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Marmer Penner Newsletter

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"Last Month's Tax Planning Is This Month's History Lesson"

In the January/February 1999 issue of *our newsletter*, we wrote about the opportunities for income splitting through the use of a management corporation held by a family trust. This allowed high income self-employed taxpayers and owner-managers to arrange with a management corporation owned by their minor children through the family trust to have certain services provided by that management company. As a result, income that might have otherwise been taxed at a 50% personal tax rate is taxed at the 22% corporate small business rate instead. If the children have little or no other income, the corporation's after-tax income may be paid out tax-free to the children to a maximum of almost $24,000 each per year. This type of structure could also be used to make child support deductible since non-deductible child support may not be required to be paid by the non-custodial spouse if the children were instead receiving these significant dividends from their own management company.

If you decided this was the way to go for you or your clients, hold your horses! On February 16, 1999, Mr. Martin announced that dividends paid after 1999 to minor children from a private corporation would be taxed at the highest marginal rate. So much for this tax structure!

If you decide to eliminate the management corporation and instead use a partnership or the trust itself to provide the

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management services, Mr. Martin thought of that too. Where a trust or partnership is used to allocate income to a minor, the income is taxed at the highest marginal rate if that minor is related to anyone who participates in the business which is paying these fees to the trust or partnership.

As the new restrictions do not take effect until December 31, 1999, there is still time for some of these rule changes to be softened. Given that many doctors, dentists, lawyers and accountants had already put such structures in place or were planning to do so, there may be a strong lobby group pressuring the finance minister to adjust or delay implementation of the new rules. In the meantime, there is no reason not to keep making use of the income splitting opportunities that remain for the rest of this year.

While closing one income splitting opportunity, Mr. Martin did open another one. Prior to the budget announcements, a married person who died could only transfer a RRIF or an RRSP to a spouse in order to avoid the deemed withdrawal and immediate taxation. Under the budget proposals, this same person may soon be able to designate a financially dependent child or grandchild as the beneficiary of a tax-free rollover. The definition of financially dependent is not perfectly clear but with a wide enough definition, this could allow the transfer of RRSP proceeds from the highest tax rate to a virtual 0% rate for minor children with little or no other income.

While those who may benefit from use of family trusts may hope that Mr. Martin softens his proposals with respect to the income splitting through a family trust, don't be surprised if his heart hardens with respect to what may be too sweet a deal on RRSP and RRIF transfers.

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 will be pleased to assist you with any matters that arise.