



## TAX LETTER

April 2010

### FEDERAL BUDGET HIGHLIGHTS TAX FILING DEADLINES TAXPAYERS AFFECTED BY EARTHQUAKES IN HAITI OR CHILE TAX-FREE "ROLLOVERS" TO CORPORATIONS CRA POLICY ON EMPLOYER GIFTS AND AWARDS PRESCRIBED INTEREST RATES AROUND THE COURTS

#### FEDERAL BUDGET HIGHLIGHTS

This year's federal budget was delivered on March 4, 2010, and contained several income tax and related measures. The following is a summary of some of the more significant measures.

- Currently, only one individual can receive the Canada Child Tax Benefit and Universal Child Care Benefit and the child component of the Goods and Services Tax/Harmonized Sales Tax Credit (GST/HST credit). The budget provides that these child benefits will be shared between parents who share custody of a child, if the parents would otherwise be eligible to receive amounts under the Canada Revenue Agency's

existing shared eligibility policy. This policy applies when a child lives more or less equally with two individuals who live separately. This measure will apply to benefits payable commencing in July 2011.

- A single parent receiving the Universal Child Care Benefit (UCCB) and who is claiming the "wholly dependent person" credit for a child will have the option of reporting the UCCB in the child's income. If the parent is unable to claim that credit, the UCCB can be included in the income of one of the children for whom the UCCB is paid. This measure applies to the 2010 and subsequent taxation years.

- Medical expenses incurred for purely cosmetic procedures, such as liposuction, hair replacement procedures, botox injections, and teeth whitening, will no longer be eligible for the medical expense tax credit. This measure applies after March 4, 2010. However, such procedures will continue to qualify for the medical credit if they are required for medical or reconstructive purposes.
- Under current rules, where a deceased person leaves his or her registered retirement savings plan (RRSP) to a financially dependent child or grandchild, the deceased is not taxed in the year of death on the RRSP proceeds (similar rules apply to registered retirement income fund proceeds and certain registered pension plan lump-sum proceeds). Instead, the child includes the amount in income. However, if the child was dependent on the deceased by reason of mental or physical infirmity, the child can get an offsetting deduction by contributing the proceeds to the child's RRSP. The budget proposes that a similar deduction will be allowed for deaths on or after March 4, 2010 where the proceeds are contributed to the child's registered disability savings plan (RDSP) to the extent of the child's contribution room (there is a lifetime limit of \$200,000). Transitional rules will allow, for deaths after 2007 and before 2011, an offsetting deduction where the child or spouse of the deceased who received the deceased's RRSP contributes the proceeds to the child's RDSP.
- Scholarships and bursaries are currently exempt from tax if the recipient attends a qualifying educational institution. For part-time students, the budget provides that for 2010 and subsequent years, the exempt portion will be limited to the amount of tuition fees plus the costs of program-related materials, unless the student is entitled to the disability tax credit or cannot be enrolled full-time because of physical or mental infirmity.
- Many employee stock option benefits are only half-taxed, in that a deduction of one-half of the benefit is allowed in computing taxable income. In some cases, where the employee is "cashed out", i.e. the employer corporation pays cash instead of issuing the shares, the one-half deduction also applies, while the employer gets a full deduction for the payout. The budget proposes that such cash-outs will be fully included in taxable income for the employee and fully deductible for the employer. However, the employer can elect to not claim the deduction, in which case the employee will be eligible for the one-half deduction. This measure applies to such cash-outs that occur after 4:00 pm Eastern Standard Time, March 4, 2010.
- In certain cases, an employee of a publicly-traded company receiving a stock option benefit can elect to defer the recognition of the benefit until the year in which the shares are sold (rather than the year in which the option is exercised). The budget repeals this deferral election for employee stock options exercised after 4:00 p.m. Eastern Standard Time, March 4, 2010. Such benefits will now be included in the year in which the option is exercised and the shares are acquired. Note that the deferral for stock option benefits in respect of shares in Canadian-controlled private corporations

(CCPCs) is **not** affected and remains in place.

- Additionally, the budget provides some relief for employees who previously elected to have the above-noted deferral apply to their stock option benefits in respect of publicly-traded shares. Effectively, the relieving provisions allow the employee to elect to eliminate the entire stock option benefit from taxable income, and to instead recognize a capital gain equal to half of the lesser of the benefit otherwise determined and the capital loss from the later disposition of the shares. If the election is made, a special tax is payable equal to the proceeds of disposition of the shares (2/3 of the taxpayer's proceeds of disposition, if the taxpayer resides in Quebec). The election applies to dispositions before 2015, and is due by the filing-due date for the year of disposition. For employees who disposed of their shares before 2010, the election is also allowed and must be made by their filing-due date for the 2010 taxation year. This special election is **not** available for employees who qualify for the deferral in respect of CCPC shares.
- The budget "clarifies" that for employee stock option benefits in respect of shares acquired after 2010 (other than deferred benefits in respect of CCPC shares), the employer must withhold tax in respect of the benefit in the taxation year in which the option is exercised and the shares are acquired. The amount is to be withheld from salary or other taxable benefits in the year, and the withheld amount is reduced by one-half if the stock option benefit qualifies for the one-half deduction noted above.
- For corporations that overpay income taxes and other federal taxes, the government currently pays interest on such amounts equal to 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, plus 2 percentage points. The budget reduces that rate by eliminating the extra 2 percentage points, effective July 1, 2010. This change will not apply to individuals.
- Non-residents disposing of "taxable Canadian property" may be subject to tax in Canada in respect of any resulting gains, and are often subject to withholding tax and "section 116" clearance certificate requirements. For these purposes, "taxable Canadian property" currently includes shares in private Canadian corporations (and shares in publicly-traded Canadian corporations where a 25% ownership threshold is met). However, in many cases the non-residents are ultimately not subject to tax in Canada because of an income tax treaty exemption. The budget provides, in general terms, that shares of a Canadian corporation will not be taxable Canadian property unless more than 50% of the value of the shares was derived principally from real estate and resource properties located in Canada at any time within 60 months preceding the sale of the shares. This rule is effective after March 4, 2010.
- The budget proposes that public consultations will be held on proposals that would combat "aggressive tax planning" and require the reporting of certain tax "avoidance transactions". The proposals are similar to ones previously

announced by the government of Quebec for provincial income tax purposes.

- The budget withdraws all of the foreign investment entity (FIE) draft legislation and proposes to replace it with more modest changes to the current "offshore investment fund" rules. The NRT draft legislation will continue on, with certain amendments to clarify that they do not apply to most types of commercial trusts, as well as other amendments.

### **TAX FILING DEADLINES**

The normal deadline for individuals to file their 2009 tax return is April 30, 2010.

However, if you or your spouse or common-law partner carried on a business in 2009, your deadline for filing your 2009 return is June 15, 2010. Unfortunately, your income taxes owing for 2009 are still due on April 30, 2010, and late taxes will be subject to an interest charge (currently 5% compounded daily). As a result, it is prudent to do at least a draft of your return by April 30 so you have an estimate of your taxes for the 2009 year.

Where an individual died in January through October 2009, the deceased's 2009 return must be filed by the normal deadline described above (April 30 or June 15, 2010, as the case may be). However, for deaths after October 2009 and before the normal filing deadline for 2009, the deadline is the later of that normal deadline and 6 months after the day of death. Thus, for example, the 2009 return for a person who died on December 18, 2009 is due on June 18, 2010.

Corporations must file their returns within six months after the end of the relevant

taxation year (which need not coincide with the calendar year). Trusts must file within 90 days after the end of the taxation year.

### **TAXPAYERS AFFECTED BY EARTHQUAKES IN HAITI OR CHILE**

The Canada Revenue Agency (CRA) recently announced that taxpayers participating in the relief efforts or personally affected by the recent earthquakes in Haiti or Chile, and who as a result are unable to meet their tax obligations, will be able to access certain administrative tax relief measures. These "taxpayer relief provisions", as they are known, can apply to natural disasters that prevent taxpayers from filing their returns or paying their taxes on time. Taxpayers should submit their request in writing using form RC 4288. The CRA will consider these requests on a case by case basis.

In addition, the CRA indicated that taxpayers who were unable to make their 2009 RRSP contributions before the yearly deadline of March 1, 2010 as a result of one of these natural disasters, can also request in writing that the CRA grant relief to effectively allow late contributions.

### **TAX-FREE "ROLLOVERS" TO CORPORATIONS**

If you transfer property to a taxable Canadian corporation in exchange for shares of the corporation, the transfer can take place on a tax-free "rollover" basis. This "Section 85 rollover" is elective, and is made in a joint election between you and the corporation (form T2057). The form must be filed by the earlier of your tax filing date and the corporation's tax filing date for the taxation year in which the transfer takes

place. Late filings up to three years after that date are allowed, with a monetary penalty. Filings after the three-year period may be allowed by the CRA in its discretion.

In the election, you choose an “elected amount” in respect of the transferred property, which becomes your proceeds of disposition of the property. Therefore, if you choose the cost of the property as the elected amount, there will be no gain or loss on the transfer for income tax purposes. The elected amount also becomes the cost of the property to the corporation.

In addition, the elected amount becomes your cost of the shares issued to you by the corporation in consideration for the transfer of the property. However, if you receive back any non-share consideration from the corporation (i.e. the corporation gives you something in addition to the shares), the cost of your shares is reduced by the value of that consideration.

The elected amount does not have to equal your cost of the transferred property. Thus, for example, if the property had an accrued gain, you could have a “partial” rollover (realizing part of the accrued gain) by electing an amount higher than the cost of the property. This might be desirable, for example, if you had losses to offset the gain, because the higher elected amount would result in a bumped-up cost of the property for the corporation and a higher cost of the shares for you.

There are various limits on the elected amount. The amount cannot exceed the fair market value of the property transferred to the corporation, and it cannot be less than the lesser of the fair market value of the property and your cost of the property.

Additionally, the elected amount cannot normally be less than the fair market value of any non-share consideration you receive back from the corporation.

#### Example

You transferred land, which is capital property to you, to your corporation in exchange for 100 common shares in the corporation. Your cost of the land was \$100,000 and its fair market value at the time of the transfer was \$300,000. You have net capital losses of \$40,000 (in respect of previous capital losses of \$80,000), which you would like to use up.

If you choose an elected amount of \$180,000, your proceeds of disposition will equal \$180,000. You will realize a capital gain of \$80,000, one-half of which, \$40,000, will be a taxable capital gain. That amount can be offset by your \$40,000 net capital losses, so that the transfer will not trigger tax. The corporation’s cost of the land and your cost of the 100 shares will be \$180,000.

Most types of property qualify for the rollover. One notable exception is land inventory, which does not qualify.

#### **CRA POLICY ON EMPLOYER GIFTS AND AWARDS**

The CRA has historically allowed certain amounts of employer-provided gifts or awards to be received by employees free of tax. The CRA’s most recent administrative position, effective at the beginning of 2010, applies to employer-provided gifts received by employees for special occasions such as religious holidays, birthdays, or weddings,

and to awards for things such as employment excellence and long-service.

The current CRA position is as follows:

Non-cash gifts and non-cash awards to an arm's length employee, regardless of number, are tax-free to the extent that the total value of all non-cash gifts and awards to the employee is less than \$500 per year. The total value in excess of \$500 is taxable.

In addition to the above, a separate non-cash long service/anniversary award is tax-free to the extent that its total value is \$500 or less. The value in excess of \$500 is taxable. In order to qualify, the award must be for at least five years of service, or at least five years have passed since the last long service award was given to the employee.

The above employer gift and award policy does not apply to non-arm's length employees or persons related to such employees.

Items of an immaterial or nominal value, such as coffee, tea, T-shirts with employer logos, mugs, plaques, and trophies are generally not considered taxable benefits.

Specific performance-related rewards such as those relating to sales targets, and cash awards, including near-cash awards such as gift certificates, continue to be taxable in full.

**Example (partly adapted from a CRA example)**

In 2010, Jeffrey's employer gave him the following gifts and awards with the following value:

T-Shirt with employer logo	\$15
Birthday gift (monetary gift certificate)	\$75
Reward for meeting sales target (weekend holiday)	\$400
Wedding gift (crystal vase)	\$300
Innovation and excellence award (tickets to a sporting event)	\$250

**Tax consequences:**

The T-shirt has no tax consequences as it is of an immaterial/nominal value.

The birthday gift certificate is not eligible for the gift and award policy since it is a near-cash gift. It is fully included in income.

The weekend holiday given to the employee for meeting the sales performance target is not eligible for the gift and award policy since it is considered a form of remuneration. Its value is fully included in income.

The total value of the remaining gifts and awards (wedding, and innovation and excellence) amount to \$550. The employee will report a taxable benefit in the amount of \$50 (\$550 - \$500).

**PRESCRIBED INTEREST RATES**

The CRA recently announced the prescribed annual interest rates for the coming quarter that will apply to any amounts owed to the CRA and to any amounts the CRA owes to taxpayers for income tax purposes.

- The interest rate charged on overdue income taxes, Canada Pension Plan contributions, and Employment Insurance premiums is 5%.

- The interest rate paid on overpayments (late refunds paid by the CRA) is 3%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 1%.

## AROUND THE COURTS

### **Motor vehicle allowance taxable, but related expenses deductible**

If a motor vehicle allowance is not reasonable, it is fully included in the employee's income. In this regard, a specific rule in the Act provides that a motor vehicle allowance is deemed not to be reasonable if it is not based solely on the number of kilometres driven in the course of employment. However, if the allowance is included in income, the employee may deduct his or her motor vehicle expenses incurred in the course of employment, subject to certain statutory requirements.

In the recent *Veinot* case, the taxpayer was employed in Nova Scotia as a forestry equipment operator. The terms of employment required that he travel to remote cutting sites with a vehicle suitable for such travel and for the transportation of equipment. He often travelled to the various cutting sites directly from his home, although he sometimes stopped in first at the employer's main office.

The taxpayer was required to pay his own motor vehicle costs, which exceeded the \$5,470 motor vehicle allowance provided to him by his employer in the relevant taxation year. The taxpayer attempted to deduct his expenses, but the CRA denied the deduction on the basis that he received a reasonable allowance (which would be tax-free). The

CRA also felt that the travel from his home directly to the cutting sites was personal rather than in the course of employment.

Upon appeal to the Tax Court of Canada, the Court disagreed with the CRA, first holding that the travel to and from the various cutting sites was not personal, since none of those sites was the regular place of employment. (Travel from home to the regular place of employment and back is generally considered personal travel.) The Court went on to hold that the allowance was unreasonable, and therefore included in the employee's income. The allowance, although based on kilometres driven in the course of employment, varied depending upon whether parts or equipment were being transported. Therefore, it was not "solely" dependent upon the kilometres driven, and was deemed not reasonable by virtue of the above-noted rule.

Since the allowance was included in the employee's income, he was allowed to deduct his related motor vehicle costs incurred in the course of employment. The amount of the actual deduction was somewhat less than he sought, because the Court was not convinced of his claim that the motor vehicle was used only for employment purposes. However, the deduction more than offset the inclusion of the allowance.

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This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.