

# 2010 Federal Budget

Tax Newsletter  
2010

## Introduction

The Honourable Jim Flaherty tabled the latest federal budget on March 4th. The government remains focused on creating the conditions for a smooth economic recovery, including the full implementation of the stimulus package announced in the previous budget. The government also has a plan to rebalance the books of our nation in the future. The potential tax changes arising from the budget and other recent announcements that may affect you or your business are outlined below.

Issues addressed in the budget and other recent announcements include:

- Purely cosmetic medical procedures might no longer qualify for medical expense credits (and may become subject to the GST)
- Certain Notices of Assessment might be issued electronically
- Charities' disbursement quotas may be relaxed
- Employee health and life trust rules may be tightened
- The home renovation tax credit has not been extended
- The Registered Disability Savings Plan rules were enhanced
- Restrictions were proposed related to qualifying programs for scholarship exemptions and the education tax credit
- The budget announcement included no new changes to personal or corporate tax rates
- U.S. Social Security Benefits received by Canadian residents may be eligible for a proposed reduction to a 50 percent income inclusion rate (if they have been in receipt of benefits since before 1996)

## inthisissue

<b>INTRODUCTION</b>	<b>1</b>
<b>AGGRESSIVE TAX SCHEMES</b>	<b>2</b>
<b>PERSONAL</b>	<b>3</b>
<b>BUSINESS</b>	<b>3</b>
<b>OTHER MEASURES</b>	<b>5</b>



- New Capital Cost Allowance rules and clarifications of previous rules were proposed
- Changes are anticipated to the rules affecting Specified Investment Flow-Through entities, Foreign Investment Entities and Non-Resident Trusts
- The Taxable Canadian Property definition may also be relaxed in certain circumstances
- Ontario taxpayers will be affected by the previously announced HST transition (effective July 1st)
- The Ontario corporate surtax is slated to be eliminated on July 1st

The budget changes proposed will generally apply to transactions entered into on the announcement date (the “Effective Date”), although other dates may apply to specific issues. An “Effective Time” of 4 p.m. on that Effective Date may also apply.

The application of tax law changes will be subject to an interpretation of the specific wording of enacted legislation, and professional tax advice should be obtained prior to entering into, or reporting, transactions affected by the proposed budget.

## AGGRESSIVE TAX SCHEMES

The federal government has announced it will issue proposals and begin a consultation process for new rules that might require taxpayers to report aggressive tax planning schemes.

However, it appears they would be limited to cases in which at least two of the following circumstances exist:

- the promoter of the scheme is entitled to contingent remuneration,
- the promoter requires confidentiality protection regarding the transaction and,
- the taxpayer receives contractual protection.

The federal proposals appear to be less rigorous than the approach being taken in Quebec, as outlined in the Quebec proposal on aggressive tax planning (January 2009) and the subsequent information bulletin on fighting aggressive tax planning (October 2009).

## PERSONAL

The budget proposes a number of changes to personal taxation, including:

- Enhancements to the Registered Disability Savings Plan (RDSP) rules, including:
  - Carry forward rules for unused entitlements to Canada Disability Savings Grants/Bonds
  - A deceased individual’s RRSP funds may be rolled over to the RDSP of a financially dependent infirm child or grandchild under certain circumstances (subject to limitations)
  - Clarification that provincial payments into an RDSP might not affect federal payments to the RDSP
- Provincial payments to Registered Education Savings Plans (RESP) might not affect federal payment amounts to the RESP
- The government may restrict the program eligibility requirements of post-secondary programs for scholarship exemptions and education tax credits
- Certain Canadian-resident recipients who have been recipients of U.S. Social Security Benefits since before 1996 may experience a reinstatement of the 50% income inclusion rate, subject to limitations
- An extension of the mineral exploration tax credit for flow-through share investors for agreements entered into on or before March 31, 2011

- The budget did not propose to extend the home renovation tax credit

### **Cosmetic procedures – medical expense credit and GST/HST changes**

After the Effective Date the budget proposes to deny the medical expense credit for expenses incurred for certain cosmetic medical procedures undertaken solely to improve appearance (such as liposuction, teeth whitening, or hair replacement). Supplies of those procedures and related goods may then be subject to the Goods and Services Tax and/or Harmonized Sales Tax.

### **Employee stock option benefit rules tightened**

The budget proposes to limit the application of the employee stock option deduction for qualifying securities on transactions occurring after the Effective Time, which in certain circumstances permit a deduction of one-half of the resulting employment benefit. The deduction would now be restricted to those cases in which the employee actually exercises the options to acquire securities of the employer, and would not be available where the employee simply cashes out their options with the employer. This restriction might not be applied in the event the employer elects to forgo the deduction for the cash payment it makes to acquire its eligible stock options.

A number of other changes to the employee stock option rules are proposed in the budget, including:

- Elimination of the \$100,000 tax deferral election for employees of publicly-traded companies on their employee stock option benefits vesting in a particular year (for options exercised after the Effective Time)
- The budget proposes a tax relief election to ensure the net tax liability on a deferred stock option benefit will not exceed the share disposition proceeds. However, those rules

will consider any tax relief arising from the use of losses on the optioned securities that could be applied to capital gains from other sources

- Clarification that employers are required to withhold and remit an amount related to the employment benefit arising from issuing a security, but with possible exceptions for certain agreements to grant options (that are subject to security disposition limitations) entered into before the Effective Time
- Clarification that a disposition of stock option rights to a non-arm's length person may result in an employment benefit at the time of the disposition

## **BUSINESS**

The budget includes a number of provisions affecting Canadian businesses, including:

- Elimination of tariffs on certain manufacturing inputs, machinery and equipment imported from outside North America
- An anti-avoidance rule may be introduced in respect of leased property valued at less than \$1 million, where property has been divided into separate leases to meet the \$1 million threshold
  - Specified leasing property rules might then apply to certain property that would otherwise be exempt in respect of leases of property valued at less than \$1 million to non-residents and certain tax-exempt entities such as a government
- The government proposes to begin considering new rules in respect of corporate groups, including a consolidating reporting and a new system for inter-corporate loss transfers

## **Restrictions on the use of losses arising from income trust conversions**

The government announced they would put restrictions in place to prevent inappropriate loss trading for specified investment flow-through (SIFT) entities. The rule changes may be relaxed for transactions arising from agreements entered into on or before the Effective Date.

A tax on SIFT entities, such as income trusts, were introduced previously, and rules are also in place to permit a SIFT to convert to a corporation on a tax-free basis. The budget proposes to apply the rules which restrict the use of losses following a corporate acquisition of control to similar circumstances where a SIFT unit is exchanged for shares of a corporation.

However, under the proposed changes the acquisition of control rules will also be amended to prevent those rules from applying in certain circumstances, such as where a SIFT trust is wound up and distributes, to its sole corporate beneficiary, the shares of another corporation the SIFT owns.

## **Capital cost allowance (CCA) changes**

The budget proposed changes to the CCA rules, including a declining balance CCA rate of 40 percent for digital satellite set-top boxes that decode television signals.

Corporations engaged in the generation of clean energy may be permitted to transfer deductions for Canadian Renewable and Conservation Expenses to their flow-through share investors. The budget proposes to clarify that eligibility for these particular flow-through deductions are restricted to corporations engaged in the principal business of distributing or generating energy, or fuel production.

The budget also proposes to broaden the scope of assets eligible for certain CCA classes. The scope

of Class 43.2 (50 percent declining balance basis) will be expanded beginning on the Effective Date for thermal waste heat recovery equipment. The budget proposes to expand the scope of eligible use, and to remove the restriction that recovered heat must be reused in the same type of process from which it was generated.

The above Class 43.2, along with Class 43.1 (30 percent declining balance basis), may also see their scopes expanded to include specified thermal energy distribution equipment used by the taxpayer in certain circumstances. The equipment must not have been previously acquired for use, and must be part of an energy system using specified renewable energy technologies to provide heating or cooling to a district.

## **Other measures**

The budget proposes a number of other measures:

- Rules may be changed to permit for the issuance of more electronic Notices of Assessment, including those in respect of income tax and the GST
- Federal credit unions may now be allowed
- Relief from the time limitations that previously may have prevented taxpayers from recovering overpayments of tax under Regulations 105 and Section 116 of the *Income Tax Act*
  - Regulation 105 relates to withholding tax requirements for payors of funds to non-resident providers of services, while Section 116 relates to the tax liability of dispositions of taxable Canadian property
  - The budget proposes to permit the Canada Revenue Agency to issue a refund of tax overpayments arising from Regulation 105 or Section 116 provided the taxpayer files a

return within 2 years of the assessment date

- The definition of taxable Canadian property may be amended to exclude the shares of certain corporations (and certain other forms of interests) that do not derive their value principally from real or immovable property located in Canada (or timber resource properties or Canadian resource properties)
- The government may identify, and take steps to prevent, foreign tax credit generator schemes which seek to escape taxation in regards to interest income on loans to foreign corporations
- The previously proposed amendments relating to foreign investment entity (FIE) rules may be repealed
- The budget proposed changes that may simplify the previously proposed amendments relating to non-resident trusts (including the deemed residency rules for those trusts, and

the joint and several liability for Canadian tax of those trusts that applied to the trustees, contributors to, and beneficiaries of, those trusts)

- Registered charities may experience more flexibility in regards to their disbursement quotas on or after the Effective Date
  - The proposed elimination of the 80 percent rule, that required charities to spend 80 percent of their receipted donations (and certain other amounts) from the prior year on charitable programs or gifts to qualified donees (subject to limitations)
  - A proposed increase from \$25,000 to \$100,000 for the quota exemption threshold on accumulated capital (not available for charitable foundations)
  - However, the government may also introduce anti-avoidance rules that would apply to charities that engage in transactions which unduly avoid or delay the distribution quota

**This newsletter was prepared by McLarty & Co's taxation services group for the benefit of clients and other interested parties.**

**Clients are invited to contact the taxation services group or their relationship manager if they have any questions about the Federal Budget or another tax or business matter.**

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