

Marmer Penner Inc. Newsletter

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Tax Savings Opportunities Where There is a U.S. Resident Payor

In situations where there is a U.S. resident payor who owes both an equalization payment and spousal support to a Canadian resident recipient, opportunities for tax savings may exist due to differences in tax law between the two countries.

Consider the following fact situation:

- 1) Mr. Payor is a resident of the United States, and expects to remain so for the foreseeable future;
- 2) Ms. Recipient (surname reverted to her maiden name) is a resident of Canada and expects to remain so for the foreseeable future;
- 3) Mr. Payor has an obligation to make a equalization payment of CDN\$1,000,000 pursuant to the *Family Law Act*;
- 4) Mr. Payor also has a spousal support obligation, which may be satisfied with a one-time CDN\$1,000,000 lump-sum payment; and

- 5) Mr. Payor and Ms. Recipient have been divorced for approximately one year.

Under existing Canadian law, the receipt of a lump sum in lieu of future spousal support is not taxable. Obviously, the receipt of a payment for equalization is not taxable. Thus, Ms. Recipient will receive the CDN\$2,000,000 tax-free. Under existing U.S. tax law, *it may be possible* to make *both* the payment for lump-sum support *and* equalization deductible for Mr. Payor. In order to be fully deductible, payments by Mr. Payor should be made in three equal installments over a period of three taxation years. It is important to know however, that these deductions are allowed only in the year of payment. If all or a portion of the payments cannot be deducted because Mr. Payor's income is not high enough, they cannot be carried forward to future years.

Although Ms. Recipient may be concerned that the receipts are periodic and therefore taxable, exposure to this risk is small. Lump-sum payments over a three-year period are within the Canada Revenue Agency's guidelines for non-periodicity. It may also be possible to make one or more payments to a third party (for example, mortgage payments or debt payments on behalf of Ms. Recipient). This alternative would lower the re-assessment risk further, because payments made to third parties are clearly exempt from Canadian taxation where no special election is made.

We have recently dealt with settlements like the one described above where tax savings were achieved based on both the equalization payment and the lump-sum payment in lieu of future spousal support. However, we have not yet seen a case where such a settlement has been reviewed by either the U.S. or

Canadian taxation authorities. Upon review, it is always possible that the law be changed, thereby closing the loophole. **Given the nature of these transactions and given the ever-changing tax rules in each country, each situation must be reviewed independently by a tax professional with both U.S. and Canadian tax expertise.**

In typical situations involving Canadian resident payors, equalization payments and lump-sum payments for future support are non-deductible. Therefore, if one or both payments can be structured so that they are deductible for a U.S. payor, that payor is a big winner. Leeway in these cross-border tax rules may help to settle cases if both parties agree to share the tax savings that might be achieved by structuring a deal in a manner that permits maximum deductibility.

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We would like to wish all our clients a healthy and happy Holiday Season, and best wishes for the New Year. We look forward to continue working with you in 2008.

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.