Vol. 15 No. 3 May 2012

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Marmer Penner Inc. Newsletter

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NEW HIGHER TAX RATE IN ONTARIO MAY SPAWN MORE TAX AVOIDANCE AND EVASION

By now, almost every taxpayer in Ontario has heard about Premier Dalton McGuinty's capitulation to the NDP leader's, Andrea Horwath, demand for higher taxes on the wealthy. Because most Ontario residents do not earn above $500,000 per annum, there was not much political risk in introducing this "2% tax" on the wealthy. While the NDP and the Premier have continually referred to the bracket increase from 11.16% to 13.16% as a "2% tax", it is actually more than that. Because Ontario taxpayers pay a surtax of 56% of the Ontario tax once their income exceeds about $81,000, the 2% tax on income over $500,000 is really a 3.12% increase. In other words, because we are "taxed on the tax" in this province, a 2% increase in the tax also increases the amount of the surtax we pay by 56% x 2% = 1.12%. As a result of this change, the top marginal bracket in Ontario rises from 46.41% in 2011 to 49.53% in 2013. As the transition occurs half way through 2012, the top marginal rate in 2012 will be 47.97%.

This increased tax will prompt wealthy people to seek ways around it. High-income employees will be limited to tax shelters such as those commonly found in the oil and gas industry to reduce their taxable

income. The self-employed have more options available to them and may resort to some or all of the following:

a) Income splitting by salary to lower-income family members;

b) Income splitting with family members by way of fees to entities held by family members;

c) Salary or bonus deferral to a future year. After all, Mr. McGuinty did indicate that the "2% tax" is just a temporary measure. (Editor's note: The *Income War Tax Act* of 1917 was a temporary means to finance Canada's effort in WWI. This later became the *Income Tax Act*. We are still waiting for it to be repealed);

d) Leaving more income in the corporation;

e) Charging more personal expenses to the business;

f) Lending or giving money to family members or trusts to allow others to report the investment income; and

g) Report less revenue.

Those earning investment income have incentive to incorporate holding companies or establish trusts resident in lower tax jurisdictions such as Alberta, where both corporate and personal tax rates are significantly lower than in Ontario. With the latest Ontario increase, the top marginal rate on personal income in Alberta of only 39% may be very tempting.

High income support-payers have always had financial incentive to attempt the above tactics. Now, they have 3.12 more reasons. And, when those support-payers do resort to non-reporting of income or

charging personal expenses as business expenses, the higher tax rate will spawn a new income tax gross-up rate of 98% due to the additional tax savings from such activities.

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We are pleased to announce to all those who practice collaborative family law that Steve Ranot will be completing Level Two of the Collaborative Team Training in a few weeks.