

Marmer Penner Inc. Newsletter

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Taxable Spousal Support – Special Situations

When drafting a separation agreement, two common issues which may arise relate to:

- a) indirect or third party payments such as mortgage or tuition payments; and
- b) prior payments such as periodic support paid prior to the written agreement.

Both topics are discussed below.

INDIRECT OR THIRD PARTY PAYMENTS

Indirect payments may be taxable and deductible if the agreement or order specifically provides such payments, e.g. rent. The agreement must state that the provisions of subsections 56.1(2) and 60.1(2) of the *Income Tax Act* apply. An exception to this rule exists. The following are the third party payments which cannot be made deductible:

- a) Amounts paid in respect of a self contained domestic establishment in which the payor resides; and
- b) Amounts paid to acquire tangible property unless the tangible property is:

- i) Medical/educational expense or pertaining to the maintenance of the recipient spouse; or
- ii) Principal and interest payments on the recipient spouse's home as long as such payments do not exceed 20% of the original principal amount of the debt.

The purpose of these rules is to avoid allowing an income split where property is being transferred. For example, a payor may not deduct a third party payment to a bank to pay off a significant portion of the recipient spouse's mortgage. As a result, care must be taken by the family law specialist when arranging for third party payments to include mortgage payments. One dollar in excess of the 20% threshold places the whole of the payments offside.

PRIOR PAYMENTS

Voluntary spousal support payments are non-taxable because they are not pursuant to a written agreement or order. However, such payments can be made taxable retroactively if a subsequent agreement or order makes reference to these payments having been made pursuant to that later agreement or order. This retroactive tax planning is generally beneficial if the payor's tax savings exceed the recipient's incremental tax costs. In order to make retroactive payments taxable, the prior payments must have been:

- a) made either in the same calendar year as the agreement or order or in the immediately preceding calendar year;
- b) periodic in nature and for the maintenance of the spouse or former spouse; and
- c) referred to as taxable and deductible in the agreement or order.

If the income tax returns have already been filed for the prior year, they must be refiled.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.