

Harvey, Lister & Webb Incorporated

is pleased to provide you with CGA-Canada's commentary and analysis of the 2010 Federal Budget.

Budget Highlights

The 2010 federal budget contains very few new tax measures. The budget documents propose to provide \$3.2 billion in personal income tax relief, but most of this is a continuation of tax measures announced in the 2009 budget. Some of the new proposals affecting individuals and businesses include:

- Allowing parents sharing child custody to split the Universal Child Care Benefit.
- Permitting single parents to include the Universal Child Care Benefit in their income or in the income of the dependent for whom an Eligible Dependant Credit is claimed.
- Elimination of purely cosmetic procedures from eligible medical expenses.
- Permitting the rollover of Registered Retirement Savings Plan (RRSP) proceeds to a Registered Disability Savings Plan (RDSP) on death of the annuitant of the RRSP.
- Changes to and clarification of scholarship exemption and education tax credit eligibility.
- Changes to Employee Stock Option rules to prevent both the stock option benefit deduction being claimed by the employee and a deduction being claimed by the employer.
- Reinstating the 50% income inclusion rate for U.S. Social Security benefits received by certain Canadian residents.
- An Accelerated Capital Cost Allowance for clean energy generation.

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What this Budget Means for Individuals

The budget offers the average individual nothing new. There were no cuts to the tax rates or increases in the non-refundable amounts. New measures are aimed at specific taxpayers, such as single parents, separated/divorced parents sharing child custody, post-secondary students and the disabled. In addition, some of these measures will not be effective until mid- 2011.

Shared Custody Benefits Entitlement

The current rules permit only one parent to receive the

Canada Child Tax Benefit and the Universal Child Care Benefit. The budget proposes to permit two eligible individuals, who are living apart, to receive the benefits in situations where the child lives more or less equally with the two individuals. The measure is extended to the quarterly GST/HST credit. It is assumed that the taxation of the benefit will also be split.

This measure will apply to benefits payable commencing in July 2011.

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What this Budget Means for Individuals

Universal Child Care Benefits for Single Parents

Single parents receiving the Universal Child Care Benefit will now have the option of including the benefit in the income of a dependent that qualifies for the Eligible Dependant Credit (formerly the Equivalent to Married Exemption) rather than their own income. If the parent is unable to claim an Eligible Dependant Credit, he or she will be able to include the benefit in the income of one of the children for whom the benefit is received. Transferring the benefit to the eligible dependent or child may not reduce the parent's tax if his or her taxable income is in the low tax rate as the claim for the dependent may be reduced as well. However, it will reduce the parent's net income, which could be of benefit in calculating such benefits as the medical expense tax credit.

This will apply to 2010 and subsequent years.

Medical Expense Tax Credit

Individuals will no longer be able to claim medical procedures that are purely cosmetic. Expenditures, both surgical and non-surgical, for procedures such as hair replacement, liposuction, botox injections and teeth whitening will not be permitted to be claimed for purposes of the Medical Expense Tax Credit unless they are required for medical or reconstructive purposes resulting from a deformity, accident or disfiguring disease. In addition, GST/HST will now be charged on all purely cosmetic procedures. It is difficult to speculate what effect these proposals may have on the businesses providing such procedures.

These measures are effective for expenses incurred after March 4, 2010.

Rollover of RRSP Proceeds to a RDSP

Going forward, the value of an RRSP has to be included in the income of an individual in the year of death unless the

beneficiary is either a spouse or common-law partner or a financially dependent child or grandchild. The budget proposes to extend the rollover provisions to include transfers to the RDSP of a financially dependent infirm child or grandchild.

RDSPs, introduced in 2007, are tax-assisted savings vehicles which permit parents or others to provide for the long-term financial security of a child with a severe disability. Although contributions to the plan are not deductible, income earned within the plan is not subject to tax until withdrawn by the beneficiary. The maximum lifetime contribution limit is \$200,000. The proposed rollover will not be permitted to exceed the available contribution room.

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

Scholarship Exemption and Education Tax Credit

In 2006, scholarships received by post-secondary students enrolled in educational programs eligible for the Education Tax Credit became exempt from tax. The 2010 Budget proposes to clarify the type of program that qualifies for the education deduction. Post-secondary programs consisting principally of research will be eligible for the Education Tax Credit only if they lead to a college or CEGEP diploma or a bachelor, masters or doctoral degree (or equivalent degree). Post doctoral fellowships will not qualify. This measure will both deny the Education Tax Credit and tax any related scholarships, fellowships and bursaries.

The budget also proposes to limit the scholarship exemption to the duration of the period of study related to the scholarship. Scholarships, fellowships or bursaries

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What this Budget Means for Individuals

received by part-time students will only be exempt to the extent of the cost of tuition and related materials paid for the program. Part-time students eligible for the Disability Tax Credit with physical or mental impairments that prevent full time enrollment will be exempt from this restriction.

These measures will apply to 2010 and subsequent years.

Employment Stock Options

Employee stock options are subject to tax as employment income on the difference between the fair- market value of the security at the time the option is exercised and the amount paid by the employee for the option. A deduction equal to one-half of the benefit is permitted so that only 50% of the benefit is taxed. No deduction is available to the employer.

Under current rules, employee stock options can be structured to give the employer a deduction where the employer cashes out the option while the employee also receives the stock option deduction. The budget proposes to prevent the stock option deduction and a deduction by the employer being claimed for the same stock option when the employee disposes of his or her stock option rights for a cash payment from the employer. On a cash out of stock option rights, the deduction for the stock option benefit is still available to the employee as long as the employer elects not to deduct the cash payment.

New rules will repeal the tax deferral election available on stock options granted to employees of publicly traded companies. In addition, the employer will be required to withhold tax on the benefit and remit it to the government. Budget 2010 also proposes new rules to alleviate the tax burden of employees who made

the tax deferral election and, because of recent declines in the markets, the value of the securities are less than the deferred tax liability.

U.S. Social Security Benefits

Until 1996, Canadian residents receiving U.S. Social Security Benefits paid tax on 50% of the amount received. From 1996 on, U.S. Social Security Benefits were taxed on 85% of the amount received. The budget proposes to reinstate the 50% inclusion for Canadian residents who were receiving U.S. Social Security Benefits prior to 1996.

Home Renovation Tax Credit Not Extended

The government chose not to extend the Home Renovation Tax Credit in this budget.

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What this Budget Means for Business

The budget has very little to offer business in general. There are no tax rate changes or increases to the income subject to the Small Business Tax Deduction. New tax measures are aimed primarily at “green industries” that are the beneficiaries of accelerated capital cost allowance rates on clean energy equipment related to electricity, thermal energy and fuels from waste.

Interest on Overpaid Taxes

Currently, the government pays interest on overpaid taxes at 2% plus the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter. The budget eliminates the 2%, leaving the rate equal to the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter.

Tariff Reductions on Manufacturing Inputs and Machinery and Equipment

The budget proposes to eliminate the remaining tariffs on manufacturing inputs and machinery and equipment.

Other Measures Include

- Changes to Charities Disbursement Quotas and Expenditure Rules.
- Extension of eligibility for one year of the mineral exploration tax credit to flow-through share agreements entered into on or before March 31, 2011.
- Changes to the definition of taxable Canadian property for purposes of Section 116 of the *Income Tax Act* to exclude shares of corporations and certain other interests that do not derive their value principally from real or immovable property in Canada.
- Amendment to Section 164 of the *Income Tax Act* to permit a refund of an overpayment of taxes withheld in accordance with Section 116 of the *Income Tax Act* and Section 105 of the *Income Tax Regulations*.
- Changes to rules related to Foreign Tax Credit Generators.
- Changes to rules governing Foreign Investment Entities and Non-Resident Trusts.
- Continued simplification of the GST/HST for the direct selling industry.

The budget proposes the issuance of various electronic notices of assessments relating to income tax, GST and other tax rules. This would take effect after Royal Assent of the enacted legislation.



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For more news and analysis of the 2010 federal budget, please visit www.cga.org/canada/budget2010