

Budget Bulletin 2010

What You Should Know March 4, 2010 Federal Budget

On March 4, 2010, the Federal Government tabled the 2010 Budget. It provides some tax measures that may impact the tax and estate planning strategies of many Canadian investors and their advisors. Please note that these measures are not yet law and may undergo revisions before receiving Royal Assent.

Changes to Personal Taxation

1) Changes to Registered Disability Savings Plans

i) Rollover of RRSP / RRIF Proceeds to RDSP

Budget 2010 proposes to allow a rollover of a deceased individual's RRSP/RRIF assets to the RDSP of a beneficiary who meets the age and residency requirements for RDSP contributions and who is a financially dependent infirm child or grandchild of the deceased. This rollover will parallel the existing RRSP/RRIF rollover available to the deceased's financially dependent infirm children or grandchildren. The RDSP beneficiary or his/her legal representative will be required to make an election to transfer the RRSP/RRIF proceeds to the RDSP on a rollover basis.

The amount of RRSP proceeds rolled into an RDSP cannot exceed the available RDSP contribution room (up to \$200,000). This amount will reduce the available RDSP contribution room, and will not attract Canada Disability Savings Grants. These amounts will be taxable to the RDSP beneficiary when withdrawn.

These measures will be effective for deaths occurring on or after March 4, 2010.

Transitional Rules

Special transitional rules will effectively allow the new proposed RRSP/RRIF rollover rules to apply as of January 1, 2008, the date that RDSPs were first permitted to be established. An "eligible individual" (a beneficiary of the deceased's estate or a person who received an amount of the deceased's RRSP/RRIF assets directly at the time of death) will be able to elect to contribute up to the amount of the deceased's RRSP/RRIF assets to the RDSP of a qualified beneficiary. If the contribution is made before 2012, an offsetting deduction will be made in the deceased's terminal income tax return or the return of the eligible individual making the contribution (depending on where the income inclusion was previously taxed).

In order to give financial institutions and Human Resources and Skills Development Canada the time needed to adjust their RDSP systems, RDSP contributions under these proposed rollover measures cannot be made before July 2011.

PLANNING POINT:

The availability of this tax-deferral should be discussed with a tax professional. There may be some instances where exposing some or all of the RRSP proceeds to taxation on the deceased's or eligible individual's return may be advantageous.

ii) New Carry Forward of RDSP Grants & Bonds

The RDSP attracts government contributions as well as tax-deferred investing. Depending on contributions made and/or income levels, the government provides support in the form of either Canada Disability Savings Grants (CDSGs) and/or Canada Disability Savings Bonds (CDSBs). Under the current rules, beneficiaries are unable to carry forward unused CDSG and CDSB entitlements to future years. In recognition of the fact that families of children with disabilities may not be able to contribute regularly to their plans, Budget 2010 proposes to amend the Canada Disability Savings Act to allow a 10-year carry forward of CDSG and CDSB entitlements.

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Upon opening an RDSP, CDSB entitlements will be determined and paid into the plan for the preceding 10 years (as far back as 2008, the year RDSPs became available) since CDSBs are solely based on the beneficiary's family income for those years and not on contributions. Balances of unused CDSG entitlements will also be determined and maintained for the same period. CDSGs will be paid on unused entitlements, up to an annual maximum of \$10,500.

2) Changes to Child Benefits

i) For separated or divorced families where one individual receives Canada Child Tax Benefits (CTB), Universal Child Care Benefits (UCCB) and GST/HST credit amount on behalf of a child but the couple share custody of that child, Budget 2010 proposes to allow two eligible individuals to equally share the CTB and UCCB amounts in a particular month [and two eligible individuals to receive GST/HST credit amounts in respect of a particular quarter if the recipients would be eligible to receive amounts under the CRA's existing shared eligibility policy.] This will apply in cases where the child lives equally, more or less, with the two individuals who live separately. This measure will apply to benefits payable commencing July 2011.

ii) Beginning in 2010, a single parent will have the option of income-splitting the UCCB amount, in respect of all of his or her children, with the dependant for whom an eligible dependant credit is claimed. If a single parent is unable to claim an eligible dependant credit, he or she will have the option of including the aggregate UCCB amount in the income of one of the children for whom the UCCB is paid.

3) Employee Stock Options

Budget 2010 proposes a number of changes as they relate to employee stock option benefits.

i) Change to Stock Option Cash Out Deductibility

Budget 2010 proposes to prevent both the stock option deduction and a deduction by the employer from being claimed for the same employment benefit. This means that in cases where an employee acquires securities under a stock option agreement, but the employee decides to give up his or her stock option rights for a cash payment from the employer, an employer must elect to forgo the deduction for the cash payment to the employee. Therefore, a decision must be made for either the employee to benefit from the stock option deduction (with the election), or the employer may benefit by claiming a deduction (without the election). As of 4:00 pm EST on March 4, 2010, the dual deduction is no longer allowed.

ii) Repeal of the Tax Deferral Election on Employer Stock Options

Currently, an employee of a publicly-traded company who exercises his or her stock options may elect to defer the employment benefit on up to \$100,000 of vested qualifying stock options each year, until the disposition of the optioned securities. The employment benefit is the dollar amount representing the difference in price between what the employee pays for the stock and the actual price of the stock on the open market. The repeal of the tax deferral election takes effect for any stock options exercised after 4:00 pm EST on March 4, 2010. Budget 2010 proposes to repeal the tax deferral election and to require the employer to withhold tax on the value of the employment benefit to ensure that the taxes triggered as a result of exercising the stock options will be remitted to the government. It has been common practice to advise employees that, where possible, they should refrain from exercising stock options until such time as they plan to sell the stock. These new proposed rules only reinforce this planning point.

iii) Tax relief for "Under-Water" Stocks obtained through a Stock Option

Budget 2010 also proposes to assist those who elected to defer their stock option benefits but the value of their stock has fallen below the deferred taxable employee benefit amount. Budget 2010 proposes to introduce a special elective tax treatment that will ensure that the tax liability on the deferred stock option benefit does not exceed the proceeds of disposition on the optioned stock. Although there is some tax relief resulting from the use of capital losses on the optioned securities against capital gains from other investments, this special elective tax treatment will help ease the tax burden for individuals who are currently in this position. The election must be filed before the filing due date for the 2010 tax year if optioned stocks were disposed of before 2010. If the optioned stocks have not yet been disposed, they must be disposed before the end of 2015 - and the election filed by no later than April 30, 2016.

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PLANNING POINT:

For individuals who hold exercised or not-yet exercised stock options, a review of the tax liability is suggested. Timing of liquidation of stocks or stock options should be planned with a tax professional.

4) Medical Expense Tax Credit

Budget 2010 proposes to exclude from eligibility for the Medical Expense Tax Credit, any expenses incurred for purely cosmetic procedures, such as liposuction, hair replacement procedures, botox injections, and teeth whitening. A cosmetic procedure will only qualify for the medical expense tax credit if it is required for medical or reconstructive purposes, such as a personal injury resulting from a car accident or disfiguring disease. This applies to expenses incurred after March 4, 2010.

5) Scholarship Exemption and Education Tax Credit

Budget 2006 introduced a full tax exemption for post-secondary scholarships, fellowships and bursaries. Budget 2010 proposes that a post-secondary program which primarily consists of research will be eligible for the Education Tax Credit, and the scholarship exemption, only if it leads to a specified diploma or degree (or an equivalent degree). Under these rules, however, post-doctoral fellowships will be taxable.

If a scholarship, fellowship or bursary amount is provided in connection with a part-time program, the Budget proposes to limit the scholarship exemption to the amount of tuition paid for the program (plus the costs of program-related materials), except under specific situations of part-time students entitled to the Disability Tax Credit, or having a mental or physical impairment. These measures will apply to the 2010 and subsequent taxation years.

6) U.S. Social Security Benefits

Currently, Canadian residents receiving social security benefits from the U.S. are subject to an 85 per cent inclusion rate, so therefore only 85 per cent of U.S. social security benefits are subject to Canadian income tax. Budget 2010 proposes to reduce the inclusion rate to 50 per cent for Canadian residents who have been receiving U.S. Social Security benefits since before January 1, 1996 as well as for their spouses and common-law partners who are eligible to receive survivor benefits. This measure will apply to U.S. Social Security benefits received on or after January 1, 2010.

PLANNING POINT:

This additional cash flow can be used for many purposes, including taking advantage of a Tax-Free Savings Account.

7) Mineral Exploration Tax Credit

The mineral exploration tax credit is available to investors in flow-through shares. This credit is equal to 15 per cent of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors. Budget 2010 proposes to extend eligibility for the mineral exploration tax credit for one year, to flow-through share agreements entered into on or before March 31, 2011. Under the current "look-back" rule, funds raised in one calendar year with the benefit of the credit can be spent on eligible exploration up to the end of the following calendar year. For example, funds raised with the credit during the first three months of 2011 can support eligible exploration until the end of 2012.

8) On-line Notice of Assessment

Budget 2010 proposes to allow for the electronic issuance of Notices of Assessment of tax, and other notices such as GST/HST and other taxes. This measure will be effective upon certain legislative amendments receiving Royal Assent.

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Changes to Business Taxation

Deductibility of Stock Options – see point 3(iii) above

This Budget Summary is prepared for information only and is not intended to address the circumstances of any particular individual or entity. We invite you to contact our Tax & Estate Planning team by email at taxandestate@mackenziefinancial.com or your Mackenzie Sales Representative to discuss any questions you may have regarding the changes proposed in this budget.