

Marmer Penner Inc. Newsletter

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The Support Delinquent Gets a Break from CRA

In March 2004, Mr. James was ordered to pay spousal support of \$5,750 per month. In June 2009, after a dismissed application to increase spousal support retroactively by the Lower Court, the British Columbia Court of Appeal allowed Ms. James' appeal to vary monthly support to \$9,000 back to January 1, 2005. On July 30, 2009, Mr. James paid Ms. James \$169,775, representing the difference between \$9,000 ordered and \$5,750 already paid from 2005 to 2009. In accordance with subsection 60(b) of the *Income Tax Act* (the "Act"), Mr. James had likely been deducting the \$5,750 monthly spousal support he paid to Ms. James on his personal income tax returns, as the original amount was pursuant to a court order. However, does the \$169,775 additional payment made by Mr. James in July 2009 qualify as deductible support?

According to the *Act*, in order for support payments to be deductible to the payor, the following must occur:

- a) The amount must be paid and specified under a court order or a written agreement;
- b) The amount must be payable on a periodic basis; and
- c) The amount is not for child support.

According to the Canada Revenue Agency, the term "periodic" does not necessarily mean frequent, although there has to be a series of payments. For example, the payments could be made monthly, quarterly, semi-annually, or annually. The court order or written agreement has to set out the timing of the payments. A new order or agreement is required if a change in the payment schedule is needed.

On his 2009 personal income tax return, Mr. James deducted the \$169,775 retroactive payment he had made to Ms. James. Upon assessment of his tax return, CRA denied the deduction. Mr. James appealed CRA's decision and surprisingly, the judge allowed the deduction for \$169,775 on the basis that the character of Mr. James' periodic payments pursuant to the original order had not changed, as the retroactive amount cannot be paid on a periodic basis due to the passage of time and a lump sum was paid only by necessity¹. Therefore, not only can an order or written agreement allow for spousal support payments to be deductible presently, but if in the future the payor is deemed to have underpaid his or her support obligations, he or she can at least be comforted by a big tax deduction. Here are a few points to consider when drafting such an agreement:

- 1) 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;

¹ As this appears to contradict other decisions, readers should consider waiting for the result of CRA's inevitable appeal of this matter.

- b) periodic in nature and for the maintenance of the spouse; and
- c) referred to as taxable and deductible in the agreement or order.

As a result, a spouse who made voluntary periodic payments in 2012 and 2013 may still obtain tax deductibility for these amounts as long as an agreement is entered into on or before December 31, 2013.

- 2) Priority is always given to child support. Accordingly, all support payments made are first considered to have been applied towards child support and any amount over and above the required child support amount is considered to be a spousal support payment. All child support payable must be fully paid before any amount can be claimed as a deduction for spousal support by the payor. Any arrears in child support are carried forward and added to the next year's support payable. Any support that is not identified in an order or agreement as being solely for the support of the recipient is considered to be child support.
- 3) If a Canadian resident receives spousal support payments from a resident of another country, the Canadian recipient must include the payments in income. However, a deduction for the full amount of the payments may be claimed by the recipient if there is a tax agreement between Canada and the other country, making the spousal support tax-free.
- 4) Third party payments or specific purpose payments can be taxable and deductible if the order or agreement specifically provides for such payments and if the recipient can use them as he or she sees fit. Specific purpose payments include:
 - a) rent, property taxes and insurance premiums;
 - b) educational or medical expenses;
 - c) maintenance costs for the home in which the recipient lives; and

- d) up to 20% of the original principal amount of any debt from buying or improving the home in which the recipient lives.
- 5) A payor who falls into arrears and pays multiple years' support all in one year must deduct the catch-up amount in the year it is paid. The recipient however has the option of treating the catch-up amount as income in the year received or re-filing tax returns for earlier years as if the support had been paid on time by the payor. This latter approach typically results in lower taxes for the recipient.

This is the time of year to ensure those agreements are signed to ensure tax savings not only for the past two years but depending on the honesty of the payor, significant tax savings with respect to a possible future retroactive payment.

This newsletter is not intended to substitute for proper professional planning. It is intended to highlight areas where professional assistance may be required or enough to discuss at the next hoedown. 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.