

Marmer Penner Inc. Newsletter

Written by Written by Steve Z. Ranot, CPA, CA, CBV
Edited by Anna M. Barrett, CPA, CA, CBV, CFF

Reasonableness of Periodic Spousal Support Payments

Spousal support paid by a resident of Canada is generally deductible to the payer and taxable to the recipient. The payer is almost always the higher income-earner of the two so income tax savings generally occur when spousal support is paid. If a global settlement is reached combining support, costs and equalization, for example, there may be income tax advantages to allocating as much as possible to support. This can be even more pronounced if the recipient can reduce income further by deducting professional fees incurred in order to determine income for support purposes. In rarer circumstances, the support-payer resides in Canada where spousal support is deductible while the recipient resides in a jurisdiction where spousal support received is not taxable, such as in the United States. This further rewards the parties who can negotiate as much support as possible as part of the settlement agreement.

As can be seen, there are advantages and that means more for the parties because less is paid to Canada Revenue Agency ("CRA"). In order to be deductible, spousal support must generally be periodic, paid to a spouse or common-law partner or a former spouse or common-law partner and be pursuant to a written agreement or order. Prior to the decision in *James v The Queen* [2013 TCC 164], we would not have inserted "generally" into the previous sentence. But, that tax decision has changed the periodic requirement when certain lump sums are ordered and that is a topic for another newsletter.

Tax advantages may exist in designating more of a possible settlement amount as support. Accordingly, one should examine what the tax courts consider when determining whether a support amount is excessive. After all, the CRA is not blind to the advantages of turning a portion of an equalization paid over time into support. In the landmark tax case of *The Queen v. McKimmon* [1990 FC 600 90 DTC 6088], the court listed the criteria that should be considered in making the distinction between periodic payments made as an allowance for maintenance as opposed to paying a capital sum in instalments. These criteria include the following:

- (a) Frequency of periods – amounts paid weekly, bi-weekly or monthly are more easily characterized as support than amounts paid less frequently. CRA's Income Tax Folio on support payments cautions that amounts paid less frequently than annually are unlikely to qualify as an allowance for maintenance;
- (b) Indefinite or fixed term – an agreement to pay an amount for an indefinite term appears more likely to be support than one with a fixed end date that might indicate it is more of a capital nature;
- (c) Amount of the payments in relation to the incomes and lifestyles of the parties – if the periodic amounts are greatly in excess of the parties' incomes and lifestyles and are for a short period, that may indicate that the amounts are part of a capital sum paid in instalments;
- (d) Payments are made in part to release the payer from future maintenance obligations – if the agreement includes a fixed end date and a waiver by the recipient releasing the payer from future maintenance obligations, all or a portion can be viewed as a lump sum paid in instalments;
- (e) Whether the amounts bear interest or are permitted to be paid early – it is pretty clear that an amount bearing interest is capital in nature and the nature of periodic support is rarely one that presupposes early payments; and

- (f) Whether the payments survive the lifetime of the payer and/or recipient – surviving the lifetime of the recipient appears to be something other than maintenance payments. However, we have seen estates pay periodic support (albeit no longer taxable and deductible as the estate cannot have a spouse or common-law partner). So, having the payments survive the payer is not nearly as conclusive.

Item (a) indicates that the less frequent the payments, the less likely it will be viewed as maintenance. We have written in the past about an annual income tax reimbursement which was accepted by the tax court as periodic.

We wish to congratulate Timmy Cheng BAFM, MAcc, CBV on passing the Canadian Institute of Chartered Business Valuators Members' Entrance Exam. Timmy has been at Marmer Penner Inc. since 2021 and he has experience valuing operating and holding companies as well as determining income in complex business structures. Timmy has completed the CPA final exam and is expected to meet the experience requirements in 2025.

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.