Tax memo

Canadian tax updates

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Ontario's "2% surtax": The bottom line

Outlines how we expect Ontario's new high-earner tax to work.

April 27, 2012

As widely reported, the McGuinty government has agreed to implement a "2% surtax" on individuals with incomes over $500,000. A press release issued by the Premier's Office on April 23, 2012, provides further details:

- Ontario will apply a tax rate of 13.16% (up from 11.16%) on taxable incomes over $500,000.
- This change will be effective July 1, 2012 (an Ontario Ministry of Finance news release dated April 25, 2012, states that for 2012, the new tax rate will be 12.16% on taxable incomes over $500,000).

The new tax will be eliminated when Ontario's budget is balanced (scheduled for 2017-2018).

What is the bottom line?

Our understanding is that Ontario's existing 56% surtax[1] will apply to the 12.16% rate in 2012 and the 13.16% rate in 2013. As a result, the tax increase will actually exceed 2%. This is illustrated in the following table, which shows combined federal/Ontario tax rates on taxable incomes over $500,000:

		Existing 2012	Proposed 2012	Proposed 2013	Total increase[1]
Ordinary income & interest		46.41%	47.97%	49.53%	**3.12%**
Capital gains		23.20%	23.98%	24.76%	**1.56%**
Canadian dividends	Eligible	29.54%	31.69%	33.85%	**4.31%**
	Non-eligible	32.57%	34.52%	36.47%	**3.90%**

1. Compares 2012 existing rates and 2013 proposed rates.

Therefore, for example, if you have taxable income of $800,000 that is entirely employment income, you will pay $9,360 ($300,000 x 3.12%) more tax in 2013 than under the current rules.

1. The existing 56% surtax is a tax on tax, unlike the "2% surtax."

Charitable donations

We expect that the new high-earner tax will increase the tax credit for individuals that contribute more than $200 to charities, because this credit is based on the top Ontario tax rate (i.e., 12.16% in 2012 and 13.16% in 2013). All individuals will benefit from the higher tax credit rate, regardless of their incomes.

Payment of dividends

The changes mean that it will not be beneficial for Canadian-controlled private corporations to distribute non-eligible dividends to trigger a refund of refundable dividend tax on hand, if the shareholder is subject to the high-earner tax. This is because the top tax rate on non-eligible dividends (i.e., 34.52% in 2012 and 36.47% in 2013) will now exceed the dividend refund rate (i.e., 33 1/3%).

A similar conclusion will apply in respect of eligible dividends, starting in 2013.

Investment holding companies

Ontario residents who earn investment income from portfolio investments that would be subject to the new high-earner tax should consider holding these investments through a corporation.

Earning interest and capital gains through a corporation rather than personally would provide a tax deferral, given current Ontario corporate tax rates (taking into account the government's decision to defer the July 1, 2012 rate decrease). It should also result in an overall tax savings when corporate earnings are distributed. However, eligible dividends received in a corporation in 2012 and not distributed in the year would cause a prepayment of tax and an overall tax cost following subsequent distribution. A tax deferral would result for non-eligible dividends in 2012, and for all Canadian dividends starting in 2013.

Other factors to consider before implementing a holding company include the additional administrative costs and tax filing requirements, potential transfer costs to move an existing portfolio and whether existing investments held personally have accrued gains or losses. Income attribution rules can apply if shareholders include family members or trusts. Finally, future changes to tax rates or personal circumstances can affect the merits of a holding company; unwinding can be costly. Accordingly, proper planning is essential.

For more help

Ontario's new high-earner tax makes tax planning to reduce your tax bite even more important.

For more information on how this change will affect you and what you can do to mitigate its impact, please contact your PricewaterhouseCoopers LLP (PwC) adviser or any of the individuals listed on our website: **www.pwc.com/ca/taxcontacts**.

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