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TAXSTRATEGY

Proposed new income-splitting and family tax measures

The new rules

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OVER THE YEARS I HAVE WRITten about how gifts and transfers of funds and property to spouses and minor children, while generous on your part, can trigger certain tax rules that will attribute any resulting income back into your own hands.

Known as the attribution rules, these are intended to curb your ability to split income with members of your family who are taxed at a lower rate. While there are a number of strategies to avoid the attribution rules, these are not always practical or widely available.

Gifts, transfers and the CRA's attribution rules

As a quick refresher, the attribution rules have two main purposes: 1) to ensure that the Canada Revenue Agency gets its fair share of the tax on any accrued gain; and 2) to prevent "abusive" income splitting transactions among related persons.

The attribution rules essentially apply to gifts of property or cash to your spouse or a minor-aged child that in turn create income; specifically, any income from the gifted property or funds will be included in your income. The attribution rules will also jump into play in the case of a loan or incurred indebtedness on a transfer of property, unless the prescribed rate of interest is charged and paid for each year the loan is outstanding. (The rate is currently one per cent).

However, while capital gains realized on a sale or other disposition by your spouse will be attributable to you, capital gains will not apply to your minor-aged kids.

So the general rule has been to avoid making gifts of property or funds to a spouse or minor-aged child as the tax effect would be to simply attribute the income back to you; at least that is the general rule unless you were able to take advantage of the prescribed loan strategy, or transfer assets at their full value.

New rules proposed

On October 30, 2014, in addition to other proposals, the Harper government announced a family-focused tax package that dealt with the ability to split income for families with children under the age of 18. Accordingly, under this new package, the attribution rules would be held in abeyance on the first $50,000 of taxable income, which can now be transferred from the higher income earning spouse to the lower tax rate spouse.

Who benefits from the new income-splitting rules

This measure will provide eligible families with a maximum of $2,000 a year in tax relief. This proposal is effective for the current 2014 taxation year.

It should be noted that only families with children under the age of 18 with two parents in different tax brackets will benefit from this new proposal. Accordingly, as many media outlets have noted, the new income splitting measures would not benefit single parents (a majority of whom are considered low income) nor families where

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the spouses are in the same tax bracket. In the end, this new allowance is not much of a game changer for many of us.

Other proposed tax changes for families

In addition to the income splitting allowance, the new package also included a number of other measure such as the expansion of the Universal Child Care Benefit and an increase to the child care expense deduction. The government advised that this new package would provide about $4.6 billion in tax relief to over four million Canadian families.

This announcement would appear to be the culmination of Prime Minister Harper's 2011 election promise to assist families with young children to reduce their tax bill. According to Mr. Harper, as a result of these new proposals, families with children under the age of 18 will receive $1,140 in tax relief and benefits per year.

In addition to the new income splitting measures discussed above, the specifics of the other family focused tax measures are noted below.

Universal Child Care Benefit

The Universal Child Care Benefit for children under the age of six will be increased from $100 to $160 per month. Additionally, a new benefit of $60 per month is being introduced for children aged six to 17. Although this expansion to the program will come into effect on January 1, 2015, payments will not begin until July 2015; accordingly, there will be a lump sum payment at that time to cover the first six months of 2015. It should be noted, however, that this enhanced Universal Child Care Benefit will replace the existing Child Tax Credit, which will be eliminated in 2015. Currently, the Child Tax Credit is equal to $338 per child (calculated as $2,255 per child multiplied by the 15 per cent credit rate).

Child care expense claims

The maximum amount that can be claimed for child care expenses will be increased by $1,000. As a result, the maximum limits will be as follows:
a) $8,000 for children under the age of seven;
b) $5,000 for children aged seven to 16; and
c) $11,000 for children eligible for the Disability Tax Credit. (There are no age restrictions for such children.)

Children's Fitness Tax Credit

The Children's Fitness Tax Credit will also be doubled, from $500 per child to $1,000 per child effective immediately.

Currently, this non-refundable credit is worth $75 if you spend $500 on fitness activities for your child (i.e., 15 per cent of $500). Starting in 2014, this credit will be refundable (in addition to being worth $150), such that even a low income taxpayer, who would not otherwise pay tax, could get a refund of $150 as a result of this credit.

New rules—other than income splitting—would benefit many families

While much of the attention has been given to the new income splitting proposals, and the lack of application to a majority of Canadian families, it should still be noted that some of the enhancements to the other tax credits may still provide some tax relief to many parents.

A by-the-numbers example: One family of six

For example, assume a family with two spouses and four children, ages four, six, eight and 10. In this case, the family also pays for child care for all three children. Assume also that the children are enrolled in various fitness activities. By tallying up all the various credits (including the new income-splitting measure), it is possible to reduce the family's tax bill by an extra $4,128 per year. This can be calculated as follows.

The enhanced *Universal Child Care Benefit* would result in the following credits:
1. Two children under the age of six results in tax credits equal to $3,340 (compared to $2,400);
2. The two older children will trigger a tax credit of $1,440 (where none was available previously).

Pleast note that *The Child Tax Credit*, which will no longer be available (equal to $338 per child, so $1,352 in total) would have to be deducted from this calculation.

As well, *child care deductions* for this family will now be available as follows:
1. $8,000 for each of the two younger children (compared to $7,000);
2. $5,000 for each of the two older children (compared to $4,000).

So that is an extra $4,000 to base the deduction from (i.e., an extra $1,000 per child). Assume that the lower income spouse is at the combined tax rate of 20 per cent for Ontario; accordingly, under the new rules the deduction would be increased by $800 (being

$4,000 x 20 per cent).

The *Fitness Tax Credit* will also create a total tax credit of $600, being $150 for each of the four children (compared to $300, previously being $75 per child).

And lastly, assume again that there is a lower income spouse in the combined 20 per cent tax rate for Ontario and a spouse in the high tax bracket. Under the new rules, the higher income earning spouse can transfer up to $50,000 of taxable income to the lower income earning spouse for *income splitting* purposes, which translates to an extra $2,000 in tax relief.

Even if the income splitting measure is not available (and it appears that this is likely the case, as it will not be available to the majority of families), the tax bill is still lower by over $2,000 in this example.

So although there are still flaws with the applicability of the new income-splitting measures, it is possible to reduce the amount of tax your family pays as long as you make sure to take advantage of all of the family credits out there. ❐