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HIGHLIGHTS

A. Personal Income Tax
B. Business Income Tax
C. International Tax
D. Sales Tax
E. Other Tax
F. Custom Tariffs
G. Previously Announced Measures

On **March 4, 2010** the Honourable **Jim Flaherty**, Minister of Finance, presented his **fifth Budget** to the House of Commons.

The **Government's fiscal positions** include deficits in the years 2009/2010 ($53.8 billion), 2010/2011 ($49.2 billion), 2011/2012 ($27.6 billion), and 2012/2013 ($17.5 billion).

The Federal Government notes that it will:

- save approximately $6.8 billion by **restricting the operating costs** of the public service including a freeze on salaries of MPs and Senators for the next three fiscal years;
- close certain **tax loopholes** such as those who receive certain stock options;
- freeze **Employment Insurance premiums** at $1.73 per $100 in insurable earnings to the end of 2010;
- consult on proposals to report **aggressive tax planning schemes**;
- subject to further discussion, consider a system of **loss transfers** between corporate groups;
- permit rollovers from a deceased person's RRSP to a **Registered Disability Savings Plan**;
- provide a single parent with the option of including the **Universal Child Care Benefit** in the income of certain dependants;
- provide $44 million over two years for the development of **elite athletes**; and
- prevent certain **cosmetic expenditures** incurred after March 5, 2010 from being eligible for the medical expense tax credit.

There were **no new corporate tax rate changes.** However, the Government's intention to eventually have a top combined federal-provincial corporate income tax rate of **25%** remains.

Although the **opposition parties** were **not** in **favour** of the Budget, the **Liberals** did indicate that they would not force an election on this issue.

	Actual	Projection (in billions of $)			
	2008-09	2009-10	2010-11	2011-12	2012-13
Budgetary revenues	233.1	213.9	231.3	249.0	266.5
Program expenses	207.9	237.8	249.2	241.3	245.1
Public debt charges	31.0	29.9	31.3	35.3	38.9
Total expenses	238.9	267.7	280.5	276.6	284.0
Balance	(5.8)	(53.8)	(49.2)	(27.6)	(17.5)
Federal debt	463.7	517.5	566.7	594.3	611.8

A. Personal Income Tax

1. Benefits Entitlement – Shared Custody

Under existing rules, only one eligible individual can receive the Canada Child Tax Benefit and Universal Child Care Benefit in respect of a qualified dependant each month. Similarly, the child component of the Goods and Services Tax/Harmonized Sales Tax Credit (GST/HST credit) is payable in respect of a qualified dependant to only one eligible individual each quarter.

To improve the allocation of child benefits between parents who share custody of a child, Budget 2010 proposes to allow two eligible individuals to receive Canada Child Tax Benefit and Universal Child Care Benefit amounts in a particular month, and two eligible individuals to receive GST/HST credit amounts in respect of a particular quarter, in respect of a child if the recipients would be eligible to receive amounts under the Canada Revenue Agency's existing shared eligibility policy.

This measure will apply to benefits payable commencing July 2011.

2. Universal Child Care Benefit (UCCB) for Single Parents

Budget 2010 proposes to allow a single parent the option of including the aggregate Universal Child Care Benefit amount received, in respect of all of his or her children, in the parent's income or in the income of 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 Universal Child Care Benefit amount in the income of one of the children for whom the Universal Child Care Benefit is paid.

This measure will apply to the 2010 and subsequent taxation years.

3. Medical Expense Tax Credit – Purely Cosmetic Procedures

Budget 2010 proposes that expenses incurred for purely cosmetic procedures (including related services and other expenses such as travel) be ineligible to be claimed under the Medical Expense Tax Credit. This generally includes surgical and non-surgical procedures purely aimed at enhancing one's appearance such as liposuction, hair replacement procedures, botulinum toxin injections, and teeth whitening.

A cosmetic procedure, including those identified above, will continue to qualify for the Medical Expense Tax Credit if it is required for medical or reconstructive purposes, such as surgery to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease.

This measure will apply to expenses incurred after March 4, 2010.

4. Rollover of RRSP Proceeds to a Registered Disability Savings Plan (RDSP)

Budget 2010 proposes to extend the existing RRSP rollover rules to allow a rollover of a deceased individual's RRSP proceeds to the RDSP of a financially dependent infirm child or grandchild.

The amount of RRSP proceeds rolled over into an RDSP will not be permitted to exceed the beneficiary's available RDSP contribution room. The lifetime contribution limit for RDSPs is $200,000.

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

Transitional Rules

Where the death of an RRSP annuitant occurs after 2007 and before 2011, special transitional rules will allow a contribution to be made to the RDSP of a financially dependent infirm child or grandchild of the annuitant that would provide a result that is generally equivalent to the proposed measures.

RDSP contributions benefiting from the proposed rollover measure cannot be made before July 2011.

5. Carry Forward of RDSP Grants (CDSG) and Bonds (CDSB)

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.

The carry forward will be available starting in 2011.

6. Provincial Payments into RESPs and RDSPs

Budget 2010 proposes to clarify that all payments made to a Registered Education Savings Plan or a Registered Disability Savings Plan through a program funded, directly or indirectly, by a province or administered by a province will be treated the same way as federal grants and bonds and will therefore not themselves attract or reduce federal grants and bonds.

7. Scholarship Exemption and Education Tax Credits

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 it leads to a college or CEGEP diploma, or a bachelor, masters or doctoral degree (or an equivalent degree). Accordingly, post-doctoral fellowships will be taxable.

Occupational training programs certified by the Minister of Human Resources and Skills Development will continue to qualify for the Education Tax Credit.

Budget 2010 also proposes that an amount will be eligible for the scholarship exemption only to the extent it can 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.

Special rules will apply to scholarships for part-time programs.

The measures will apply to the 2010 and subsequent taxation years.

8. Charities: Disbursement Quota Reform

Budget 2010 proposes to reform the disbursement quota for fiscal years that end on or after March 4, 2010. Specifically, Budget 2010 proposes to:

- repeal the charitable expenditure rule;
- modify the capital accumulation rule; and
- strengthen related anti-avoidance rules for charities.

Repeal of Charitable Expenditure Rule

Budget 2010 proposes to repeal the charitable expenditure rule. Consequently, provisions relating to a number of concepts will no longer be required to calculate the disbursement quota.

Budget 2010 also proposes to amend the existing rule that provides the Canada Revenue Agency with the discretion to allow charities to accumulate property for a particular purpose, such as a building project.

9. Employee Stock Options

Budget 2010 proposes to prevent both the stock option deduction and a deduction by the employer from being claimed for the same employment benefit. To this effect, the stock option deduction will generally be available to employees only in situations where they exercise their options by acquiring securities of their employer. An employer may continue to allow employees to cash out their stock option rights to the corporation without affecting their eligibility for the stock option deduction provided the employer makes an election to forgo the deduction for the cash payment.

Budget 2010 also proposes to amend the income tax rules to clarify that the disposition of rights under a stock option agreement to a non-arm's length person results in an employment benefit at the time of disposition (including cash out). Although the Government considers that these benefits are taxable in these circumstances under existing tax rules, the Government also believes that clarification of these rules is warranted.

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

Tax Deferral Election and Remittance Requirement

Budget 2010 proposes to repeal the tax deferral election and to clarify existing withholding requirements to ensure that an amount in respect of tax on the value of the employment benefit associated with the issuance of a security is required to be remitted to the government by the employer.

The repeal of the tax deferral election will apply to employee stock options exercised after 4:00 p.m. Eastern Standard Time on March 4, 2010.

The clarifications to remittance requirements will apply to benefits arising on the issuance of securities after 2010, to provide time for businesses to adjust their compensation arrangements and payroll systems.

Budget 2010 proposes to introduce a special elective tax treatment for affected taxpayers who elected under the current rules to defer taxation of their stock option benefits until the disposition of the optioned securities. In effect, the special elective treatment will ensure that the tax liability on a deferred stock option benefit does not exceed the proceeds of disposition of the optioned securities, taking into account tax relief resulting from the use of capital losses on the optioned securities against capital gains from other sources.

10. U.S. Social Security Benefits

Changes made to the Canada-U.S. Tax Convention effective beginning in 1996 increased the inclusion rate for U.S. Social Security benefits to 85 per cent from 50 per cent.

Budget 2010 proposes to reinstate the 50-per-cent inclusion rate for Canadian residents who have been in receipt of U.S. Social Security benefits since before January 1, 1996 and 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.

11. Mineral Exploration Tax Credit

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.

12. Eco-ENERGY Retrofit Program

Even though the Home Renovation Tax Credit Program expired on January 31, 2010, the Government is allocating another $80 million to the eco-ENERGY Retrofit Program.

B. Business Income Tax

1. Accelerated Capital Cost Allowance for Clean Energy Generation

Budget 2010 proposes to expand Class 43.2 to include: (a) heat recovery equipment used in a broader range of applications; and (b) distribution equipment used in district energy systems that rely primarily on ground source heat pumps, active solar systems or heat recovery equipment.

Budget 2010 also proposes to broaden Class 43.1 and Class 43.2 to include specified distribution equipment that is part of a district energy system used by the taxpayer to provide district heating or cooling through the use of thermal energy provided primarily by a ground source heat pump system, an active solar system, heat recovery equipment, or a combination of these energy sources, provided the generation equipment is included in Class 43.1 or Class 43.2, as the case may be.

These measures will apply to eligible assets acquired on or after March 4, 2010 that have not been used or acquired for use before that date.

Budget 2010 also proposes that the definition "principal-business corporation" be amended to clarify that flow-through share eligibility extends to corporations for which the principal business is one of, or any combination, of:

- producing fuel
- generating energy
- or distributing energy

2. Television Set-top Boxes – Capital Cost Allowance

Budget 2010 proposes that satellite and cable set-top boxes that are acquired after March 4, 2010 and that have neither been used nor acquired for use before March 5, 2010 be eligible for a declining-balance-CCA rate of 40 per cent.

3. Interest on Overpaid Taxes

Budget 2010 proposes that, effective July 1, 2010, the interest rate payable by the Minister of National Revenue to corporations will be set at the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point.

4. SIFT Conversions and Loss Trading

The *Income Tax Act* includes provisions intended to allow specified investment flow-through (SIFT) trusts and partnerships – commonly referred to as income trusts and partnerships – to convert their structures into corporate form on a tax-deferred basis. Aggressive schemes have been designed to use these provisions to achieve inappropriate tax loss trading that would not be allowed as between two corporations.

In particular, the ability of a corporation to utilize its tax losses is constrained where control of the corporation has been acquired. In the case of a "reverse takeover" of a public corporation, an existing rule in the *Income Tax Act* generally deems there to be an acquisition of control of the public corporation in situations where shares of the public corporation are exchanged for shares of another corporation. Budget 2010 proposes to extend this rule to ensure that it also applies to impose restrictions on the use of losses in situations where units of a SIFT trust or SIFT partnership are exchanged for shares of a corporation.

It is proposed that these amendments apply to transactions undertaken after 4:00 p.m. Eastern Standard Time on March 4, 2010, other than transactions that the parties are obligated to complete pursuant to the terms of an agreement in writing between the parties entered into before that time.

C. International Tax

1. Section 116 and Taxable Canadian Property

Budget 2010 proposes that the definition of taxable Canadian property in the *Income Tax Act* be amended to exclude shares of corporations, and certain other interests, that do not derive their value principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property (subject to the 60 month rule). This measure will eliminate section 116 compliance obligations for these types of properties.

2. Refunds under Regulation 105 and Section 116

Budget 2010 proposes an amendment to section 164 of the *Income Tax Act* to also permit the issuance of a refund of an overpayment of tax under Part I of the *Income Tax Act* if the overpayment is related to an assessment of the payor or purchaser in respect of a required withholding under section 105 of the *Income Tax Regulations* or section 116 of the *Income Tax Act* and the taxpayer files a return no more than two years after the date of that assessment.

This measure will be effective for applications for refunds claimed in returns filed after March 4, 2010.

3. Foreign Tax Credit Generators

Some Canadian corporations have recently been engaging in schemes, often referred to as "foreign tax credit generators", which are designed to shelter tax otherwise payable in respect of interest income on loans made, indirectly, to foreign corporations. These schemes artificially create foreign taxes that are claimed by the Canadian corporation as a foreign tax credit (FTC), or a foreign accrual tax (FAT) or underlying foreign tax (UFT) deduction.

Budget 2010 proposes measures that will deny claims for FTCs, and FAT and UFT deductions, in circumstances in which the income tax law of the jurisdiction levying the foreign income tax, or another relevant jurisdiction, considers the Canadian corporation to have a lesser direct or indirect interest in the foreign special purpose entity than the Canadian corporation is considered to have for the purposes of the *Income Tax Act.*

This measure is proposed to be effective for foreign taxes incurred in respect of taxation years that end after March 4, 2010.

4. Foreign Investment Entities and Non-Resident Trusts

Budget 2009 stated that the Government would review the outstanding proposals before proceeding with measures in this area. As a result of this review, the Government has developed revised proposals to replace the outstanding proposals for public consultation with a view to developing revised legislation, which will then also be released for comment.

Date of Application

It is proposed that the measures regarding foreign investment entities apply for taxation years that end after March 4, 2010. A taxpayer who voluntarily complied with the outstanding proposals in previous years will have the option of having those years reassessed. If the taxpayer does not wish to be reassessed for those years, and had more income than would have been the case under the existing rules, the taxpayer will be entitled to a deduction in the current year for the excess income.

D. Sales Tax

1. GST/HST and Purely Cosmetic Procedures

Budget 2010 proposes to clarify that GST/HST applies to all purely cosmetic procedures, to devices or other goods used or provided with cosmetic procedures, and to services related to cosmetic procedures. Taxable procedures would generally include surgical and non-surgical procedures aimed at enhancing one's appearance such as liposuction, hair replacement procedures, botulinum toxin injections, and teeth whitening.

A cosmetic procedure will continue to be exempt if it is required for medical or reconstructive purposes, such as surgery to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease. As well, cosmetic procedures paid for by a provincial health insurance plan will continue to be exempt.

This applies to supplies made after March 4, 2010 and to supplies made before that time if GST/HST had been charged.

2. Simplification of the GST/HST for the Direct Selling Industry

The direct selling industry distributes goods to final consumers through a large number of contractors and sales representatives, rather than through retail establishments.

Budget 2010 confirms the Government's intention to implement the Budget 2009 proposals for simplification of the GST/HST for the direct selling industry and proposes certain enhancements with clarifications to the previously announced measure.

Budget 2010 proposes that these enhancements apply in respect of fiscal years of a network seller that begin after 2009, matching the timing of the Budget 2009 proposals.

E. Other Tax

1. Specified Leasing Property Rules

Budget 2010 proposes to extend the application of the Specified Leasing Property rules to otherwise exempt property that is the subject of a lease to a government or other tax-exempt entity, or to a non-resident. However, such a lease will continue to be exempt if the total value of the property that is the subject of the lease is less than $1 million. In this regard, an anti-avoidance rule will apply if it may reasonably be considered that one of the purposes of dividing property (or a class of property) among separate leases is to meet the $1 million exception.
These measures will apply to leases entered into after 4:00 p.m. Eastern Standard Time March 4, 2010.

2. Information Reporting of Tax Avoidance Transactions – Public Consultation

Budget 2010 announces a public consultation on proposals to require the reporting of certain tax avoidance transactions.
A regime under which a tax "avoidance transaction" that features at least two of three "hallmarks" would be a "reportable transaction" that must be reported to the Canada Revenue Agency. The proposed hallmarks would reflect certain circumstances that commonly exist when taxpayers enter into tax avoidance transactions, such as contingent remuneration, confidentiality protection and contractual protection.
These proposals, as modified to take into account the consultations, would apply to avoidance transactions entered into after 2010, as well as those that are part of a series of transactions completed after 2010.

3. Online Notices

Budget 2010 proposes that the *Income Tax Act, Excise Tax Act, Excise Act, 2001, Air Travellers Security Charge Act, Canada Pension Plan* and *Employment Insurance Act* be amended to allow for the electronic issuance of those notices that can currently be sent by ordinary mail, if authorized by a taxpayer. However, notices that are specifically required to be served personally or by registered or certified mail will not be eligible to be transmitted electronically.
The necessary legislative amendments will be effective as of the date of Royal Assent of the implementing legislation. However, the application of these measures will commence at such time as will be announced by the Minister of National Revenue.

4. Tax Evasion and the Proceeds of Crime and Money Laundering Regime

Budget 2010 proposes to rationalize the rules concerning the application of the proceeds of crime and money laundering regime, and provide further support for international efforts to counter criminal and terrorist activities, by repealing the exclusion for indictable tax offences under the *Income Tax Act*, the *Excise Tax Act*, the *Excise Act*, and the *Budget Implementation Act, 2000* from the definition of "designated offence" under the *Criminal Code*, such that the Crown will be able to prosecute these tax offences using that regime, regardless of whether prosecuted under the *Criminal Code* fraud provisions or the tax statutes. Budget 2010 also proposes consequential amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* consistent with the proposal above with respect to the *Criminal Code*.

5. Taxation of Corporate Groups

The Government will explore whether new rules for the taxation of corporate groups - such as the introduction of a formal system of loss transfers or consolidated reporting – could improve the functioning of the tax system. Stakeholder views will be sought prior to the introduction of any changes.

6. Aboriginal Tax Policy

The Government of Canada supports initiatives that encourage the exercise of direct taxation powers by Aboriginal governments.

F. Customs Tariffs

Tariff Reductions on Manufacturing Inputs and Machinery and Equipment

Budget 2010 proposes to eliminate the remaining tariffs on manufacturing inputs and machinery and equipment. The Department of Finance consulted extensively with stakeholders in preparing this measure, including through the publication of a notice in the *Canada Gazette* on September 19, 2009.
The tariff reductions will be applicable to goods imported on or after March 5, 2010.

G. Previously Announced Measures

Budget 2010 confirms the Government's intention to proceed with previously-announced tax measures, as modified to take into account consultations and deliberations since their release, including:

- Improvements to the application of the GST/HST to the financial services sector released on September 23, 2009;
- Modifications to the rules governing Tax-Free Savings Accounts, announced on October 16, 2009;
- Technical legislative proposals addressing recent court decisions on the GST/HST and financial services, announced on December 14, 2009;
- Measures released in draft form on December 18, 2009 relating to the income taxation of shareholders of foreign affiliates, as well as the remaining measures released in a previous draft relating to foreign affiliates.

In addition, the Government intends to reintroduce Bill C-10 from 2007.