

FOCUS ON TAX LAW

## *2010 Federal Budget - Implications for individuals and corporations*



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individuals and corporations.

The 2010 Federal Budget contained some good news and some bad news for

### **FIRST THE BAD NEWS: CLOSING LOOPHOLES**

#### **Employee stock options:**

##### **1. Elimination of tax deferral election for public companies:**

Currently, employees of publicly-traded companies can elect to defer tax on up to \$100,000 of employee stock option benefits vesting in a particular year. The budget repeals this tax deferral election for employee stock options exercised after March 4, 2010. Some interim tax relief is proposed under the budget in order to ensure that the tax liability on the deferred stock option benefit does not exceed the proceeds from the shares' disposition.

##### **2. Stock Option cash outs:**

As of March 4, 2010, the employee stock option deduction of one-half of the employment benefit (which is available provided certain conditions are met) can only be claimed where the employee exercises his or her options by acquiring securities from their employer. Previously, where employees disposed of their stock option rights for cash, the employment benefit could be eligible for the stock option deduction while the cash payment was fully deductible to the employer. Employers may continue to allow employees to cash out their stock option rights and claim the deduction, provided the employer makes an election to forego the deduction for the cash payment. The employee stock option rules are also changed to clarify that a disposition of rights under a stock option agreement to a non-arm's length person results in an employment benefit at the time of the disposition.

##### **3. Information Reporting Regime for Aggressive Tax Planning:**

The Budget proposes to initiate a public consultation on proposals requiring the reporting of certain potentially abusive tax-avoidance transactions which would be in addition to the general anti-avoidance rule and the tax-shelter rules. Under the proposed regime, an "avoidance transaction" will be a "reportable transaction" if it features at least two of three "hallmarks" that commonly exist when taxpayers enter into avoidance transactions including: circumstances in which a promoter or tax advisor is entitled to fees to the extent they are attributable to the amount of the tax benefit or contingent on obtaining a tax benefit, the promoter or tax advisor requires confidential protection related to the transactions, and where the taxpayer or the person who entered the transaction for the benefit of the taxpayer obtains contractual protection in respect of the transaction. A

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taxpayer would be denied the benefit related to an unreported avoidance transaction, subject to providing the required information and being assessed a penalty.

**NOW THE GOOD NEWS:  
RELIEVING PROVISIONS**

**1. Corporate tax reductions:**

While there were no new corporate rate reductions announced, Canada is staying on course to the lowest corporate income tax rate in the G7 by 2012. Currently, the federal general corporate income tax rate is 18 per cent and the small business rate is 11 per cent and are expected to drop to 15 per cent and 11 per cent respectively by 2012.

**2. Loss consolidations within corporate groups:**

The Budget proposes to introduce a formal system of loss transfers within a corporate group and consolidated reporting.

**3. Section 116 and taxable Canadian property:**

The Budget has proposed two relieving measures for foreign investors by narrowing the circumstances in which tax reporting and filing requirements are imposed. These include a proposed amendment to the

definition of "taxable Canadian property" in section 116 of the *Income Tax Act* which will exclude the shares of corporations (and certain other interests) which do not derive their value principally (i.e., more than 50 per cent) from real or immovable property situated in Canada. As a consequence, section 116 filing requirements will no longer apply to most share investments in private and public corporations, regardless of the level of ownership. The second proposal fixes a technical loophole that previously prevented taxpayers from applying for refunds of overpayments of tax withheld under section 105 of the Regulations or section 116 of the Act.

**OTHER MEASURES**

The Budget contains a dramatic overhaul of the proposed rules applicable to foreign investment entities and non-resident trusts. In addition, the Budget contains certain measures which affect specified foreign investment flow-through entities as well as certain

measures that target certain transactions that permit Canadian taxpayers to obtain tax relief for foreign taxes.

We are still reviewing the Budget documents but would be pleased to answer any questions that you may have with respect to the proposed changes.

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