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Marmer Penner Inc. Newsletter

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2017 Federal Budget – Family Law Implications

Finance Minister Bill Morneau tabled the 2017 federal budget yesterday. There were no changes to personal or corporate income tax rates but there were measures announced that may impact the determination of an investor's and business owner's income, the net cost of Section 7 expenses as well as certain tax credits.

Personal Income and Small Business Measures

This author was recently asked to speak at the *11th Annual Family Law Summit* ("*Summit*") on the topic of "Determining Guidelines Income". Among the issues discussed were the following:

1) Income splitting with family members by paying dividends to those who are taxed at lower rates;
2) Understating professional income (such as that earned by accountants and lawyers) by deferring the billing of unbilled work in progress; and
3) Using straddle transactions to continually defer and lower investment income.

Mr. Morneau promised to spend $524 million more to prevent tax evasion and improve tax compliance. Perhaps some of that budget was spent on undercover attendees at the *Summit* because all three of these topics were addressed in his budget.

Last year's budget targeted professionals in a partnership who set up individual corporations to bill the partnership by requiring these corporations to share one $500,000 small business limit. We noted last year that, while the structure might still be available for income splitting with family, the very significant tax deferral created by the low small business tax rate is virtually wiped out. Now, the income splitting with family by way of dividends appears to be soon on its way out. The government announced that it is continuing to review the use of tax planning strategies involving private corporations and family members of high income earners. The examples of offensive planning cited include income splitting arrangements through private corporations to use the lower tax rates of other family members who are shareholders of the company. The budget also cited those who earn investment income in a private corporation as an example of an offensive strategy. We have no clue what can be offensive about that, given that refundable taxes have already been increased by this Liberal government in lockstep with the 4% personal tax increase on those in the high bracket.

One of the examples we gave at the *Summit* on understating professional income was the use of the provision in *The Income Tax Act* that permits certain professionals to exclude unbilled work-in-progress ("WIP") from taxable income. We wanted family lawyers to be aware that a professional could defer tax and possibly lower *Guidelines* income by intentionally deferring an ever-increasing amount of unbilled WIP. Well, Mr. Morneau paid attention to our example, and announced that unbilled WIP must now be included in taxable income with a 50% phase-in for a taxpayer's initial fiscal year beginning after this budget and the full amount included for every year thereafter. This means that, very soon, firms will need to report as income all of their unbilled WIP at year-end. So, what you will hear in the halls of every professional firm in the last week of its fiscal year is the managing partner urging everyone to fully bill out their WIP or write it off because nobody wants to pay tax on income that has not been collected.

For sophisticated investors, we described how straddle transactions could be used to continually defer investment income. In a simple example, an investor buys 100 shares of TD Bank on the same day as she sells short 100 shares. The two positions will result in exactly offsetting gains and losses. The investor could trigger just the loser of the two on December 31 and trigger the opposite gain on January 2 deferring the gain into the following year when another such straddle would continue the deferral. Thank you again for paying close attention, Mr. Morneau. The budget proposes to introduce specific anti-avoidance measures in relation to straddle transactions. In particular, a stop-loss rule will apply to the loss in the example given to the extent of any unrealized gain on an offsetting position.

Tax Credits and Possible Impact on Section 7 Expenses

The budget eliminated the public transit pass credit. For a TTC Metropass with an annual cost of about $1,600, this eliminates a credit worth $240 in tax savings. If a parent was paying for this as a Section 7 expense, the annual after-tax cost just rose by about that amount. For the remainder of 2017, the credit will be available for passes purchased and used until June 30.

The budget also consolidates the three tax credits available to caregivers – that is, the infirm dependant credit, the caregiver credit and the family caregiver credit into a new Canada Caregiver Credit and will no longer be available in respect of non-infirm seniors cared for by their adult children. You may not need to understand this but

Divorcemate will need to consider this in determining net disposable income.