obtain a refund of any overpayment of tax due to the interaction of the prescribed time limits to obtain a refund and the lack of a deadline for CRA to assess a payor who fails to withhold taxes.

The Budget proposal will permit a refund of an overpayment of tax if the overpayment is related to an assessment of the payor (or purchaser) and the taxpayer files a return no more than two years after the date of that assessment. This measure is effective for refunds claimed in returns filed after March 4, 2010.

#### **FOREIGN TAX CREDIT GENERATOR SCHEMES**

The government introduced proposals in Budget 2010 which target taxpayers who structure transactions in a manner where they receive tax arbitrage benefits as a result of the foreign tax treatment relating to the same transaction. Situations where this may arise are where Canadian corporations use foreign partnerships or foreign corporations that are intended to qualify as a foreign affiliate.

Some Canadian corporations have engaged in plans referred to as “foreign tax credit generators” which are designed to shelter tax otherwise payable in respect of interest income on loans made (directly or indirectly) to foreign corporations. These plans can artificially create foreign taxes that are claimed by the Canadian company (as a foreign tax credit (“FTC”), a foreign accrual tax (“FAT”) or an underlying foreign tax (“UFT”) deduction which will offset Canadian tax otherwise payable). Budget 2010 proposes measures that will deny claims for FTC’s, and FAT and UFT deductions in specific situations. These proposals are effective for foreign taxes incurred in respect of taxation years that end after March 4, 2010.

#### **FOREIGN INVESTMENT ENTITIES (FIES) AND NON-RESIDENT TRUSTS**

The government initially tabled legislation which proposed very complex rules to limit the use of these types of structures to reduce or defer Canadian income taxes. Budget 2010 proposes to simplify these proposals.


### **IV. Indirect Tax Measures**

#### **DIRECT SELLING INDUSTRY**

Budget 2010 proposes that network sellers using the commission based model for GST/HST purposes will now be able to apply for the use of a special GST/HST accounting method, provided the network seller meets certain qualification criteria. In addition, Budget 2010 clarifies that host gifts will not be subject to GST/HST, and further, a safety mechanism will be available for direct sellers where their annual sales may exceed \$30,000.

#### **COSMETIC MEDICAL PROCEDURES**

Budget 2010 proposes to clarify that cosmetic medical and dental procedures, as well as the goods and services related to these procedures, will be subject



to GST/HST. Only those cosmetic procedures that are required for medical or reconstructive purposes and are paid for by the provincial health insurance plan are exempt from GST/HST.

### **TARIFFS ON MANUFACTURING EQUIPMENT**

Budget 2010 proposes to eliminate tariffs on a number of different items of manufacturing equipment. There will be 1,160 items that will have a duty rate of free and a number of other items that will have their duty rate reduced to free over a period of time.

## **V. Other Measures**

### **INFORMATION REPORTING OF TAX AVOIDANCE TRANSACTIONS**

The government announced a public consultation on proposals that would require reporting of certain tax avoidance transactions as part of an initiative to improve the fairness of the Canadian tax system. These proposals would be in addition to the current general anti-avoidance rules (GAAR) and tax shelter rules found in the Act, and are not as strict as other similar regimes found in the US, the UK and the Province of Quebec.

The proposals state that a tax "avoidance transaction" that features at least two of three "hallmarks" will be considered a "reportable transaction". These "hallmarks" include situations where:

1. a promoter or tax advisor is entitled to fees that are attributable to the amount of the tax benefits or contingent upon the obtaining of a tax benefit;
2. the promoter or tax advisor requires "confidential protection" about the transaction; and
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.

If a reportable transaction is not reported when required, CRA could deny the tax benefit resulting from the transaction (the taxpayer would then be forced to provide the required information plus pay a penalty if they still wanted to claim the tax benefit).

The disclosure of a reportable transaction would not be considered an admission that GAAR applies to the transaction.

The proposals (as modified to take into account the pending consultations) would apply to avoidance transactions entered into after 2010, and any part of a series of transactions completed after 2010.

## **CHARITIES – DISBURSEMENT QUOTA REFORM**

Budget 2010 proposes the following measures, to apply to the fiscal years of charities ending on or after March 4, 2010:

- Elimination of all disbursement quota requirements except those requiring the annual disbursement of a minimum amount of investments and other assets not used directly in a charity's operations;
- Repeal of the charitable expenditure rule;
- Increase in the exemption threshold of the capital accumulation rule from \$25,000 to \$100,000 for charitable organizations. The threshold for charitable foundations will remain at \$25,000;
- Strengthening of anti-avoidance rules.

## **VI. Reintroduction of Previously Announced Corporate Measures**

Budget 2010 confirms the Government's intention to proceed with the following previously announced tax measures:

- Foreign Affiliate Proposals – December 18, 2009;
- Bill C-10 [2007] – proposed FIE and NRT rules (with new changes as discussed above), restrictive covenant rules, and other technical amendments which "died on the order paper" due to the dissolution of Parliament on September 7, 2008.



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