The new rules do not benefit the average individual whose income is rising solely by virtue of inflation since the base income is indexed each year. Also, the cash flow disadvantage from paying tax at the top rate will make it virtually impossible for lower rate taxpayers to take advantage of the provisions. For example, a taxpayer might have a marginal rate in a given year of 20% and that rate could be reduced next year to 18% by averaging. In order to pay the tax now for averaging, he will have to borrow the extra 14% and, at today's interest rates, the small averaging benefit will be more than lost before it can be claimed.

PRINCIPAL RESIDENCE

The new rules restrict the principal residence exemption to one residence per family. For the period up to December 31, 1981, each taxpayer may claim an exemption on the capital gain realized on the sale of his principal residence. After 1981, only the capital gain on one principal residence per family (including spouses living together and unmarried children under 18 years of age) will be exempt from tax. Some transitional relief is available to a family that owns more than one residence since a second residence would have been exempt from tax under the pre-1982 rules. The portion of the capital gain accruing to December 31, 1981 on the second residence is exempt from tax when the property is sold after 1981. Any gain accruing after December 31, 1981 will be subject to tax. In order to determine the gain accruing to December 31, 1981, the fair market value at that date should be established – another V-Day! The family does not have to decide until the year of the sale which residence will be designated as the principal residence and thereby be entirely exempt from tax. The designation will be made by the family member who owns the residence in his tax return for the year of the sale. The draft legislation appears to have a flaw in the designation provision that Finance officials have indicated will be remedied.

DIVIDEND TAX CREDIT

No changes were made in the June Budget to the minor reduction in the dividend tax credit announced in November 1981. The dividend tax credit for dividends received after 1981 is reduced from 37.5% to 34% of the actual dividend, or from 25% to 22.67% of the grossed-up dividend. Because the Federal credit is reduced, provincial taxes will be increased since they are calculated as a percentage of Federal tax after reduction for the dividend tax credit.

IAAC'S

The draft legislation will eliminate Income-Averaging Annuity Contracts (IAAC's) after 1981. Provision is made for the "one-year IAAC's" for qualifying income realized in 1981 for which an IAAC was purchased after November 12, 1981 and before March 2, 1982. All payments under this IAAC must be received by December 31, 1982. For individuals who claimed a deduction for a "one-year IAAC" on their 1981 tax returns, Revenue Canada is offering two alternatives in assessing their returns:

1) the 1981 return will be stockpiled until the draft legislation becomes law and then will be assessed; or

2) the 1981 return will be assessed without the deduction for the "one-year IAAC" and will be reassessed with the IAAC deduction when the draft legislation becomes law.

An individual who expects a refund without his "one-year IAAC" deduction should choose the second alternative.