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94 Cumberland Street, Suite 200, Toronto, Ontario M5R 1A3
Telephone: (416) 961-5612 Fax: (416) 961-6158
e-mail: valuators@marmerpenner.com

Marmer Penner Inc. Newsletter

Written by Steve Z. Ranot, CA•IFA/CBV
Edited by James A. DeBresser, CA•IFA/CBV

Dalton Hits Professionals Hard

Much has been written in the media today following yesterday's release of the 2009 Ontario provincial budget. First and foremost, the media concentrated on the province's decision to increase provincial sales tax revenues by harmonizing the old provincial retail sales tax ("PST") with the Federal Goods and Services Tax ("GST"). The Provincial Finance Minister focused on the significant paperwork reduction from combining the two sales taxes. So, now instead of paying 5% GST on most goods and services plus another 8% PST on primarily goods alone, we live in a province where we will pay 13% tax on most goods and services.

Not much was written about the increased costs to individuals of professional services. Most matrimonial litigation clients must pay their legal and accounting fees personally, so the sales tax harmonization just increased their costs by 8%. Clients who can claim professional fees as a business expense will not see any cost increase, as the additional tax will be recoverable as an input tax credit. In a nutshell, however, fee sensitive clients involved in matrimonial litigation will be paying more for professional services commencing July 1, 2010.

The budget also announced that the top corporate income tax rate will slowly be reduced from 14% to 10%. From a family law perspective, this increase is a taxpayer's incentive to leave income in a corporation, thus creating more instances where arguments will potentially exist whether title spouses have access to pre-tax corporate income.

The sales tax harmonization will have another impact on matrimonial litigation in terms of determining *Guidelines* income. Most family law specialists are familiar with the 86.6% gross-up on personal expenses charged as business

expenses. For example, if a title spouse charges, say $10,000 per year in personal automobile expenses to a business, we generally add back the $10,000 expenses to income plus another $8,660 of income tax gross-up to adjust for the fact that a high rate taxpayer needs to earn $18,660 pre-tax to be left with the same $10,000 after-tax benefit. In the past, the additional 5% GST benefit to the business owner was generally ignored. Not only was the $10,000 never subject to income tax, but the 5% GST therein was recovered by the business. Now that the Harmonized Sales Tax is a much more significant 13%, let's examine what the real gross-up will become in 2010.

If Dalton charges $10,000 of matrimonial litigation fees to his business after July 1, 2010, his company will pay the $10,000 fee and will deduct it from income. If he treats the legal fees properly, he should pay $11,300, which now includes the 13% sales tax. In order to be left with $11,300 after-tax, an Ontario high-rate taxpayer needs to earn about $21,100. Accordingly, the proper adjustment becomes an addback of the $10,000 to corporate income plus another $11,100 of income tax gross-up. As can be seen, the new gross-up in this situation has increased to 111% of the inappropriate business expense. What we see here is that the higher tax creates greater incentive for:

a) Business owners to charge personal expenses to the business; and

b) Professionals who represent support recipients to uncover these personal expenses.

As always, tax hikes increase the volume of underground activity and tax evasion. Consumers have more incentive to pay cash now for home renovations, automobile repairs and even professional fees. So, in addition to greater incentives for businesses to pay personal expenses, we will also see greater incentive for business owners to avoid reporting certain revenues. Ironically, while Mr. McGuinty's sales tax increase has augmented the likelihood of unreported income, it has also diminished the non-title spouse's financial ability to uncover these transgressions.