

Marmer Penner Inc. Newsletter

Written by Steve Z. Ranot, CA•IFA/CBV, CFE
Edited by Michael S. Penner, BBA, CA•IFA/CBV, ASA, CFE

A TALE OF TWO PENSION CASES

Two cases. Similar issues. Different results.

The Tax Court heard *O'Brien v. The Queen* (2005 DTC 1539) in October 2005. Ms. O'Brien's former husband, Mr. Dand, was a retired policeman.

They separated in 1998 and the only property Mr. Dand owned was his entitlement to a pension from the Metropolitan Toronto Police Service. The pension was valued at \$327,889 at date of separation. Mr. Dand was to pay an equalization payment of \$163,944 by transferring \$32,500 to Ms. O'Brien's RRSP and to pay the remaining \$131,444 in monthly payments of \$1,000.

The Minister of Revenue included twelve monthly payments of \$1,000 in Ms. O'Brien's 2002 income on the basis that these amounts were taxable pension benefits. Ms. O'Brien argued that the \$1,000 monthly payments were part of an equalization payment paid in installments and should not be included in her income.

The Tax Court was aware that Mr. Dand's property with a value of \$327,889 was a pre-tax asset and that the first \$32,500 of equalization was paid on a pre-tax basis to Ms. O'Brien by transferring it to her RRSP. However, the Tax Court found there was no clear evidence if any consideration was given to the tax consequences of ordering the payment of the equalization payment directly from the pension. The Tax Court found that the order as ultimately drafted was silent as to who was to bear the income tax liability of the payment from the pension fund to Ms. O'Brien. As a result, the court concluded there was nothing to support the inference urged by the crown (and Mr. Dand as an intervener) that the parties intended or agreed that Ms. O'Brien share in any income tax liability that Mr. Dand might incur from his use of the pension plan to satisfy his equalization obligation to her. Accordingly, the court determined that Ms. O'Brien was not required to include the \$1,000 monthly payments in her income and that Mr. Dand was required to pay income tax on the full amount of the pension benefits including the portion received by Ms. O'Brien.

While this may be inequitable from an economic standpoint, it is just another reminder of the importance of proper drafting of a separation agreement.

In April 2005, the Tax Court heard *Andrews v. the Queen* (2005 DTC 1546). Mr. Andrews had entered into a written agreement with his former spouse, Ms. Andrews, which included the following clause:

“2. Commencing on the first day of September 2000, the respondent shall pay to the applicant the sum of \$556 per month as further equalization of the respondent’s pension. Such sum shall be tax deductible to the respondent and taxable in the hands of the applicant.”

Mr. Andrews had deducted the \$556 monthly payments as spousal support and the Minister of Revenue disallowed this deduction on the basis that the amount was characterized as equalization payments in the agreement.

In its decision, the court held that the \$556 paid by the appellant to his ex-spouse is not a support payment. It was paid as an equalization payment in the division of family property. It was not stated to be a support payment. Furthermore, the \$556 per month are not pension benefits to be taxed in the former spouse’s hands. Based on this conclusion, one would expect that this is how the decision ends – that is, the amount is non-deductible to the husband and non-taxable to the wife.

But that is only half the conclusion. The court ruled that the amount is non-taxable to the wife. However, in an unusual turn of events, the court found that the amount was deductible to the husband on the basis of a decision ten years earlier in *Walker v. Canada* (95 DTC 753). In this decision of the Federal Court of Appeal, the court found under similar circumstances that payments were deductible to the payor and taxable in

the hands of the recipient. The Tax Court in Andrews concluded that it was bound by the rule of stare decisis to follow the decision of the Federal Court of Appeal because “it is for all practical purposes indistinguishable from this case”. As a result, Mr. Andrews was permitted to deduct the amount as a support payment, while Ms. Andrews was permitted not to include the amount in her income as it was an equalization payment.

If it wasn't for the likelihood of this case being appealed, the Andrews decision would offer a great opportunity for income tax planning for separating spouses in a similar situation.

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.