

# *Tax* **Bulletin**

The Wilkinson Tax Group

## **FEDERAL BUDGET** **March 4, 2010**

### **Analysis**

The Minister of Finance, Jim Flaherty, presented his Budget on March 4, 2010. We have analyzed the Budget and have identified those items that are of most importance to our clients.

The Budget does not introduce significant amendments to the *Income Tax Act of Canada*. There have been no changes to the personal and corporate tax rates; in particular, the previously announced decreases in the corporate tax rate will proceed. The basic calculation of income for tax purposes will, for the most part, remain unchanged.

As always, there are proposed tax changes and we have identified those that we consider most important.

### **Personal Tax**

#### *Employee Stock Options*

- Employees can currently receive a stock option in shares or receive cash in lieu of shares. After March 4, 2010, if the employee receives cash in lieu of shares, then the employer will be precluded from deducting the amount paid.
- Employers will be required to remit withholding taxes on the value of the stock option benefit.
- Some employees have received stock options in the past and deferred the recognition of the income, only to face an adverse tax situation because the value of the stock has declined from its value at the time of exercise. Those individuals will be able to elect that the tax liability does not exceed the ultimate proceeds realized on the sale of the shares.
- Shareholders of public companies have been able to defer the recognition of the income benefit under certain circumstances. This ability to defer the income will terminate for stock options exercised after March 4, 2010.

### *Medical Expense Tax Credit*

- After March 4, 2010, qualified eligible medical expenses for the medical expense tax credit will not include those which are purely cosmetic procedures. Expenses will continue to qualify if they are for medical or reconstructive purposes.

### *Scholarship Exemption and Education Tax Credit*

- A few years ago the federal government provided that any scholarships received were simply tax-free. Effective for 2010, they have narrowed the amount of a scholarship that can be received tax-free or the program that qualifies for the education tax credit. In particular, they have made the following restrictions:
  - Post-doctoral fellowships will not be tax-free.
  - Only amounts that are related to the period of study will be tax-free.
  - If the amount relates to part-time study, the tax-free amount will be limited to the tuition paid.

### *Registered Disability Savings Plans (RDSP)*

- In 2007 the federal government introduced the Registered Disability Savings Plans and financial institutions have been slow in implementing these plans. Amendments have been introduced to make these plans more attractive:
  - A deceased person will be eligible to transfer an amount from a RRSP directly into a RDSP without including the amount in the income of the deceased.
  - Entitlements of the Canada Disability Savings Grants (CDSG) and Canada Disability Savings Bonds (CDSB) will be eligible for a 10 year carryforward. This means that an individual can open a RDSP now and get CDSGs or CDSBs back to 2008.
  - The rules will be amended to allow provincial contributions to a RDSP without altering the amount of any federal grants or bonds.

### *United States Social Security Benefits*

- Up to 1995, only 50% of US Social Security was required to be included in income of a Canadian resident. After that year, the inclusion rate was increased to 85%. For payments after 2009, the inclusion rate will be reduced to 50% for persons (or their survivors) who have been in receipt of US social security since before January 1, 1996.

### *Child benefits*

- Recipients of the Universal Child Care Benefit, the Canada Child Tax Benefit and the GST/HST tax credit will be permitted to:
  - Elect to split the benefit between them in the case of separated parents.
  - Elect to put the income in the hands of certain dependants in the case of a single parent.

### *Mineral Exploration Tax Credit*

- This program was to end March 31, 2010 and it has been extended to include agreements entered into on or before March 31, 2011.

## **International Tax**

Several amendments are proposed regarding international taxation. A list of the items being amended is:

- Revisions are made to the section 116 withholding requirements and the definition of taxable Canadian property.
- Refunds will be paid to non-residents up to two years after a tax return has been filed by a non-resident for section 116 and regulation 105 returns.
- The Foreign Investment Entity rules which were first announced in 1999 and never passed will now be scrapped.
- Non-resident trust rules introduced in 1999 will be simplified and anomalies related to the application of these rules simplified.
- Certain loans to non-residents will be denied a foreign tax credit where the purpose of the transaction is to artificially increase the foreign tax credit to a Canadian taxpayer.

## **Business Tax**

Several amendments are introduced but very few of them relate to small businesses and owner-managed enterprises. The business amendments cover:

- A new regime of reporting tax avoidance transaction where a promoter or tax advisor is paid a percentage of the tax saved and/or the transaction requires “confidential protection” for transactions entered into after 2010 or a series of transactions completed after 2010.
- The capital cost allowance rate (CCA) for television set-top boxes will be increased.
- The definition of clean energy generation equipment will be expanded for CCA purposes.
- The specified leasing rules will permit the application of the deemed loan rules to be applied to leases to governments and other tax-exempt entities.
- The transfer of corporate losses within a corporate group will be studied.
- Rules regarding the use of losses by a specified investment flow-through trust (SIFT) will be amended.
- Health and Welfare trusts will be allowed to continue, but will require that the trust be a resident of Canada, that payments to the trust must relate to current expenses and that the only employees who will be eligible to benefit from the plan will be non-key employees.

## **Charities**

Since 1976 there have been rules imposed by the *Income Tax Act of Canada* which require that a specified amount is disbursed each year by a registered Charity. This specified amount is called the “disbursement quota”. The calculation of the disbursement quota is complex and has been amended many times over the past 34 years. Imbedded in the definition of the disbursement quota are the terms “enduring property”, “capital gains reduction”, “capital gains pool”, “specified gifts” and the “accumulation of capital”. Significant amendments are proposed:

- The disbursement quota is being repealed for fiscal years that end on or after March 4, 2010 and all of the related terms used in that definition will terminate.
- There will still be a requirement to disburse 3.5% of investment and other non-charitable use assets. Charitable organizations will be allowed to ignore the first \$100,000 of investment assets in calculating the 3.5% income distribution rule (charitable foundations will have to use \$25,000).
- The anti-avoidance rules will be extended to ensure that the current disbursement rules are not circumvented.



## **WILKINSON & COMPANY LLP**

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Trenton • Belleville • Kingston

613-392-2592   613-966-5105   613-634-5581

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