Vol. 27 No. 1 April 2024

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

Co-written by Steve Z. Ranot, CPA, CA, CBV
and Pier Sperti, BBA, CPA, CA, CBV, CFF

2024 Federal Budget – Family Law Implications

Finance Minister Chrystia Freeland tabled the 2024 federal budget last week. This newsletter will address some of the announcements as they may impact the calculation of income for support purposes and net family property.

Change to Capital Gain Inclusion Rate

A capital gain is realized when an investment is sold for more than its cost, such as buying a 100 shares of Dollarama last year for $8,500 and selling those yesterday for $11,400. The capital gain on that disposition is $2,900. However, capital gains are not fully taxed as is most other income. Currently, only 50% of a capital gain is included in income. So, the investor who realized this $2,900 capital gain is required to include only $1,450 in taxable income. The 50% of the capital gain that is included in income is referred to as the capital gain "inclusion rate". Prior to 1972, capital gains were not taxable in Canada. From 1972 to 1987, the inclusion rate was 50%. In 1987, it was announced that the rate would increase to 66.67% for 1988 and 1989 before increasing to 75% for years after 1989. In 2000, in two separate announcements, the rate was decreased first to 66.67% and then back down to 50% where it has remained until this most recent budget.

The capital gain inclusion rate will increase to 66.67% after June 24, 2024 for capital gains realized by corporations and trusts. For individuals, the capital gain inclusion rate will increase to 66.67% after June 24, 2024 for capital gains in a year that, on a combined basis, exceed $250,000. Accordingly, for the vast majority of individual taxpayers, there will be no impact on the taxation of their capital gains. Individuals with large portfolios of marketable securities might still be able to stagger their gains to avoid reaching the higher inclusion rate. However, they may be unable to avoid exceeding the $250,000 threshold in three particular occasions:

1. Selling a second home or vacation property (which includes transferring it to the next generation);

2. Selling an investment property; and

3. The deemed disposition of all capital property on death or on departure from Canada.

These are all situations that differ from an investor who can choose how much of a gain to realize each year in order to try to stay under the $250,000 threshold before the higher inclusion rate kicks in. Accordingly, a new grey area in the calculation of net family property has been created. Some assets held personally will have attached to them capital gains that are expected to be taxed based on the 50% inclusion rate while others will have attached to them capital gains that are expected to be taxed based on the 66.67% inclusion rate. It will depend on when they are expected to be disposed and whether it will be one large gain that cannot be staggered over a number of years.

The Income Tax Act allows for capital gains to be spread over up to five years if all of the proceeds of disposition are not received at the time of sale. This is called a capital gains reserve. An example includes selling a property and accepting an interest-bearing loan as part of the proceeds. For example, you can sell an investment property for a gain of $1 million and receive a 25% down payment and a five-year mortgage for the remainder. The capital gains reserve rules allow you to report just 25% of the capital gain in the year of sale and spread out the remainder over the next four years. In this example, the capital gain recognized in each year would be under $250,000 thus allowing the vendor to avoid paying tax on capital gains at the higher inclusion rate. We have not read anything in the budget in relation to allowing the capital gains reserve to circumvent the higher inclusion rate on gains in excess of $250,000 in one year.

The next two months should see a higher than normal amount of sales of capital property with large gains as individuals, trusts and corporations try to avoid realizing gains after June 24, 2024. For net family property purposes, the expected future tax costs on capital gains for all trusts and corporations will increase thus lowering net family property for beneficiaries and shareholders.

Parents who own a cottage that they were eventually planning to transfer to the next generation might be thinking of accelerating that transfer to June 24, 2024 in order to save some tax. Such clients need to be reminded of the family law implications of transferring what might become a date of marriage trust interest or a gifted matrimonial home.

When it comes to calculating income pursuant to the *Federal Child Support Guidelines* (“the *Guidelines*”), it has been widely accepted that paragraph 19(1)(h) of the *Guidelines* allows a court to increase a spouse’s income if a spouse earns a significant portion of his/her income from lower-taxed capital gains. Under the current capital gain inclusion rate, for a spouse paying income tax at the highest marginal rate in Ontario, the income tax gross-up on capital gains increased the capital gains by about 57.6% when calculating *Guidelines* income. Under the newly-proposed 66.67% capital gain inclusion rate, for a spouse paying income tax at the highest marginal rate in Ontario, the income tax gross-up on capital gains will decrease to about 38.4%.

Employee Stock Options

The taxation of employee stock options tends to mirror those of capital gains in that, under certain circumstances, a non-taxable portion is permitted. And, the non-taxable portion of an employee stock option benefit has generally matched that of capital gains. This budget introduced an increase to the portion of employee stock options in excess of a $250,000 annual limit that will also see 66.67% taxed.

Lifetime Capital Gains Exemption

The capital gains news was not all bad. Currently, the Lifetime Capital Gains Exemption ("LCGE") allows the owners of qualified small business corporation shares or qualified farm or fishing property to shelter up to $1,016,836 in 2024. That will be increased to $1,250,000 after June 24, 2024 and will be indexed to inflation afterwards.

Canadian Entrepreneurs' Incentive

In addition to the LCGE, business owners will now benefit from a reduction in capital gain tax arising from the disposition of eligible shares. Similar to the eligibility requirements of the LCGE, shares must be those of a small business corporation, owned directly by an individual, with more than 50% of the fair market value of the corporation's assets being used principally in active business carried primarily in Canada over the 24-month period immediately before disposition. There are further eligibility provisions such as the requirement for the owner to be a founding investor, having been actively engaged in a continuous and substantial basis in the activities of the business and having held the shares for a period of five years prior to disposition.

The measure proposes a drop in the capital gains inclusion rate on qualifying shares from the proposed 66.67% to half or 33.33% on gains up to $2 million during an individual's lifetime. It will take some time to fully achieve this incentive as the budget proposes to phase it in over 10 years by increments of $200,000, reaching full capacity by January 31, 2034. Based on this, upon the full roll-out of this incentive, entrepreneurs will have a combined full and partial exemption of $3.25 million on eligible shares including $1.25 million in tax free gains and $2 million in gains included at a rate of one-third. This measure applies to dispositions occurring on or after January 1, 2025 and will increase the net family property of certain entrepreneurial spouses.

Now, the bad news. This measure will not be available to all types of businesses. Some excluded businesses include those involved in financial services, real estate, personal care, consulting, food and accommodation, insurance and arts, recreation or entertainment. We expect that a comprehensive list of excluded industries will be made available in the coming weeks. It appears that this incentive is geared towards start-up businesses especially involved in the technology and manufacturing sectors.

RRSP Home Buyers' Plan

This plan was first announced many years ago and permitted first-time home buyers to draw up to $20,000 from an RRSP to assist with the down payment. The withdrawal was not taxed as long as at least one-fifteenth was repaid to the RRSP over the fifteen years following the year of purchase. Since then, the $20,000 withdrawal limit had been increased to $35,000. This budget has proposed to increase that amount to $60,000. That means that, for those who qualify and withdraw the maximum amount, they will be required to repay

$4,000/year to an RRSP in order to avoid the amount being included in income. Newly separated spouses with mortgages might be unable to find the money to repay their RRSP Home Buyers Plan loans. Accordingly, you might start seeing $4,000 of RRSP income on spouses' personal income tax returns next year and this amount is included in Total Income. That does not necessarily mean it is equitable to include in *Guidelines* income.

So far, the courts have shied away from including in *Guidelines* income the tax-free or tax-deferred income earned in a year inside an RRSP and a TFSA. However, with all of these registered accounts available, the amount of sheltered income each year might soon reach the level where courts can no longer ignore them.