CI Investments

2010 FEDERAL BUDGET

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Tax highlights from the 2010 federal budget

Finance Minister James Flaherty tabled the 2010 federal budget on March 4, 2010. As widely expected, the economic turmoil of the past 18 months, combined with the government's $47 billion stimulus package, has resulted in the projection of a series of annual deficits until the end of the 2014–2015 fiscal year. It is expected that the deficit for the almost completed fiscal year 2009–2010 will come in at a slightly lower than anticipated $53.8 billion. This budget includes a three-point plan for returning to a balanced budget in the future. Those points include:

- following through with the exit strategy built into the economic stimulus measures introduced last year;
- restraining spending through the limiting of program growth to an average of 1.3% per year, resulting in $17.6 billion of savings over a five-year period; and
- undertaking a comprehensive review of government administrative functions and overhead costs.

This plan is based on the assumptions that the government will neither raise taxes nor cut transfers to individuals or other levels of government. Deficits for the next four years are projected to be $49.2 billion in 2010–2011, $27.6 billion in 2011–2012, $17.5 billion in 2012–2013, and $1.8 billion in 2014–2015. These projections are based on various economic assumptions with respect to growth in overall GDP, increasing tax revenues and spending control. Much will depend on the resilience of the economy south of the border, as the United States is our largest trading partner and a driver of Canadian economic activity.

As expected, there was very little new tax relief beyond what was introduced as part of the stimulus measures in the 2009 budget. In fact, over the next five years, three of the proposed tax measures – relating to the medical expense tax credit, employee stock options, and interest on corporate tax overpayments – are projected to generate incremental tax revenue in excess of the revenue forgone by extending certain other benefits.

The following pages are a summary of the changes announced in the budget. Please note that these changes are still proposals until passed into law by the federal government.

PERSONAL TAX MATTERS

Personal income tax rates

There were no changes announced with respect to personal income tax rates in this budget. The effective rates for 2010 and corresponding tax bracket thresholds are shown in the following table.

Taxable income range	Tax rate
$10,382 – $40,970	15%
$40,971 – $81,941	22%
$81,942 – $127,021	26%
$127,022 or more	29%

Universal child care benefit for single parents

The 2010 budget proposes to put single parents receiving the universal child care benefit on an equal footing with single-earner couples earning the same level of income, effective January 1, 2010. The budget allows a single parent the option of including the total amount of universal child care benefit received on behalf of his or her eligible children in either the parent's income or in the income of the child claimed under the eligible dependent credit. If not entitled to the eligible dependent credit, the parent could opt to include the universal child care benefit in the income of one of the children.

Benefit entitlement in cases of shared custody

The budget proposes to allow for the allocation of child benefits between parents who share custody of a child. Where a child lives separately with each parent for a fairly equal amount of time, the child tax benefit, universal child care benefit, and the child component of the GST/HST credit will be split equally between them. This proposal will apply to benefits payable on or after July 1, 2011.

Medical expense tax credit

The 2010 budget proposes to exclude expenses incurred for purely cosmetic reasons from qualifying for the medical expense tax credit. Expenses (including related expenses such as travel) incurred after March 4, 2010 for surgical and non-surgical procedures used to enhance one's appearance such as liposuction, hair replacement, botox injections, and teeth whitening will no longer qualify. This is consistent with tax treatment in other jurisdictions including Quebec, the United States, and the United Kingdom.

Cosmetic procedures such as those described above will remain eligible for the medical expense credit in cases where they were required for medical or reconstructive purposes.

Rollover of RRSP proceeds to an RDSP on death

RRSP funds of deceased annuitants currently can be rolled over to RRSPs of surviving spouses, common-law partners or disabled dependent children or grandchildren. Similar rules apply to RRIFs and RPPs.

The 2010 budget extends this tax-deferred rollover treatment to allow transfers of a deceased individual's RRSP proceeds to the RDSP of a financially dependent infirm child or grandchild. An infirm child or grandchild is generally considered to be financially dependent if the child's income for the preceding year was less than the specified threshold ($17,621 in 2010).

The amount of RRSP proceeds that can be rolled over to the RDSP is limited to the beneficiary's available RDSP contribution limit, which has a lifetime maximum of $200,000. These proceeds will reduce available contribution room but will not attract Canada disability savings grants. Since tax is deferred on the rollover, the full amount of the transferred proceeds will form part of the disability assistance payment that is included in income when withdrawn from the RDSP.

This measure is effective for deaths occurring on or after March 4, 2010, and it will be necessary for the RDSP beneficiary or his or her legal representative to make an election to transfer the RRSP proceeds to the RDSP on a rollover basis.

Where the death of the RRSP annuitant occurs after 2007 and before 2011, the budget provides transitional relief. These rules allow an eligible individual to make an election to contribute an amount up to the amount of the deceased's RRSP proceeds to the RDSP of the qualifying child. An eligible individual could be either a beneficiary of the deceased's estate or a direct recipient of the deceased's RRSP proceeds. An offsetting tax deduction will be provided to either the deceased annuitant's final tax return or the contributing individual, depending on where the income inclusion originally was recorded. In order to qualify for this transitional provision, the required election forms must be filed and the contribution must be made before 2012. It should be noted that contributions cannot be made before July 1, 2011, in order to provide time for financial institutions and the government to adjust their systems.

Carry forward of RDSP grants and bonds

Annual RDSP contributions can earn matching Canada disability savings grants of up to $3,500 per year and matching Canada disability savings bonds of up to $1,000 per year, depending on family income. However, unlike the RESP rules, the RDSP rules have no provision to allow for a carry forward of unused grant and bond entitlements.

The 2010 budget proposes to amend the Canada Disability Savings Act to allow for a 10-year carry forward of unused CDSG and CDSB entitlement. The carry forward will be available starting in 2011. As contributions are made to the plan, CDSGs will be paid on unused entitlements up to an annual maximum of $10,500 per year.

Provincial payments into RDSPs and RESPs

This budget proposes to clarify that all payments made to an RDSP or RESP through a program funded, either directly or indirectly, by a provincial government will be treated the same way as federal grants and bonds. Accordingly, these provincial payments will not attract or reduce the federal grants or bonds.

Scholarship exemption and tuition tax credit

The 2010 budget proposes to clarify that a primarily research-based post-secondary education program will be eligible for the education tax credit and the scholarship exemption, only if it leads to a college or CEGEP diploma, or a university degree. Accordingly, post-doctoral fellowships will be taxable.

If a scholarship, fellowship or bursary relates to a part-time program, it is proposed that the scholarship exemption be limited to the amount of tuition paid for the program plus the cost of program related materials, unless mental or physical impairment restricts the student from enrolling on a full-time basis.

Both of these measures will apply to the 2010 and subsequent tax years.

Employee stock options – cash-less exercise

In order to address a perceived tax loophole, the budget proposes to address an issue related to the taxation of stock options for employees of publicly traded companies. In certain circumstances, an employer may structure a stock option agreement to allow the employee to dispose of the option for a cash payment from the employer, sometimes referred to as a "cash-less exercise." In these cases it may be possible for the employee to benefit from the stock option deduction provision, which allows for a deduction equal to 50% of the taxable employment benefit, while at the same time the employer benefits from a tax deduction equal to the full amount of the employment benefit.

Effective at 4 p.m. (EST) on March 4, 2010, the budget proposes to limit the ability for both the employee and employer to claim deductions on the same amount. Going forward, the stock option deduction will generally only be available to employees who exercise their options by acquiring shares of their employer. The proposal leaves the door open for the employee to claim the deduction for the cash-less exercise; however, that would require the employer to file an election to forgo the deduction for the cash payment.

The budget also clarifies that the disposition of rights under a stock option agreement to a non-arm's length party will result in an employment benefit at the time of disposition.

Employee stock options – tax deferral election and remittances

Current legislation allows employees of publicly traded companies to defer taxation on up to $100,000 of stock option benefits vesting in a particular year. The budget proposes the repeal of this tax deferral election for employee stock options exercised after 4 p.m. (EST) on March 4, 2010.

The budget goes on to clarify that for employment benefits arising from the exercise of employee stock options after 2010, the employer will be required to withhold tax at source and remit same to the government on behalf of the employee.

Employee stock options – relief for tax deferral election

The tax deferral election noted above was originally introduced in the 2000 budget. As a result of declining equity values, some individuals may continue to own shares that are valued at less than the outstanding deferred tax liability on the employment benefit. To provide some relief in these situations, the budget proposes a tax election that ensures that the tax liability on the deferred stock option benefit does not exceed the proceeds of disposition of the underlying shares.

This election allows the individual to pay a special tax for the year equal to the proceeds received on the sale or other disposition of the optioned securities. This relieving provision will only apply to stock option benefits that were subject to the deferral election. In addition:

- individuals who disposed of these securities before 2010 will have to make this election on or before their filing deadline for the 2010 tax year (generally April 30, 2011); and
- individuals who have not disposed of these securities before 2010 must do so before 2015. They must make the election before the filing deadline for the year that includes the disposition of the shares.

U.S. social security benefits

The Canada-United States Tax Convention was modified, effective January 1, 1996, to require Canadian residents to include 85% of U.S. social security benefits received in taxable income. This was an increase from the previous 50% inclusion rate.

The 2010 budget proposes to reinstate the 50% income inclusion rate for Canadian residents who have been in receipt of U.S. social security benefits since before January 1, 1996. This provision also applies to their spouses and common-law partners who are entitled 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 for flow-through share investors

The budget extends this credit for flow-through share arrangements that was scheduled to expire on March 31, 2010. The credit will continue to be available for flow-through share arrangements entered into on or before March 31, 2011.

CORPORATE TAX MATTERS

Corporate income tax rates

There were no changes announced with respect to corporate income tax rates in this budget. The effective rates for 2010 and subsequent years are shown in the following table.

Year	Small business rate	General corporate rate
2010	11%	18%
2011	11%	16.5%
2012	11%	15%

The federal government has confirmed that it still wants to achieve a maximum combined federal-provincial corporate income tax rate of 25% by 2012.

Interest on overpaid taxes

The government has been paying interest on outstanding corporate taxpayer balances each quarter at a rate equal to the average yield on three-month government of Canada treasury bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2%. The auditor general recently commented that given current interest rates, this rate was very favourable and that corporations were essentially banking with the government to receive this above-market rate, resulting in the government essentially borrowing funds at an interest cost higher than it would pay on the public debt markets.

The budget proposes that, effective July 1, 2010, the interest rate payable by the minister of national revenue to corporations be reduced by 2%, to the average yield on three-month government of Canada treasury bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point.

Various other tax measures

The budget proposes various other measures that are applicable to specific industry sectors, large business enterprises, income trust conversions, international taxation, and tax avoidance transactions. These proposed measures include:

- accelerated capital cost allowance provisions for clean energy generation;
- expansion of the definition of "heat recovery equipment" for eligible assets acquired on or after March 4, 2010;
- expansion of the definition of "distribution equipment of a district energy system" for eligible assets acquired on or after March 4, 2010;
- amendment of the definition of "principal business corporation" for the purpose of flow-through share eligibility related to renouncing Canadian renewable and conservation expenses;
- increasing the capital cost allowance rate for satellite and cable television set-top boxes;
- allowing for the establishment of federally chartered credit unions;
- amending the acquisition of control rules in the Income Tax Act to impose restrictions on the use of losses in situations where units of SIFT trusts or partnerships are exchanged for shares of a corporation;
- reducing tax compliance obligations with respect to section 116 clearance certificates on the disposition of certain types of property to non-residents of Canada;
- denying foreign tax credits in certain circumstances where taxpayers use foreign corporate entities structured as "foreign tax credit generators," that are designed to shelter Canadian tax that would otherwise be payable;
- further changes to the foreign investment entity and non-resident trust rules;
- changes to the specified leasing property rules;
- announcement of a public consultation process regarding information reporting for "tax avoidance transactions"; and
- review of loss consolidation rules within corporate groups.

OTHER PROPOSALS

Employment insurance

The budget proposes to freeze EI premiums at the current level of $1.73 per $100 until December 31, 2010.

Tariff relief on machinery and equipment

The budget proposes to permanently eliminate all remaining tariffs on manufacturing inputs and machinery and equipment imported into Canada.

GST/HST and purely cosmetic procedures

The budget clarifies that GST/HST applies to all purely cosmetic procedures, as well as to devices and other goods and services related to these procedures. The same criteria and types of procedures as noted above in the discussion of the medical expense tax credit would apply. This provision applies to supplies made after March 4, 2010.

Simplification of GST/HST for direct sellers

This budget confirms the 2009 budget proposal to simplify GST/HST accounting method for direct sellers who sell through a network of self-employed sales representatives. This method may be used where none of the sales representatives are expected to earn over $30,000 per fiscal year and a joint election is filed between the network seller and the sales representative. This measure is proposed to be effective for fiscal years of a network seller that begin after 2009.

Disbursement quota reform for charities

Registered charities are required to spend a certain amount of their tax-receipted funds every year for charitable purposes. This is currently accomplished through the disbursement quota mechanism. The budget proposes to reform the disbursement quota for fiscal years that end on or after March 4, 2010, by:

- repealing the charitable expenditures rule;
- modifying the capital accumulation rule; and
- strengthening related anti-avoidance rules for charities.

Other legislation

The prorogation of Parliament in December 2009 resulted in the demise of a number of outstanding legislative proposals. The government noted that it intends to reintroduce a number of these previously-announced tax measures in the current session of Parliament.

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