

MARCH 4, 2010

KNV TAX MEMO

FEDERAL BUDGET 2010

The 2010 Federal budget confirms the government's commitment to stimulus spending; however, income tax changes were narrowly targeted and relatively minor in nature. The more significant changes of interest to KNV clients are discussed below.

STOCK OPTION TAX DEFERRAL ELECTION AND REMITTANCE REQUIREMENT

Under the current tax rules, a deferral election is available for an employee of a publicly-traded company to defer the recognition of the employment benefit in respect of up to \$100,000 of qualifying stock options per year until the disposition of those securities. The budget 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. This amount will be added to the employer's remittances of tax withheld at source in respect of all employee salary and benefits for the period that includes the date on which the security was issued or sold.

For the taxpayers who made the deferral election and experienced financial difficulties due to the declining security value, the budget proposes a special elective treatment to ensure that the tax liability on a deferred stock option benefit does not exceed the proceeds of the disposition of the optioned securities.

The repeal of the tax deferral election will apply to employee stock options exercised after March 4, 2010.

STOCK OPTIONS - DEDUCTION FROM INCOME

Current legislation allows an employee a 50% deduction for certain stock option related employment benefits. The budget proposes to prohibit the possible situation where the employee can benefit from the 50% stock option deduction by disposing of their stock option rights for a cash payment from the employer while the cash payment is fully deductible to the employer. If preferential tax treatment is provided to the employee on stock-based benefits, the employer will generally not be allowed a tax deduction for the cost of such benefits.

These measures will apply to dispositions of employee stock options that occur after March 4, 2010.

TAXATION OF CORPORATE GROUPS

The government will explore new rules for the utilization of losses within a corporate group. No formal policy has been proposed, so the status quo regarding the use of losses within a corporate group is applicable.

U.S. SOCIAL SECURITY BENEFITS

For Canadian residents receiving US Social Security benefits, the current income inclusion rate is 85 percent. The budget proposes to change it to a 50 percent inclusion rate for a Canadian resident who has been in receipt of US 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 US Social Security benefits received on or after January 1, 2010.

MEDICAL EXPENSES - COSMETIC PROCEDURES

Effective March 5, 2010, expenses incurred for purely cosmetic procedures will *not* be eligible for the Medical Expense Tax Credit. This generally includes surgical and non-surgical procedures aimed at enhancing one's appearance such as liposuction, hair replacement procedures, botulinum toxin injections, and teeth whitening.

ROLLOVER OF RRSP PROCEEDS TO AN RDSP

For deaths occurring on or after March 4, 2010, proceeds of the deceased individual's RRSP may be transferred to a registered disability savings plan (RDSP) of a financially dependant infirm child or grandchild up to their available RDSP contribution room.

CHILD BENEFITS

Shared custody: The budget proposes to improve the allocation of child benefits for parents who share custody by allowing each parent to receive one-half of the Child Care Tax Benefits.

Single parents: The budget proposes to give a single parent the option of including the Universal Child Care Benefit in the income of certain dependants; rather than having it taxed in the single parent's hands.

INTEREST ON OVERPAID TAXES

The current applicable interest rate in respect of over-payments of most taxes and other levies is the average yield of three-month Government of Canada T-Bill sold in the first month of the preceding quarter (rounded up to the nearest percentage point) plus 2 percentage points.

The budget proposes that, effective July 1, 2010, in respect of over-payments of most taxes and other levies, the interest rate payable by the Minister of National Revenue to corporations will be the average yield of three-month Government of Canada T-Bill sold in the first month of the preceding quarter (rounded up to the nearest percentage point). This new rate for corporations will apply in respect of income tax, GST/HST, EI premiums, CPP contributions, and other levies.

CHARITIES DISBURSEMENT QUOTA REFORM

The budget relaxes the disbursement quota requirements; except for the requirement that a Charity must annually disburse a portion of their investments and other assets not used directly for charitable purposes.

TAX AVOIDANCE MEASURES

The budget materials also address the government's progress on a number of tax avoidance measures including non-resident trusts, foreign investment entities ("FIE") and aggressive tax planning.

The non-resident trust and FIE proposals have been revised to address the concerns of a number of parties who suggested the rules were overly complex. If you have a non-resident trust or FIE it is recommended that you discuss your circumstance with your KNV advisor to determine the impact of these proposals.

The government will be initiating for consultation a proposal requiring the reporting of potentially abusive tax-avoidance transactions. In particular, tax planning arrangements involving the payment of contingent fees to advisors appear to be targeted.

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