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My Holiday Tax Reading

While most people who go on long holiday plane rides watch in-flight movies or sleep, I use the occasion to catch up on my tax reading. This article deals with some of it – summarizing some recent developments which may be of interest to readers.

Report on International Tax

Last month, the "Advisory Panel on Canada's System of International Taxation" released its final report,[1] which featured a large number of recommendations to improve Canada's international tax system.

While many readers are only vaguely aware of the Panel's deliberations,[2] it's a different story for international tax specialists – where every word in the report is dissected. In case you are not familiar with this group, they are a special breed of tax advisors, whose preferred habitat is in a big tower at King and Bay (or a reasonable facsimile). Apart from this, they are rarely seen (even by their families), other than getting in and out of their BMWs – or maybe in the first-class lounge, en route to an IFA conference.

For months they had been stewing about what the committee would come out with. But not to worry. Generally, the report not only largely affirms business as usual,[3] it supports more liberal rules, even restoring a tax planning opportunity which many tax planners thought had gone the way of the dodo bird. Unfortunately, space constraints (and my penchant for purple prose) do not permit more than a sampling of the recommendations in the report, but here are a few. The Panel recommends "a broader exemption system for foreign active business income earned through foreign affiliates",[4] so that active business income can be repatriated to Canada as a tax-free dividend irrespective of whether the income is earned in a country with which Canada has a tax treaty. The report states that a by-product of this would be the elimination of surplus tracking, which the Panel believes generates little, if any Canadian tax revenue.[5]

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A related recommendation is that Canada's exemption system should be extended to capital gains by Canadian shareholders on foreign affiliate shares[6] where the shares derive all or substantially all of their value from assets used or held principally to earn active business income.[7] As for the fact that it may seem inconsistent to exempt gains on the sale of foreign affiliate shares while taxing gains on the sale of Canadian company shares, "this difference can be accepted on the basis that the current rules are out of step with most other countries that have exemption systems," and would also result in a simpler tax system.[8]

On other fronts, the Panel believes that the proposed FIE and NRT rules should be "reconsidered" and that the government "should undertake a fresh review to coordinate the FAPI, FIE and NRT regimes".[9] The Panel also recommends the repeal of section 18.2,[10] slated to come into effect for periods beginning after 2011, which restricts the deductibility of interest on borrowings by Canadian companies used to invest in foreign affiliates, i.e., for so-called "double dips". The Panel made no recommendation for further laws to restrict treaty shopping, their view being that "businesses should be able to organize their affairs to obtain access to treaty benefits".[11]

Whew! It must have been high fives at King and Bay when the report came out. Now the international people can stop worrying about it – and get back to worrying about their mutual funds. All kidding aside, recent months illustrate the importance of having a competitive international tax system which is free of red tape and ambiguities.

TAX NOTES

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Now in Effect: the Canada–U.S. Protocol

The Protocol to amend the Canada–U.S. income tax treaty came into effect on December 15. A number of provisions have differing effective dates. Interest paid between related parties in Canada and the United States is subject to a withholding tax rate of 7% (reduced from 10%), effective January 1, 2008. If tax was withheld at 10% rate, it is possible to get a refund of the extra 3%. In calendar 2009, the rate will reduce to 4% and will be phased out starting January 1, 2010. Interest between unrelated persons would be subject to a zero rate of withholding effective January 1, 2008, but effective the same date, Canada changed its tax laws so that similar rules apply to interest payments to residents of all foreign countries. Other changes to withholding tax take effect on February 1, 2009 (e.g., the nil withholding rate for guarantee fees).

The Protocol rules that limit the availability of treaty benefits to hybrid entities – particularly ULCs – are effective January 1, 2010. A 25% withholding rate will apply to cross-border dividends paid by these entities.

Before relying on the treaty, Canadians should make sure that the new "limitation on benefits" provisions now applying on the "Canadian side" do not knock out favourable withholding rates or other benefits.[12] The basic thrust of these provisions is that the benefits of the treaty apply to "qualifying persons", including natural persons, publicly-traded companies and their subsidiaries, and government bodies. Companies controlled by qualifying persons may qualify for the treaty but must meet "base erosion" rules designed to protect against siphoning income outside of the United States.[13] In other cases, two other exceptions may apply: (i) an "active trade or business test" whereby the treaty may apply to income derived in Canada, provided that the U.S. resident or a related person carries on a business which is substantial in relation to the Canadian activities and (ii) a "derivative benefits test" applying to interest, dividends or royalties, where the U.S. company is owned by a resident of a third country which has a treaty with Canada with applicable rates at least as favourable as under the Canada-U.S. treaty, provided that the third-country resident would be a "qualifying person" if resident in the United States.[14]

Ontario Harmonization – Get Out Your Reading Glasses

Readers in Ontario who are tax advisors or corporate tax return preparers will be interested in learning more about federal and provincial harmonization. This will come online for Ontario taxpaying corporations with taxation years ending after 2008 – so the first filing deadlines will start cropping up this summer. Sometime between now and then, it will be advisable to develop a working knowl-

edge of the new system, especially the transitional debits and credits.

Replacing the old provincial tax forms are a series of federal forms starting at Schedule 500, which is used to calculate basic Ontario tax (e.g., the small business deduction and clawback, but excluding tax credits and additional taxes which are calculated on other 500 series schedules). Schedule 506 is a computation of transitional debits/credits, which arise because Ontario tax balances are replaced by federal balances.[15] The general idea is simple: you tally up various Ontario balances, such as non-capital and net capital losses, UCC, etc., and likewise for federal balances. If Ontario tax balances exceed federal balances, so that the company loses coverage, it gets an Ontario tax credit based on 14% of the difference, which is normally amortized over five years.[16] If the opposite is the case – Ontario tax balances are less than federal balances, so that the company gains coverage – there will be a transitional tax debit (i.e., extra tax) based on 14% of the difference, which is also normally amortized over five years.

While this sounds simple enough, the devil, as they say, is in the details. And a good way to get a flavour for them is to go to the CRA's Web site, www.cra-arc.gc.ca, and pull the form. You will see that it is eight pages long, with the first page devoted to new and unfamiliar terminology and definitions. Some of the complications arise from wind-ups and amalgamations occurring within the amortization period.[17] There is also a special adjustment to Ontario SR&ED balances, whereby federal investment tax credits may be added, as well as an election to defer transitional debits in respect of SR&ED. One possibly time-consuming requirement is to calculate the adjusted cost base of partnership interests, for both federal and provincial purposes, the rationale being to pick up differences in partnership-level balances. This, of course, could be particularly burdensome for older partnerships. The transitional credits/debits are entered on Schedule 5[18] which deals with provincial tax (in the new section for Ontario), along with the results of Schedule 500.[19]

Tax return preparers should make sure they have budgeted extra time to cope with these new forms. Hopefully, PD courses and additional explanatory material will be available in coming months.

Faraggi Appeal Released

Last month, the *Faraggi* case[20] – which had been dragging through the courts for so long that it predates GAAR – was released by the Federal Court of Appeal. The facts of the case are complex. But in a nutshell, the taxpayers were – literally – in the business of crafting capital dividends for sale to third-party corporations through an intricate series of gains and offsetting losses, with the capital dividends in between. The buyers would pay a premium on certain share subscriptions which were paid out as capital dividends to the devisers of the plan. In the case, the CRA's focus was on the devisers of the plan and their companies. It sought to recharacterize the premium paid to the companies as income from a business, and knock out the capital dividend account elections which had allowed the devisers to pocket the premium tax free – or so they thought.

The lower court decision was troubling to practitioners for at least two reasons. As has been observed by my MERITAS colleague, Tim Huot,[21] the sham doctrine was expanded by including an additional element, namely an abuse of the provisions of the *Income Tax Act*, contrary to their object and spirit. Potentially, this opened a second line of attack which could complement GAAR. Also troubling was the attack on the "papering" of the transaction, particularly the daylight loans that were used. The judge attacked the loans on the basis that they were invalid, among other things, because there was no security or interest charged. Trouble is, temporary loans and the like are common in tax planning. Practitioners are left to wonder where this sort of thing stops – when will a loan without commercial terms be vulnerable to an attack?

The Court of Appeal by and large cleared up these concerns (but it may have opened up another – see below). The Court indicated that the doctrines of sham and abuse are not the same[22] and that "subject to the invocation of the GAAR in a particular case, taxpayers are entitled to arrange their affairs in such a way as to minimize their tax burden, even if in doing so, they resort to elaborate plans that give rise to results which Parliament did not anticipate."[23] The Court also indicated that it is not possible to conclude that there was a misrepresentation of the relationship of lender/borrower; and the loans in question could not be held to be shams.[24]

The Court of Appeal held that the share subscription premiums were business income: as no transaction or operation is systematically excluded from the concept of business, the question whether a given operation amounts to a business must be determined in accordance with the particular facts of each case.[25] Moreover, because the gain-making shares were acquired by the subsidiaries for the purpose of their immediate sale, this excludes the possibility that the shares could have been capital property in the hands of the subsidiaries.[26] Thus, the characterization as a capital gain was a misrepresentation and the resultant capital dividend elections were shams.[27] Accordingly, the taxpayers were grossly negligent for failing to report fully taxable income at the corporate level as well as taxable rather than capital dividends – so that penalties also applied.[28]

What I find a bit troubling is penalties being imposed as a result of reporting capital gains rather than income – and the reasoning that led to this result.[29] The Court observed that capital gains status was out of the question

because the acquisition of the gain-making shares by the subsidiaries and their sale had been "preordained".[30] The concept that a preordained sale pre-empts capital gains status could be troublesome, e.g., in respect of a series of transactions involving a pre-sale reorganization which ultimately leads to a sale of an asset. [31]

Hopefully, this will be clarified in another case. Personally, however, I am not really fussed about the issue. The real point may be that the Court was not sympathetic to the appellants, so that this line of reasoning could end up being largely confined to the case. On that note, I think that *Faraggi* is also indicative that the Federal Court of Appeal – usually the court of last resort – is not particularly sympathetic to taxpayers. In a very unscientific attempt to check this out, I counted the last 50 Federal Court of Appeal decisions on my system (other than those dealing with procedural-type issues). I counted only three which went in favour of taxpayers.

– David Louis, J.D., C.A., Minden Gross LLP, Toronto, a member of MERITAS law firms worldwide

Notes:

[1] *Enhancing Canada's International Tax Advantage*, Advisory Panel on Canada's System of International Taxation, December 2008.

[2] The genesis of the Panel is the 2007 federal Budget, which contained controversial proposals to eliminate the deductibility of interest on debt incurred by corporations to finance foreign affiliates. This was later withdrawn in favour of section 18.2, focusing on double dips.

[3] Some recommendations are taxpayer negative, notably the proposal to lower the thin capitalization ratio in subsection 18(4) from 2 to 1 to 1.5 to 1.

[4] Paragraph 4.33 of the report.

[5] Paragraph 4.26 of the report

[6] As well as "capital gains realized by foreign affiliates on the sale of shares of other foreign affiliates" (currently the gains themselves may be exempt, but 50% is taxable when the proceeds are repatriated to Canada as dividends).

[7] Paragraph 4.52 of the report.

[8] Paragraph 4.53 of the report.

[9] Paragraphs 4.103 and 4.104 of the report.

[10] Recommendation 4.7 of the report.

[11] Paragraph 5.68 of the report.

[12] Limitation on benefits provisions have been in effect on the "U.S. side" since 1995.

[13] Where deductible expenses for the preceding fiscal period to persons that are not qualifying persons is equal or greater than 50% of gross income for that period.

[14] Otherwise, a person can be granted treaty benefits by competent authority.

[15] This is done as at the "transition time", which is the first day of the corporation's particular taxation year that includes January 1, 2009.

[16] A carryforward mechanism applies in respect of periods where the credit cannot be used.

[17] "Eligible post-2008 winding-up" and "eligible amalgamation". There may also be an adjustment for an "eligible pre-2009 winding-up", which contemplates situations where taxation years in respect of the wind-up straddle December 31, 2008. There may also be adjustments for "straddle" non-arm's length transfers.

[18] Lines 414 or 276.

[19] The Ontario section also includes various additional taxes/tax credits computed on schedules which follow 500 (e.g., the new 4.5% Ontario R&D credit: Schedule 508). The total provincial tax liabilities are summarized on line 255 of Schedule 5, which is entered on lines 750/760 of the T2.

[20] *2529-1915 Québec Inc., 2530-1284 Québec Inc., Robert Langlois and Ralph E. Faraggi v. The Queen*, 2008 FCA 398.

[21] Of BCF, Montreal. See "Sham – As Bad As It Gets", *Tax Topics* No. 1857, October 11, 2007.

[22] Paragraph 55.

[23] Paragraph 56.

[24] Paragraphs 70 and 71.

[25] Paragraph 65. It is interesting to compare this approach with the old cases involving SRTC "quick flips", which are somewhat reminiscent of the fact situation, in that the SRTC debentures were similarly acquired for immediate redemption. Notably, *Loewen v. The Queen* (94 DTC 6265, FCA) held that the gain on the redemption of a SRTC debenture was on capital account rather than an adventure in the nature of trade. While at first blush, this seems inconsistent, the Court indicated that, for there to be an adventure in the nature of trade, it must be one which could produce a profit. A purely notional profit, therefore, cannot serve to turn an otherwise unprofitable transaction into an adventure in the nature of trade. In *Faraggi*, for the reasons indicated, the transactions did produce a profit.

[26] Paragraph 73.

[27] Paragraphs 72, 77 and 79. As stated at paragraph 59: "the existence of a sham under Canadian law requires an element of deceit which generally manifests itself by a misrepresentation by the parties of the actual transaction taking place between them." (The classic definition of sham refers to acts done or documents executed by the parties which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.)

[28] Paragraph 85.

[29] In addition, although the relationship of the sham doctrine and deceit are well known, query whether future applications of the sham doctrine may more commonly involve the imposition of penalties, by virtue of *Faraggi*.

[30] Paragraph 74.

[31] Or, even for some investors in securities, where an ultimate sale is a virtual certainty.

2009 Automobile Rates and Limits

In News Release No. 2008-114, dated December 30, 2008, the Department of Finance announced that for 2009, the automobile expense deduction limits and prescribed rates for automobile operating expense benefits would remain unchanged from those for 2008.

For vehicles acquired after 2008, the limit on the capital cost of passenger vehicles for purposes of capital cost allowance remains at $30,000, plus applicable federal and provincial sales taxes (Regulation 7307(1)); the limit on deductible leasing costs remains at $800 per month, plus applicable federal and provincial sales taxes (Regulation 7307(3)); and the maximum interest deduction for amounts borrowed to purchase an automobile remains at $300 per month (Regulation 7307(2)). The limit on tax-exempt allowances paid to employees for business use of the employee's vehicle and that are deductible by employers remains at 52 cents per kilometre for the first 5,000 kilometres and 46 cents for additional kilometres

(Regulation 7306). For Yukon Territory, Northwest Territories and Nunavut, these figures remain at 56 cents and 50 cents, respectively. The rate for determining the operating expense taxable benefit for the personal portion of automobile expenses paid for by an employer remains at 24 cents per kilometre (Regulation 7305.1). This rate for taxpayers employed principally in selling or leasing automobiles remains at 21 cents per kilometre.

CRA's 2008 Meal and Vehicle Rates

The CRA has released the 2008 meal and vehicle rates that can be used by individuals to calculate meal and travel expenses for purposes of the northern residents' deductions, moving expenses, and transportation to obtain medical services. The flat rate meal amount remains at $17 per meal to a maximum of $51 per day. For the simplified method of calculating vehicle expenses, the 2008 per kilometre rates are shown in the chart below.

Province/Territory	*Cents/Kilometre*
Alberta	53.0
British Columbia	54.0
Manitoba	50.5
New Brunswick	52.0
Newfoundland and Labrador	55.5
Northwest Territories	64.0
Nova Scotia	52.5
Nunavut	64.0
Ontario	55.5
Prince Edward Island	52.5
Quebec	58.0
Saskatchewan	49.5
Yukon	66.0

Prescribed Interest Rates – First Quarter of 2009

The prescribed interest rates for the first quarter of 2009 are noted below:

- 2% to calculate a deemed interest taxable benefit on subsidized employee and shareholder loans;
- 4% on refunds of income tax overpayments; and
- 6% on payments of overdue income taxes, insufficient income tax instalments, unremitted employee source deductions, CPP contributions or EI premiums, and unpaid penalties.

These rates will be in effect from January 1, 2009 to March 31, 2009.

Fifth Protocol to Canada–U.S. Tax Treaty Enters into Force

In Department of Finance News Release No. 2008-104, dated December 15, 2008, the Minister of Finance announced that the Fifth Protocol to the Canada–U.S. Tax Treaty entered into force on December 15, 2008. In accordance with paragraph 2 of Article 27 of the Protocol, for taxes withheld at source, the provisions of the Protocol have effect for amounts paid or credited on or after February 1, 2009. For other taxes, the provisions of the Protocol have effect for taxable years that begin after 2008. As well, paragraph 3 of Article 27 sets out effective dates for certain specific provisions in the Protocol.

Average Exchange Rates for 2008

Reproduced below is a chart from the Bank of Canada showing the 2008 average exchange rates for several currencies. The noon exchange rate for the U.S. dollar on Wednesday, December 31, 2008 was 1.2246 and the closing rate on that day was 1.218.

BANK OF CANADA

FINANCIAL MARKETS DEPARTMENT
YEAR AVERAGE OF EXCHANGE RATES

BANQUE DU CANADA

DÉPARTEMENT DES MARCHÉS FINANCIERS
MOYENNE ANNUELLE DES TAUX DE CHANGE

Ottawa, 2008 Average of 252 days

COUNTRY PAYS	MONETARY UNIT UNITÉ MONÉTAIRE	PRESENT VALUE IN CAN. CURRENCY VALEUR ACTUELLE EN MONNAIE CAN.
Argentina Argentine	peso	0.3319
Australia Australie	dollar	0.9002
Bahamas	dollar	1.0660
Brazil Brésil	new real nouveau real	0.5868
Burma (Myanmar) Birmanie (Myanmar)	kyat	0.1976
Chile Chili	peso	0.002057
China Chine	renminbi	0.1536
Colombia Colombie	peso	0.000544
Croatia Croatie	kuna	0.2160
Czech. Republic République tchèque	koruna couronne	0.06259
Denmark Danemark	krone couronne	0.2093
East Caribbean Caraïbes Orientales	dollar dollar	0.4040
European Euro Europe Euro	Euro	1.5603
Fiji Fidji	dollar	0.6701
Communauté Financière Africaine	franc C.F.A	0.002379
Comptoirs Français du Pacifique	franc C.F.P.	0.01308
Ghana	cedi	0.9865
Guatemala	quetzal	0.1410
Honduras	lempira	0.05641
Hong kong	dollar	0.136931
Hungary Hongrie	forint	0.006215
Iceland Islande	krona couronne	0.01264
India Inde	rupee roupie	0.02458
Indonesia Indonésie	rupiah roupie	0.000111
Israel Israël	new shekel nouveau shekel	0.2974
Jamaica Jamaïque	dollar	0.01466
Japan Japon	yen	0.01037
Malaysia Malaisis	ringgit	0.3195
Mexico Mexique	peso	0.09587
Morocco Maroc	dirham	0.1375
Neth. Antilles Antilles néerlandaises	guilder florin	0.5990

Ottawa, 2008 Moyenne de 252 jours

COUNTRY PAYS	MONETARY UNIT UNITÉ MONÉTAIRE	PRESENT VALUE IN CAN. CURRENCY VALEUR ACTUELLE EN MONNAIE CAN.
New Zealand Nouvelle-zélande	dollar	0.7547
Norway Norvège	krone couronne	0.1900
Pakistan	rupee roupie	0.01515
Panama	balboa	1.0660
Peru Pérou	new sol nouveau sol	0.3642
Philippines	peso	0.02400
Poland Pologne	zloty	0.4456
Romania Roumain	nouveau leu	0.4241
Russia Russie	rouble	0.04285
Serbia Serbe	dinar	0.01918
Singapore Singpour	dollar	0.7525
Slovakia Slovaquie	koruna couronne	0.04999
South Africa Afrique du Sud	rand	0.1299
South Korea Corée de sud	won	0.000979
Sri_Lanka	rupee roupie	0.009836
Sweden Suède	krona couronne	0.1623
Switzerland Suisse	franc	0.9840
Taiwan	new dollar nouveau dollar	0.03377
Thailand Thaïlande	baht	0.03229
Trindad & Tobago Trinité et Tobago	dollar	0.1718
Tunisia Tunisie	dinar	0.8650
Turkey Turquie	new lira nouvelle livre	0.8207
United Arab Emirates Émirats arabes unis	dirham	0.2902
United Kingdom Royaume-Uni	pound livre	1.96166905
United States Etats-Unis	dollar	1.06601429
Venezuela	bolivar fuerte	0.4964
Vietnam	dong	0.000065

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Federal Indexed Amounts for 2009

On December 8, 2008, the CRA released a Fact Sheet setting out the 2009 personal tax bracket thresholds and amounts and thresholds pertaining to personal tax credits. The Fact Sheet stated that the indexation factor for 2009 is 2.5%.

The following chart lists the indexed amounts for the 2008 and 2009 tax years. Generally, the increased amounts take effect as of January 1. However, increases to the Canada Child Tax Benefit (including the National Child Benefit Supplement and the Child Disability Benefit) and the Goods and Services Tax Credit take effect as of July 1, 2009.

	2009 ($)	2008 ($)
Tax Bracket Thresholds		
Taxable income above which the 22% bracket begins	38,832	37,885
Taxable income above which the 26% bracket begins	77,664	75,769
Taxable income above which the 29% bracket begins	126,264	123,184
Amounts relating to non-refundable tax credits		
Basic personal amount **(See footnote below)**	10,100	9,600
Age amount	5,408	5,276
Net income threshold	32,312	31,524
Spouse or common-law partner amount (maximum) **(See footnote below)**	10,100	9,600
Amount for an eligible dependant (maximum) **(See footnote below)**	10,100	9,600
Amount for children under age 18 (maximum per child)	2,089	2,038
Canada employment amount (maximum)	1,044	1,019
Infirm dependant amount (maximum per dependant)	4,198	4,095
Net income threshold	5,956	5,811
Caregiver amount (maximum per dependant)	4,198	4,095
Net income threshold	14,336	13,986
Disability amount	7,196	7,021
Supplement for children with disabilities (maximum)	4,198	4,095
Threshold relating to allowable child care and attendant care expenses	2,459	2,399
Adoption expenses (maximum per adoption)	10,909	10,643
Medical expense tax credit – 3% of net income ceiling	2,011	1,962
Refundable medical expense supplement		
Maximum supplement	1,067	1,041
Minimum earnings threshold	3,116	3,040
Family net income threshold	23,633	23,057
Old Age Security repayment threshold	66,335	64,718
Certain board and lodging allowances paid to players on sports teams or members of recreation programs		
Income exclusion (maximum per month)	313	306
Tradesperson's tools deduction		
Threshold amount relating to cost of eligible tools	1,044	1,019
Goods and Services Tax Credit		
Adult maximum	248	242
Child maximum	130	127
Single supplement	130	127
Phase-in threshold for the single supplement	8,047	7,851
Family net income at which credit begins to phase out	32,312	31,524
Canada Child Tax Benefit		
Base benefit	1,340	1,307
Additional benefit for third child	93	91
Family net income at which base benefit begins to phase out	38,832	37,885
National Child Benefit (NCB) Supplement		
First child	2,076	2,025
Second child	1,837	1,792
Third child	1,747	1,704
Family net income at which NCB supplement begins to phase out	21,816	21,287
Family net income at which NCB supplement phase-out is complete	38,832	37,885

Note:

Under changes announced on October 30, 2007, in the 2007 Economic Statement, the basic personal amount, the maximum spouse or common-law partner amount, and the maximum amount for an eligible dependant were increased to $9,600 for the 2007 and 2008 tax years, and are further increased to $10,100 for 2009.

As announced in the 2007 Federal Budget, the net income threshold has been eliminated for the 2007 and subsequent tax years. The spouse or common-law partner amount and the amount for an eligible dependant are calculated by subtracting the net income of the spouse or common-law partner or the dependant, as applicable, from the maximum amount ($10,100 for 2009, $9,600 for 2007 and 2008).

Deadline Extended for Registered Disability Savings Plans

In Department of Finance News Release No. 2008-110, dated December 23, 2008, the Minister of Finance announced that the deadline for opening a registered disability savings plan ("RDSP"), making contributions, and applying for the matching grant and the income-tested bond for the 2008 contribution year has been extended from December 31, 2008 to March 2, 2009. The 2009 contribution year will begin on March 3, 2009.

The concept of the registered disability savings plan was introduced in the 2007 Federal Budget with the stated purpose of helping parents and others save for the long-term financial security of a child with a severe disability. The RDSP was introduced along with the Canada Disability Savings Grant ("CDSG") program, under which the federal government will provide matching grants to an RDSP depending on net family income, and the Canada Disability Savings Bond ("CDSB") program, under which the government will contribute bonds to an RDSP for low and modest income level beneficiaries and families. The CDSG and CDSB programs are governed by the *Canada Disability Savings Act*, whereas the RDSP program is governed by the *Income Tax Act*, and in particular section 146.4 and Part XI of the Act. The programs are applicable beginning in the 2008 year.

Contributions to an RDSP are not tax deductible and are not included in income when withdrawn. Investment income earned in the plan as well as grants and bonds are included in the income of the beneficiary when withdrawn. RDSP payments do not affect federal income-tested benefits and credits. An RDSP may be set up for the benefit of a beneficiary who is eligible for the disability tax credit (section 118.3 of the Act) and resident in Canada.

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