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Marmer Penner Inc. Newsletter

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What is Significant?

The *Federal Child Support Guidelines* ("the *Guidelines*") allow a court to impute additional income to a spouse who benefits from:

1) Being exempt from paying federal or provincial income tax (Section 19(1)(b));

2) Being taxed at lower effective rates by virtue of living in a country whose tax rates are significantly lower than those in Canada (Section 19(1)(c));

3) Deducting excessive expenses from taxable income (Section 19(1)(g)); and

4) Deriving a significant portion of income from capital gains and Canadian-source dividends, both of which are taxed at preferential rates (Section 19(1)(h)).

The additional amount added to the spouse's income as a result of these income tax advantages is known as an "income tax gross-up". The applicability of a gross-up is a legal issue but has become a commonly-accepted component of *Guidelines* income where a spouse unreasonably deducts personal expenses.

The actual calculation of the income tax gross-up for the deduction of personal expenses is not subject to much controversy. If a high rate Ontario taxpayer (currently 53.53%) deducts $10,000 of personal automobile expenses, we add the $10,000 to income as well as an $11,519 gross-up using the logic that one would need $21,519 additional pre-tax income to be left with this $10,000 after-tax benefit. We have seen the court accept these calculations many times. However, let's not be blind to the second highest type of tax paid, that is, the HST. The spouse not only saved $11,277 of notional income tax but also recovered the 13% HST (here in Ontario) by charging the automobile expenses as business expenses. This additional gross-up was discussed in our July 2016 newsletter.

The income tax gross-up is also applied when a spouse benefits from lower income tax rates on a significant portion of his/her income. "Significant" is defined in the Merriam-Webster dictionary as "large enough to be noticed or have an effect" but is not defined in the *Guidelines.* It has been our experience that parties tend to agree that amounts less than 10% are considered less than significant while amounts in excess of 25% are similarly agreed to meet the "significant" threshold. It is the grey area between 10% and 25% that lacks matrimonial judicial guidance.

The Income Tax Act defines "significant" in a number of areas as follows:

1) A corporation's interest in a partnership is significant if it exceeds 10% (Subsection 34.2(1));

2) A person's interest in a corporation is significant if it amounts to 25% or more of votes or entitlement to corporate value (Paragraph 80.01(2)(b));

3) For the purpose of the capital gains exemption, a reduction of dividends by more than 10% of the average annual dividend is significant (Subsection 110.6(8) 142.2(2)(b));

4) For the purpose of financial institutions, a person's interest in a corporation is significant if it amounts to 10% or more of votes or entitlement to corporate value (Paragraph 142.2(2)(b));

5) For the purpose of pooled pension plan, a person's interest in a corporation is significant if it amounts to 10% or more of votes or entitlement to corporate value (Paragraph 147.5(30)(b)); and

6) For the purpose of certain tax-deferred vehicles, a person's interest in a trust is significant if it (together with related parties) amounts to 10% or more of entitlement to value of all of the beneficiaries (Subsection 201.01(4).

Accordingly, if *The Income Tax Act* can be a source of guidance for the *Guidelines*, then the threshold appears to be closer to 10% than 25%.

So, if a spouse deducts personal expenses from income or earns well over 10% of his/her income from capital gains or Canadian-source dividends, an income tax gross-up can be applied to increase income. What about 19(1)(c)'s significantly lower tax rates in another country? For anyone earning over $220,000, the top Ontario rate has jumped from 46.41% to 53.53% in the three years from 2013 to 2016. If the 10% rule applies, then perhaps any jurisdiction with a top rate below 48.17% now meets the "significantly lower" threshold. As far as Ontario taxpayers are concerned, the world has plenty more tax havens than it used to.

Back in the good old days, Canada was a lower-taxed jurisdiction than many western European countries. Would the inverse apply to a payer-spouse residing in the higher-taxed United Kingdom? In some cases, countries had lower taxes, in part, because governments did not pay for certain services that we in Canada take for granted. Accordingly, the cost of living might be higher as a result of lower income taxes. Both of these questions were answered in *McGouran*, where the UK support-payer could not reduce his income for the higher taxes and cost of living in the UK.