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Marmer Penner Newsletter

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OCTOBER 2000 MINI BUDGET

Following the 2000 Federal Budget released on February 28, 2000 and on the heels of an expected election call, Finance Minister Paul Martin released his Economic Statement and Budget Update on October 18, 2000. As expected, the “mini-budget” contained good news for both high- and low-income earners.

Federal tax rates have been reduced and tax brackets have been increased to effectively allow all individuals to have more of their income taxed at lower rates. Effective January 1, 2001, it is proposed that:

a) the 17% low tax bracket will be reduced to 16%;
b) the 24% bracket (already reduced from 26% as a result of the February 28, 2000 budget) will be reduced further to 22%; and
c) the 29% high bracket will be split into two new brackets with a 26% rate applying on income up to $100,000 and the previous 29% rate continuing thereafter.

In addition, the federal tax brackets which as a result of the February 28, 2000 budget are now fully indexed to inflation, have been increased as follows:

Income	Marginal Rate
0 to $31,754	16%
$31,755 to $61,509	22%
$61,510 to $100,000	26%
Above $100,000	29%

Furthermore, the 5% federal surtax, which affected only those in the highest bracket, will be eliminated in 2001 reducing the top marginal bracket in Ontario to 46.42%. Ontario residents have not seen a top marginal tax rate this low since 1988 when Michael Wilson announced his tax reform.

As Ontario has now moved to create its own tax system, this is the first federal budget where federal tax rate reductions do not result in additional provincial reductions. Previously, the Ontario tax was calculated as a percentage of federal tax. The 2000 Ontario budget announced that provincial tax rates will now be calculated based on a separate taxable income calculation.

Self-employed individuals benefit from a change to the deductibility of CPP payments. Previously all CPP paid was eligible for a credit worth about 23%. Now one-half of the CPP will be deductible at marginal rates up to 46%.

Low-income earners will realize savings in addition to reduced rates from:

a) increased GST benefits of $125 per person to offset the cost of higher oil and natural gas costs; and
b) increased Canada Child Tax Benefit which was previously scheduled to increase by $200 per child and is now being increased by $300 per child.

Credits will also be increased for those who may claim the following:

a) the disability credit;
b) the cost for caring for an infirm dependent; and
c) the education tax credit.

The education tax credit is available to students who attend post-secondary school on either a full-time or part-time basis. Where the student has insufficient taxable income to utilize all of the education and tuition tax credits, the excess may be transferred to a supporting parent. As a result of the increased education tax credits, it is now more likely that a supporting parent will realize personal tax savings from funding the cost of a child’s education. As the *Federal Child Support Guidelines* (“*Guidelines*”) indicate that related tax savings should be deducted from the cost of "Add-Ons", this budget change may reduce the effective cost of post-secondary school tuition for *Guidelines* purposes.

In a much anticipated move, the Finance Minister reduced the capital gains inclusion rate to 50%. Unlike the other tax measures announced, this one takes effect immediately. As a result, dispositions of capital property after October 17, 2000 are subject to the 50% inclusion rate. As the February budget already announced a decrease to 66.7% from the previous inclusion rate of 75%, there will be three inclusion rates applicable for 2000:

a) 75% for the period between January 1, 2000 and February 27, 2000;
b) 66.7% for the period between February 28, 2000 and October 17, 2000; and
c) 50% for the period between October 18, 2000 and December 31, 2000.

Where a taxpayer has gains or losses in more than one of the three periods, a complicated three-step formula must be followed to determine the effective inclusion rate for the 2000 taxation year. To parallel the reduced capital gains inclusion rate, the deduction for qualifying employee stock options will be increased to 50% for post-October 17, 2000 benefits.

For *Guidelines* purposes, the non-taxable portion of capital gains and stock option benefits is to be added to the calculation of income. With three different inclusion rates, family law practitioners should be careful to ensure the appropriate amount is being added to taxable income.

As a result of the changes to the marginal tax rates and the capital gains inclusion rate, a resident of Ontario will face the following top marginal tax rates:

Interest and ordinary income	46.42%
Dividend income	31.35%
Capital gains	25.30%

The capital gains rate is not equivalent to one-half the ordinary income rate as the Ontario budget reduced the capital gains inclusion rate to 62% for 2001 and is scheduled to reduce the inclusion rate to 50% by 2004.

As already announced in the February 28, 2000 budget, the federal general corporate tax rate was being reduced from 28% to 27% effective January 1, 2001 with a promise to further reduce the rate to 21% within five years. The economic statement has now clarified the timing of the tax rate reductions as follows:

January 1, 2001	27%
January 1, 2002	25%
January 1, 2003	23%
January 1, 2004	21%

The reduction of personal and corporate tax rates provides increased disposable income to all taxpayers however those with higher income will realize greater savings. As the Child Support tables were calculated based on intended after-tax income to both the payor and the recipient, it will be interesting to see if these tables are amended to reflect the greater savings afforded to most payors.