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Marmer Penner Inc. Newsletter

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2011 Federal Budget – Family Law Implications

Finance Minister Jim Flaherty tabled the 2011 federal budget yesterday. While there were no changes to personal income tax rates, there were changes which may impact the calculation of income pursuant to the *Child Support Guidelines* ("*Guidelines*") and certain tax credits available to parents. Accordingly, family law specialists should consider these changes:

a) A new $500 per child Children's Arts Tax Credit similar to the Fitness Credit will be available to offset the costs of artistic, cultural and recreational activities. The tax savings from these should reduce the costs of what may qualify as Section 7 expenses;

b) A new $2,000 Family Caregiver Tax Credit is available for caregivers of dependants with a mental or physical infirmity including spouses, common law partners and minor children. This credit will apply beginning in 2012;

c) Previously, the $2,131 Child Tax Credit was limited to one claim per household. This has now been changed so that separated parents living under the same roof can now each claim this credit;

d) In addition to the “Kiddie Tax” which applies to taxable dividends received from certain related corporations, a new similar tax has been introduced to apply to capital gains realized by a minor from the disposition of shares to a related person. These capital gains will be treated as dividends and therefore will not benefit from the capital gains inclusion rate or qualify for the capital gains exemption;

e) The capital gain on donated flow-through shares will no longer be tax-free. In order to encourage charitable donations, the capital gain on donated marketable securities has been tax-free for a number of years. This created an opportunity to make relatively inexpensive charitable donations using flow-through shares which generally create tax deductible losses to the investor followed by capital gains on disposition. From now on, any capital gain up to the cost of the flow-through share at the time it is donated will be taxable even if the share is donated. While all capital gains are considered for *Guidelines* purposes, these capital gains which arose from tax shelters, might have been ignored;

f) Individual pension plans (“IPP’s”) will now require a minimum withdrawal starting at age 72 similar to Registered Retirement Income Funds (“RRIF”). This will increase the income of support payers with IPP’s as they previously had the option of retaining income inside the plan;

g) The corporate expense to fund IPP’s may also be reduced as the cost to fund past service contributions must now first be satisfied by transfers from the individual’s RRSP before a new past service contributions can be made. Where an individual sets up an IPP, he or she can cause his/her corporation to pay significant amounts as tax deductible contributions to this pension plan. This will greatly reduce a corporation’s income. This may also create the impression that the individual’s income for the *Guidelines* has been reduced. If contributions to an IPP are viewed as discretionary, then these expenses should not impact *Guidelines* income.

Accordingly, the change to the rules will reduce expenses and increase reported income, but should not impact the calculation of *Guidelines* income; and

h) In the 1995 budget, the Liberal government ended the use of non-calendar year-ends for unincorporated businesses. This ended the ability of individuals to defer tax on business income for a year. The Conservatives are now doing the same thing for partnership income earned by corporate partners. Until now, tiered corporate partnership interests allowed income to be deferred by using different year-ends. For example, a corporation with a December 31 year-end was a partner in a business with a January 31 year-end. Accordingly, the partnership's income for the year ended January 31, 2010 would not be included in the corporation's taxable income until its year ended December 31, 2010 thus allowing an eleven-month deferral. For multiple tiers of partnerships, this deferral was even greater. The 2011 budget eliminates this tax deferral for all corporate partners that are entitled to more than a 10% income allocation from a partnership in a year. Partnerships will have the option to change their fiscal year-end in order to simplify the process. Otherwise, the corporate partners will have to accrue estimated partnership income for the stub period between the partnership's year-end and the corporation's year-end. This will increase corporate income and create a scenario similar to the stub period inclusion on personal income tax returns of self-employed individuals from 1995 to 2004. It was generally accepted that the stub income was not to be included for *Guidelines* income in those years. It remains to be seen whether the same will apply to the corporate stub period income.