



March 2010

### ***2010 Federal Budget Overview***

On Thursday, March 4, 2010, Canadian Finance Minister Jim Flaherty delivered a budget laden with tax measures ("Budget 2010"), including:

- employee stock option holders will no longer be afforded capital gains treatment on any options that are cashed out instead of being exercised, unless the employer is prepared to forego the deduction of the cash expense;
- the election to defer taxation of a stock option benefit on publicly traded shares has been eliminated;
- new rules will be enacted to restrict loss trading in SIFT conversions;
- compliance requirements on sales of Canadian shares that do not constitute a real property interest will be eliminated; and
- a consultation process regarding the federal government's proposal to require taxpayers to report avoidance transactions to the Canada Revenue Agency.

#### **Employee Stock Options**

Budget 2010 proposes significant changes to certain aspects of the tax treatment of stock options granted to employees.

##### ***Elimination of Tax Deferral for Publicly-Traded Securities***

An employee is generally required to include in income the difference between the fair market value of an optioned security at the time of exercise and the exercise price paid by the employee (this difference being the stock option benefit). Under certain conditions, an employee of a publicly-traded employer was able to elect to defer the recognition of some or all of the stock option benefit until the employee actually sold or disposed of the optioned securities. Budget 2010 proposes to repeal this tax deferral election for public-company stock options exercised after March 4, 2010, thereby essentially forcing employees to either sell optioned securities immediately or fund the associated tax burden with other sources of cash. The change is particularly unfavourable to employees of listed entities whose options will expire unless exercised, but who may or may not be in a position to sell securities. However, Budget 2010 does not eliminate or amend the more generous deferral available for employees exercising options granted by employers which are Canadian-controlled private corporations.

##### ***Deductions for Stock Option Cash Outs***

An employee is generally required to include in income the entire stock option benefit associated with the exercise of options. Moreover, if certain conditions are met, the employee is entitled to a deduction equal to one-half of the stock option benefit (the "**one-half deduction**"). On the other hand, employers are not entitled to a tax deduction equal to the value of the employees' taxable benefit option exercise where securities are issued.

A taxable benefit also arises where employees dispose of their rights under their options for cash as opposed to exercising them and option plans are often structured to allow an employee to "cash out" the options by disposing of them for a cash payment from the employer. In these "cash out" scenarios the employee continued to be eligible for the one-half deduction, and the employer, because it was paying cash as opposed to issuing shares, was able to deduct the payment to the employee as a compensation expense.

Budget 2010 proposes to eliminate those opportunities for both the one-half deduction for the employee and the employer deduction for the same stock option benefit. Under the proposed rules, the one-half deduction will continue to be available in situations where employees exercise their options by acquiring securities of their employer. However, the employee may only take the one-half deduction on a cash out if the employer elects to forgo the deduction for the cash payment.

These new rules will apply to cash outs that occur after March 4, 2010.

### ***Special Relief for Tax Deferral Elections***

Some taxpayers who took advantage of the deferral of the stock option benefit previously available for listed securities have seen a decline in the value of their unsold, optioned securities.

Budget 2010 introduces a time-sensitive election for taxpayers who deferred taxation of their stock option benefits until the disposition of the optioned securities. If available, the new election will generally ensure that the tax liability on a deferred stock option benefit does not exceed its proceeds of disposition.

The new election will only be available for stock option benefits that have been validly deferred until the date of disposition under the existing legislation. Individuals who disposed of their optioned securities before 2010 must make the election on or before their filing-due date for the 2010 taxation year (generally April 30, 2011).

It should be noted that individuals who have not disposed of their optioned securities before 2010 must do so before 2015 if they wish to have the benefit of this relief so the measure also enhances the collection of otherwise deferred income tax. Moreover, it must be noted that the limitation of tax liability on the benefit to the proceeds of disposition received will take into account tax shelter created by the share sale – in particular the application of the resulting capital losses to capital gains from other sources.

### ***Remittance Requirement***

Budget 2010 proposes to clarify that withholding tax on the value of the stock option benefit must be collected and remitted by the employer when the stock option is exercised, except in the case where the taxation of the stock option benefit is deferred for Canadian-controlled private corporations. Previously, a Canada Revenue Agency technical interpretation suggested that the CRA might not enforce the employer's obligation to collect and remit in certain circumstances.

The clarification proposed changes to remittance requirements will apply to stock option benefits arising on the exercise of options and issuance of optioned securities after 2010.

#### ***Other Budget Measures Duly Noted:***

- *enhanced provisions for rollover of registered savings plan proceeds to registered disability savings plans;*
- *charity disbursement quota reform;*
- *accelerated capital cost allowance and flow-through shares for clean energy generation;*
- *reduction of interest rate for refunds payable to corporations.*

## **SIFT Conversions and Loss Trading**

As a result of the new tax regime imposed on specified investment flow-through ("SIFT") trusts and entities, many SIFT trusts and partnerships have converted or are considering a conversion to a corporate structure. Some of these transactions have been structured as mergers with unrelated corporations whose corporate tax attributes would result in significant sheltering of income tax by the post-merger business.

These transactions relied on the fact that rules applicable to the conversion of SIFT trusts and partnerships did not include acquisition-of-control stop-loss rules. Budget 2010 proposes to amend the existing rules to apply to mergers between corporations and SIFT trusts and partnerships. This will have the effect of restricting the basis on which a corporation can use its tax attributes, including the ability to deduct its non-capital losses previously incurred, following an exchange of equity or units of a SIFT trust or partnership for its shares.

Budget 2010 also proposes to amend the acquisition of control rules to prevent the unintended application of such rules upon the distribution of shares of a corporation by a SIFT trust during its corporate conversion.

It is proposed that these amendments apply to transactions that occur after March 4, 2010. They will not apply to transactions that parties are obligated to complete pursuant to agreements entered into before that time, unless the agreement states that the obligation to complete the transaction does not apply if there is a change in the law of taxation (a tax "out"). Further, they will have no retroactive application; transactions that converted SIFT trusts and partnerships into corporations before March 4, 2010 do not appear to be subject to these proposed changes.

## **Non-resident Taxation**

### ***Taxable Canadian Property***

The Tax Act imposes a tax on non-residents who dispose of "taxable Canadian property." Currently, taxable Canadian property includes shares of corporations resident in Canada, real or immovable property (including Canadian resource property), as well as certain interests the value of which is, or was within the previous 60 months, derived principally from real or immovable property. Many of Canada's international tax treaties exempt the disposition of taxable Canadian property from tax unless the property is real or immovable property or shares that derive their value principally from real or immovable property.

The means through which Canada collects this tax is by placing an onus on the purchaser to withhold and remit a portion of the payment amount unless the purchaser receives a clearance certificate from the Canada Revenue Agency. This process is mandatory whenever a non-resident disposes of taxable Canadian property, regardless of whether the transaction is exempt from tax pursuant to an international treaty.

Budget 2010 proposes to limit the circumstances under which the withholding tax regime applies by narrowing the definition of taxable Canadian property to exclude shares of corporations and certain other interests that do not derive their value principally from real or immovable property located in Canada, Canadian resource property, or timber resource property.

These rules are applicable after March 4, 2010.

### ***NRTs and FIEs***

In 1999, extensive complex draft legislation was released with the intention of curtailing the use of off-shore entities to defer or even eliminate the taxation in Canada of certain income earned by Canadian taxpayers. The legislation has never been passed into law. Budget 2010 contains its own set of proposals, which are intended to replace the 1999 proposals and which will be subject to a consultation process before being tabled in Parliament.

## Information Reporting of Tax Avoidance Transactions – Public Consultation

If the consultation process for NRTs and FIEs wasn't enough, Budget 2010 also announces a consultation process regarding proposals under which taxpayers would be required to report certain transactions deemed to constitute or further tax avoidance. Currently, the Income Tax Act is replete with substantive rules intended to counter what is perceived as aggressive tax planning. However, it appears that the Canada Revenue Agency is having difficulties applying the rules because there are currently no rules that require taxpayers to identify themselves as having undertaken such planning unless certain tax benefits have been quantified such that the structures must be registered as tax shelters.

Budget 2010 proposes a regime that would require taxpayers to report transactions to the Canada Revenue Agency if two of the three following hallmarks were present:

- a promoter or tax advisor is entitled to fees that are attributable either to the amount of the tax benefit, contingently or otherwise, or to the number of taxpayers who participate in the transaction or who have been provided access to advice given by the promoter or advisor regarding the tax consequences;
- a promoter or tax adviser requires "confidential protection" with respect to the elements of the transaction; or
- the taxpayer or the beneficiary of the transaction obtains "contractual protection" in respect of the tax results of the transaction.

Failure to report could result in Canada Revenue Agency denying the tax benefit. Appeals would still be possible, but only after payment of a penalty and filing of any information required by Canada Revenue Agency.

It is surprising that Canada felt the need to engage in public consultation. In October 2009, Quebec went ahead with measures to counter aggressive tax planning after a lengthy consultation process. There, disclosure will be required in similar circumstances those described in Budget 2010, where the transaction results in a tax benefit of at least \$25,000 or a reduction in income of at least \$100,000.

### Contact the BD&P Tax Team

John A. Brussa  
403-260-0131  
[jab@bdplaw.com](mailto:jab@bdplaw.com)

David W. Ross  
403-260-0296  
[dwr@bdplaw.com](mailto:dwr@bdplaw.com)

Michael J. Flatters  
403-260-0107  
[mjf@bdplaw.com](mailto:mjf@bdplaw.com)

Denise Dunn McMullen  
403-260-0361  
[ddm@bdplaw.com](mailto:ddm@bdplaw.com)

Jeff Fortin, C.A., C.P.A.  
403-206-0315  
[jaf@bdplaw.com](mailto:jaf@bdplaw.com)

Heather R. DiGregorio  
403-260-0341  
[hrc@bdplaw.com](mailto:hrc@bdplaw.com)

Kirk W. Lamb  
403-806-7803  
[kwlamb@bdplaw.com](mailto:kwlamb@bdplaw.com)

### Tax Litigation and Dispute Resolution

Michel H. Bourque  
403-260-0191  
[mhb@bdplaw.com](mailto:mhb@bdplaw.com)

Barry R. Crump  
403-260-0332  
[brc@bdplaw.com](mailto:brc@bdplaw.com)

### Estate Planning

James S. Palmer, C.M. A.O.E., Q.C.  
403-260-0241  
[jsp@bdplaw.com](mailto:jsp@bdplaw.com)

*If you would like further information regarding any member of our team, please feel free to contact any team member directly. Additional information is also available on our website at [www.bdplaw.com](http://www.bdplaw.com).*