Income Tax Rates for Top Marginal Rate Ontario Taxpayers

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For family law purposes the *Sengmueller* decision clarified the relevance of contingent personal tax costs of disposition in the determination of net family property ("NFP"). As a result, the prevailing tax rates at any valuation date became paramount in calculating contingent disposition costs.

Contingent disposition costs may arise in relation to ownership of shares of private and public corporations, stock options, unincorporated business interests, accrued income, unused or accrued tax losses, accrued and realized capital gains or losses, pensions, RRSP's and other assets.

Even in non-family law matters, tax rates affect discount factors in business valuations.

In order to properly determine contingent tax costs of disposition at any point in time, the tax rates in effect at that time must be known. The following chart summarizes personal tax rates from 1972 to 1997 for Ontario taxpayers for income earned at the top marginal rate. As income tax rates are not always known at the beginning of each year, the appropriate tax rate for a January valuation date may be the prior year's rates.

With our federal and provincial governments apparently getting their financial houses in order, we have seen a reduction of income tax rates for the last three years. The following schedule indicates that after Finance Minister Michael Wilson's tax reform in 1988, income tax rates peaked for Ontario taxpayers in 1994 and 1995, thanks mostly to Ontario income tax rate increases.
As bad as those 1994 and 1995 memories may be, they pale in comparison to the marginal tax rates paid by Ontario taxpayers between 1972 and 1981 where the top

marginal income tax rate ranged from 61.34% to 66.04%.

The movement of the top marginal tax rate for capital gains tends to mirror the increases and decreases in the overall marginal rate of taxation with two exceptions in this trend. Between 1972 and 1987, one-half of capital gains were included in income and accordingly the top marginal rate for capital gains is one-half of the top marginal rate of taxation for other income. For 1988 and 1989 the capital gains inclusion rate increased to two-thirds. For years after 1989, the inclusion rate has been three-quarters, and accordingly the top rate paid on capital gains has been 75% of the marginal rate of taxation for other income for each year. It should also be noted that the capital gains exemption was introduced and phased in commencing in 1985. It remains available after 1994 only for shares of a Qualified Small Business Corporation or Qualified Farm Property.

Prior to 1972, capital gains were not taxable in Canada. However, life was not the paradise one may envision for investors as the top marginal tax rates in 1970 and 1971 were 82.4% and 79.66% respectively.

The tax rate on dividends from Canadian corporations has also seen some volatile fluctuations, ranging from a high of 50.58% in 1976 to a low of 25.16% in 1982. It should be remembered that the marginal rate of tax paid by an individual on dividends from a Canadian corporation is related to the dividend gross-up, the dividend tax credit and the refundable portion of corporate taxes on investment income, all of which, themselves, have fluctuated over the years.

Example #1:

Mr. Smith held a portfolio of investments in his holding corporation. The shares of Holdco were valued at $1,000,000 at the valuation date. What is the tax cost of wind-up? If the valuation date was in 1976, the future tax cost on wind-up of the corporation would be $505,800 ($1,000,000 x 50.58%) adjusted for the relevant present value factor which itself is dependant on the current tax rate. Conversely, if the valuation date was in 1982, the future tax cost would be $251,600 adjusted for the relevant present value factor. That represents quite a significant difference in just a six year period!

Example #2:

Ms. Jones has untaxed work-in-process of $500,000. What is her future tax cost?

With a 1981 valuation date, the related tax on this asset is $313,900 ($500,000 x 62.78%). The same situation in 1988 results in reduced taxes of $230,700 ($500,000 x 46.14%). A present value adjustment may be required in determining these contingent liabilities.

Example #3:

Ms. Brown owns a cottage worth $300,000 with an original cost of $50,000 in 1969. The property was worth $60,000 on December 31, 1971 and was used as a principal residence until 1981. In 1994, Ms. Brown elected on her personal income tax return to increase her cost base by her remaining capital gains election of $34,657. What is her tax cost on disposition? You didn't really expect this chart to be able to answer this one did you?