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2 Bloor Street West, Suite 2603, Toronto, Ontario M4W 3E2
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

2013 Federal Budget – Family Law Implications

Finance Minister Jim Flaherty tabled the 2013 federal budget last Thursday. While there were no changes to personal income tax rates for those earning employment or interest income, there were changes which may impact the calculation of income pursuant to the *Child Support Guidelines* ("*Guidelines*"). This newsletter comments on the changes most relevant to family law. Accordingly, family law specialists should consider these changes:

VALUATION OF BUSINESS INTERESTS

a) The value of certain corporations may include a component based on unused non-capital losses available to be carried forward for future use. The budget has tightened the rules restricting the transfer of such losses upon the change of control of the corporation, which may now result in lower business values;

CONTINGENT INCOME TAX LIABILITIES

b) Where a corporation is expected to be wound up, the tax impact to the individual shareholder is that of a deemed

dividend. For corporations that earn income subject to the small business deduction or investment income, this dividend is considered an ineligible dividend and is currently taxed in Ontario at 32.57% for taxpayers with income between $135,000 and $500,000. As a result of this budget, that tax rate will increase to $34.21% in 2014 subject to any possible changes made by the provincial authorities. When such dividends currently appear on a tax return, they are grossed up by 25%. Starting in 2014, they will be grossed up by just 18%. So, a $100 ineligible dividend in 2013 will appear as $125 on a 2013 personal income tax return. That same dividend will appear as $118 on a 2014 personal income tax return. From a net family property standpoint, the tax on wind-up will increase somewhat;

c) Where the shares of a Canadian-controlled private corporation carrying on active business in Canada are sold by an individual, the contingent income tax should consider the availability of the lifetime capital gains exemption which until last week, was capped at $750,000 per person. Last Thursday's budget has increased it to $800,000. Accordingly, the contingent tax on shares for qualified small business corporations will now decrease. This also applies to the sale of qualified farm property;

d) Charitable donation tax shelters are still very popular despite how many have been re-assessed and leave the taxpayer in limbo for years waiting to hear how Canada Revenue Agency ("CRA") will treat the deal. Taxpayers who are confident that CRA would not win a re-assessment always had the option not to pay any of the re-assessed tax, penalties and interest and just let the balance increase with further interest if they eventually lost. Now, such taxpayers are required to pay at least 50% of the re-assessed amount while waiting for

settlement or a court decision. Prudent taxpayers should still pay 100% of the amount because CRA pays 3% interest on the balance if the taxpayer has overpaid tax on such a re-assessment. Where else can you get 3% interest backed by the federal government?

INCOME DETERMINATION

e) Taxpayers who incur a loss from farming where farming is not the taxpayer's chief source of income have been subject to a restriction on the amount they may claim on their personal income tax returns. This limitation is known as the "restricted farm loss". Previously the amount of the loss was limited to $8,750. The budget doubles this to $17,500, which amount of loss is included in the calculation of Line 150 income. Farming has traditionally included maintaining race horses, fur farming, keeping bees and growing fruit. So, clients with farm losses may not be limited to those who till the soil. Many money-losing farms eventually are sold as undeveloped land to builders and this sale of farm land may qualify for the now enhanced $800,000 lifetime capital gains exemption. Accordingly, this has been a good news budget for those with a little bit of dirt under their fingernails;

f) As discussed above, the effective tax rate on ineligible dividends will rise in 2014. Accordingly, adjustments to *Guidelines* income for those who earn a significant portion from such dividend income will be somewhat reduced; and

g) A beneficiary of a testamentary trust has the advantage of a second set of graduated personal income tax rates. While an intervivos trust (that is, one created during the life of the settlor) pays tax on income at the highest marginal rate, a testamentary trust (that is, one created on the death of the

settlor, such as one created by will) has the advantage of paying the lower graduated rates on income below $135,000. The budget announced the government's intention to look at eliminating this advantage of testamentary trusts and estates. This would likely end common tax planning tools such as the spousal trust created on death, which was used to maintain the assets for a testator's children but allow income to be paid to a surviving spouse.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at ***www.marmerpenner.com***.