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Marmer Penner Inc. Newsletter

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2014 Federal Budget – Family and Estate Law Implications

Finance Minister Jim Flaherty tabled the 2014 federal budget yesterday. There were no changes to personal or corporate income tax rates but there were measures announced that may impact tax planning using spousal trusts and trusts for the benefit of minor children, as well as Section 7 expenses and calculating the contingent income tax costs of disposition.

Trusts and Estates

a) A testamentary trust has the advantage of allowing a beneficiary a second set of graduated personal income tax rates. Conversely, an inter vivos 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 $136,000. Last year's budget announced the government's intention to look at eliminating this advantage. 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. From 2016 on, most testamentary

trusts will be permitted the advantage of graduated rates for the first 36 months only following an individual's death. The exception is a trust for the benefit of an individual eligible for the disability tax credit;

b) Commencing in 2015, testamentary trusts must convert to December 31 year ends;

c) Certain professionals and business owners had their family income splitting curbed by the introduction in 1999 of the "kiddie tax" which effectively prevented parents from causing their companies to pay dividends to their minor children. Creative tax planners then began using family trusts to earn unincorporated business income which flowed to the low-taxed minor beneficiaries, thus avoiding the special tax on dividends. The 2014 budget proposes modifications to the definition of "split income" such that it will now include an allocation of business income earned through a trust. Gone will be the scenario where a law partnership, for example, will permit a trust for the benefit of the partners' children to charge it certain management fees that effectively transfer income from the parents to the children;

d) Presently, charitable donations made by an individual's will are deemed to be made by the individual immediately before death so the tax credit is available on the individual's terminal income tax return. Beginning in 2016, the donation will be deemed to be made by the estate at the time the donation is made to the charity. At that time, the estate will have the option to claim the tax credit either in that year, any earlier taxation year of the estate or the last two years of the individual's personal income tax return.

Personal Income and Section 7 Expenses

a) Tax credits are increased for adoption expenses, search and rescue volunteers and certain therapy plans

Contingent Income Tax Costs of Disposition

a) The purchase and disposition of goodwill has been treated as eligible capital property for years with inclusion rates similar but not always the same as the capital gains inclusion rates. The budget proposes consultations with respect to replacing this mechanism with a new capital cost allowance class with 100% inclusion. This will impact the calculation of taxes on the sale of business assets and the corporation's capital dividend account

b) We are all familiar with the lifetime capital gains exemption on shares of a qualified small business corporation and both farming and fishing properties. The definition of qualified farm property and qualified fishing property was that it must be used principally in a farming business or a fishing business. Now, the exemption applies to those who use a property for both activities and never met the previous definition because neither activity was the property's principal use. A palpable sigh of relief was heard from Ontario's lake trout farmers. Both of them.