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Tax Issues on Separation and Divorce
IFDA Workshop – October 20, 2016

Kim G C Moody FCA, TEP
Roy A Berg JD, LL.M (US Tax)
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Topics

1. U.S. Issues in Divorce and Separation
2. Spouses and Common-Law Partners
3. Property Transfer Issues
4. Life Insurance Issues
5. Support Payments
6. Professional Fees
7. Miscellaneous

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Why Are U.S. Issues Important in Divorce Context?



**Why Are U.S. Tax Issues Important?
Passport Confiscation For "Seriously Delinquent Tax Debt"**

1. Fixing America's Surface Transportation Act.
2. Signed into law on December 4, 2015.
3. Section 32101 of the Bill provides:
 - "Seriously Delinquent Tax Debt" means taxes, penalties, interest >\$50,000.
4. Passport shall be revoked!




**Why Are U.S. Tax Issues Important?
Foreign Account Tax Compliance Act ("FATCA")**



Why Are U.S. Issues Important in Divorce Context?


1. Transfer of property from one U.S. citizen to non-U.S. citizen **is taxable to US citizen.**
2. Transfer of U.S. real estate between non-U.S. citizens **is taxable to transferor.**
 - a. Transferee will have withholding obligations.
3. If U.S. citizen is not compliant with tax filings – may have **substantial latent penalties.**
4. If U.S. citizen or U.S. real estate, **transfer may also be subject to gift tax!**

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Property Transfer Issues – U.S. Real Estate

- If U.S. real estate is transferred pursuant to order or agreement and the recipient spouse is not a U.S. citizen, the transferor spouse may be subject to U.S. income tax on any gain resulting from the transfer.
- Therefore consider electing out of rollover for Canadian income tax purposes to avoid double taxation.
- Canadian tax purposes – no gain on transfer.
- Even if spouse is U.S. citizen or resident, watch U.S. income tax result if common law relationship rather than legal marriage.

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Property Transfer Issues – U.S. Real Estate – Cont'd


- Even if there is no gain or loss on the transfer, the transferor will still have to file US tax returns – 1040NR.
- If the transferor is not a US citizen the amount realized by the transferor (i.e. in most cases this will be the FMV of the property at the date of transfer) may be subject to a 10 percent U.S. withholding tax.

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Property Transfer Issues – Cross Border Transactions

Canadians – Transfer of U.S. Real Estate – Gift Tax.


- US gift tax does not apply to transfer if divorce occurs within three year period beginning one year before separation agreement entered into between spouses.
- Value of property received from non U.S .citizen spouse is less than value of property transferred.
- Gift tax return required if not divorced by due date for filing a gift tax return for the year in which the agreement became effective.
- Certified copy of the divorce decree should be furnished to the IRS not later than 60 days after the divorce is granted.


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Property Transfer Issues – Cross Border Transactions – Cont'd


Non-U.S. Citizen Transfer to U.S. Citizen.

- No US tax income consequences – U.S. citizen inherits Non U.S. citizen spouse's cost base.
- Ensure subsection 74.5(3) election filed for Canadian tax purposes to avoid double taxation on sale of property.
- Gift tax will not apply to transfer of US property since property transferred to U.S. citizen spouse (legally married).
- U.S. citizen may be required to file Form 3520 (Gifts from foreign persons) – harsh penalties for failure to file.


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US Citizenship and US Residency
You Probably Know Someone With US Reporting Obligations



To Whom Do Reporting Obligations Apply? U.S. Citizens




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U.S. Citizenship

- Born in the U.S. = U.S. Citizen.
- Born in Canada to two U.S. Citizens = U.S. Citizen.
- Born in Canada to one U.S. Citizen = U.S. Citizen if:
 - Born on or after November 14, 1986:**
 - U.S. Parent resided in U.S. for five years.
 - Two of which were after that U.S. parent's 14th birthday.
 - Born before November 14, 1986:**
 - US Parent resided in U.S. for ten years.
 - Five of which were after that U.S. parent's 14th birthday.

US green card holders


- Termination of income and reporting requirements not effective until Form 8854 filed.


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Note: It Is Illegal For US Citizens To Enter Or Leave The U.S. Without A Valid U.S. Passport
22 CFR 53.1


§ 53.1 Passport requirement; definitions.

(a) It is unlawful for a citizen of the United States, unless excepted under 22 CFR 53.2, to enter or depart, or attempt to enter or depart, the United States, without a valid U.S. passport.

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Counting Days and Counting Sheep
Why 2014 Is A Wake Up Call For All Canadians Traveling To The U.S.



**Counting Days and Counting Sheep:
2014 CHANGES EVERYTHING!**

Why Counting Days is Important:

- U.S. income tax consequences. Residency determined by day count:**
 - Except: "Closer Connection" (facts and circumstances).
 - Except: Treaty tiebreaker rules (facts and circumstances).
- U.S. estate tax consequences. Residency determined by:**
 - Intent, and
 - Location at date of death.
- U.S. immigration tax consequences. Residency determined by:**
 - Intent, and
 - Day count.
- Canada's "Departure Tax." Cessation of residency determined by intent.**
- Loss of Provincial Health Care. Residency determined by:**
 - Intent.
 - Day count.


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**Counting Days and Counting Sheep:
2014 CHANGES EVERYTHING! – Cont'd**

Why Have So Few Practitioners Encountered Audit Triggered by Day Count?

Historically, Canadian Border Services Agency ("CBSA") and US Customs and Immigration Service ("USCIS") only keep track of people entering the country.

In order to obtain an accurate day count must contact both CBSA and USCIS.

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**Counting Days and Counting Sheep:
2014 CHANGES EVERYTHING! – Cont'd**

2011 Canada and the US launched the **"Exit/Entry Initiative"**.

- Enacted in four phases.
- Final two phases scheduled to go into effect 6/31/2014.
- Travelers will be required to swipe passports both when:
 - Enter the respective country; **AND**
 - Depart the respective country.


BOTH COUNTRIES WILL BE ABLE TO INDEPENDENTLY DETERMINE DAY COUNT FOR TAX AND IMMIGRATION PURPOSES.

<http://www.cbsa-asfc.gc.ca/agency-agence/reports-rapports/pia-efvp/atip-ajprp/ee-es-phase-2-eng.html>

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Tax “Day Count” ≠ Immigration “Day Count”!

TAX




Department of the Treasury
Internal Revenue Service

182 Days in the Calendar Year



0 Days 120 Days 182 Days 365 Days


No action required File Form 8840 Treaty tie-breaker exception may apply



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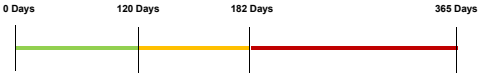
Tax “Day Count” ≠ Immigration “Day Count”! – Cont’d

TAX




Department of the Treasury
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182 Days in the Calendar Year



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- J-1 Visa for Teachers and Students are exempt 301.7701(b)-3(b)(2).
- “In Transit” exception if <24 hrs and do not work 301.7701(b)-3(d).
- “Pre-existing medical condition” NOT exempt if: a) pre-existing; and b) knew regardless if was being treated -3(c)(3).
- Regular Commuters – 75% work days in US; and returns within 24 hrs -3(e).

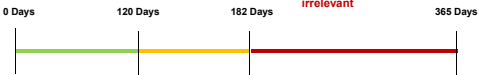
Tax “Day Count” ≠ Immigration “Day Count”! – Cont’d

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Department of the Treasury
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182 Days in the Calendar Year




0 Days 120 Days 182 Days 365 Days

No action required File Form 8840 Treaty tie-breaker exception may apply



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IMMIGRATION



180 Days in Rolling 12 Months – Treaty, “Closer Connection”, and “Substantial Presence” are irrelevant


Spouses and Common-Law Partners

- "Spouse" not defined in the *Income Tax Act*...must be given its ordinary meaning.
- Extended definition of "spouse" (subsection 252(3)).
- 2005 same-sex marriage bill changed "another individual of the opposite sex" to "another individual."

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Spouses and Common-Law Partners – Cont'd

- Definition of "common-law partner" (subsection 248(1)).
- Rules in Act generally apply equally to heterosexual and same-sex unions and married and unmarried spouses (heterosexual or same-sex).

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Spouses and Common-Law Partners Summary

	Definition of Spouse	Definition of Common-Law Partner
"Current"	Legally married.	A person who is living in a conjugal relationship with the taxpayer and: • Has lived with the taxpayer throughout the previous 12-month period; or • Is the natural or adoptive parent (legal or in fact) of the taxpayer's child.
"Separated"	A spouse who is separated due to a breakdown of the marriage.	A common-law partner who has been separated for less than 90 days due to a breakdown of the conjugal relationship.
"Former"	Petition for divorce must be filed and a judgment of divorce granted.	A common-law partnership under the Act is considered to continue until the parties have ceased living together for a period of at least 90 days due to the breakdown of their conjugal relationship. Individuals will be considered former common-law partners on the first day after the 90-day separation.

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**Spouses and Common-Law Partners
Multi-Jurisdictional Issues**

- Where spouses reside in different jurisdictions, look to laws of both jurisdictions to determine tax consequences (e.g. taxability/ deductibility of support payments).
- Residence for tax purposes.
- U.S. – citizen of lawful permanent resident?
 - substantially present?

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**Spouses and Common-Law Partners
Definition of "Related"**

- Individuals "connected by marriage" or "common law partnership" are related persons and are dealing with each other at non-arm's length.
- No longer "connected by marriage" when marriage is dissolved by divorce or if common law and have ceased to live together for at least 90 days due to breakdown of relationship.
- Separated spouses are still related.

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Spouses and Common-Law Partners

- Can have different results:
 - For example separated but not divorced spouses are "related" – can participate in a paragraph 55(3)(a) butterfly.
 - Common law partners cease to be "related" 90 days after breakdown of their common law relationship because of definition in subsection 248(1) therefore no paragraph 55(3)(a) butterfly.

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Property Transfer Issues



Property Transfer Issues – Attribution

- Spousal attribution rules contained in subsection 74.1(1) (income attribution) and subsection 74.2(1) (capital gains attribution).
- Rules do not apply where parties cease to be spouses or common law partners.
- If parties separated but not divorced:
 - No income attribution.
 - No capital gains attribution if parties jointly elect not to have section 74.2 apply – see paragraph 74.5(3)(b).
 - Subsection 74.4(2) – “corporate attribution rules” do not apply - see subsection 74.5(4)


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Property Transfer Issues – RRSPs, RRIFs and TFSAs

- RRSP funds transferred tax-deferred to spouse's RRSP if:
 - parties are living separate or apart;
 - payment made pursuant to court order or agreement;
 - transferee spouse not disqualified by reason of age from having an RRSP; and
 - transfer made directly between plans (Form T2220).
- Similar rules for RRIFs.
- A former spouse may withdraw funds from a spousal RRSP without triggering the usual inclusion in income of the contributor.


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Property Transfer Issues – RRSPs, RRIFs and TFSA – Cont'd


Withdrawal from spousal RRSP.

- Ordinarily the contributor to a spousal RRSP will be taxed on withdrawals made by the spouse unless he or she did not make any contributions in the year of the withdrawal or in the two previous taxation years.
- This time requirement is waived if the couple is living apart because of the breakdown of the relationship at the time of the withdrawal.

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Property Transfer Issues – RRSPs, RRIFs and TFSA – Cont'd

- TFSA from one spouse can be transferred to another. However, the transfer neither increases the transferor's contribution room, nor reduces the transferee's contribution room.

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Property Transfer Issues – Splitting Pensions

- Transfers of pensions from one spouse to another can occur on rollover basis.
- Must transfer directly to transferee spouse's RPP, RRSP or RRIF.
- Transfer must occur pursuant to court order or agreement.
- CPP benefits can be split between spouses.

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Property Transfer Issues – Principal Residence

- Transfers of a "principal residence" deemed to occur at cost.
- Property can continue to qualify for principal residence exemption following transfer.
- Each spouse can only designate one property as a principal residence.

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Property Transfer Issues – Principal Residence – Cont'd

- Former spouses will not be entitled to an additional principal residence deduction until they have been living apart for a full calendar year and are separated under a judicial order or written separation agreement.
- Important that the couple agrees on the date of the separation, and that date is stipulated in an order in agreement.
- If no separation agreement that identifies a date, the principal residence deduction will continue for the couple rather than each being eligible for the exemption.

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Property Transfer Issues – U.S. Real Estate

- If U.S. real estate is transferred pursuant to order or agreement and the recipient spouse is not a U.S. citizen, the transferor spouse may be subject to U.S. income tax on any gain resulting from the transfer.
- Therefore consider electing out of rollover for Canadian income tax purposes to avoid double taxation.
- Canadian tax purposes – no gain on transfer.
- Even if spouse is U.S. citizen or resident, watch U.S. income tax result if common law relationship rather than legal marriage.

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Property Transfer Issues – U.S. Real Estate – Cont'd


- Even if there is no gain or loss on the transfer, the transferor will still have to file U.S. tax returns – 1040NR.
- If the transferor is not a U.S. citizen the amount realized by the transferor (i.e. in most cases this will be the FMV of the property at the date of transfer) may be subject to a 10% U.S. withholding tax.

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Property Transfer Issues – Cross Border Transactions

Canadians – Transfer of U.S. Real Estate – Gift Tax.


- US gift tax does not apply to transfer if divorce occurs within three year period beginning one year before separation agreement entered into between spouses; and
- Value of property received from non U.S. citizen spouse is less than value of property transferred.
- Gift tax return required if not divorced by due date for filing a gift tax return for the year in which the agreement became effective.
- Certified copy of the divorce decree should be furnished to the IRS not later than 60 days after the divorce is granted.

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Property Transfer Issues – Cross Border Transactions – Cont'd


Non-U.S. Citizen Transfer to U.S. Citizen.

- No U.S. tax income consequences – US citizen inherits Non U.S. citizen spouse's cost base.
- Ensure subsection 74.5(3) election filed for Canadian tax purposes to avoid double taxation on sale of property.
- Gift tax will not apply to transfer of US property since property transferred to U.S. citizen spouse (legally married).
- US citizen may be required to file Form 3520 (Gifts from foreign persons) – harsh penalties for failure to file.

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Property Transfer Issues – Division of Marital Property

- Subsection 73(1) rollover is automatic for transfers of capital property.
- Transferor can elect out (utilize capital gains exemption, use capital losses, principal residence exemption).
- No prescribed form to elect out.
- Subsection 73(1) does not apply to non-capital property (inventory, ECP, resource property, or property held in the course of an adventure in the nature of trade).
- What is capital property?

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Property Transfer Issues – What is Capital Property?

- Subsection 73(1) does not apply to non-capital property (inventory, ECP, resource property, or property held in the course of an adventure in the nature of trade).
- Capital property defined in section 54 of the Act (paragraph 39(1)(a) also relevant).
- Inventory, eligible capital property (i.e. goodwill), resource property and life insurance policies are not capital properties.
- Can lead to problems when transferring non-capital properties.

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Property Transfer Issues
Example of Electing Out of Section 73 - Facts

- Mr. and Mrs. Apple are getting a divorce.
- Mr. Apple has \$400,000 of capital losses carried forward.
- Mr. and Mrs. Apple jointly owned 20 acres of raw land outside Calgary.
- The FMV of the land is \$1M with a cost base of \$200K.
- As part of the settlement of their marital property, Mr. Apple has agreed to transfer his interest to Mrs. Apple.
- GST / HST and transfer taxes will need to be considered (although beyond the scope of this seminar).


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Property Transfer Issues
Example of Electing Out of Section 73 - Results

1. Section 73 applying – automatic.

a) Mr. Apple - proceeds \$100K
 - ACB \$100K
 - capital gain 0

b) Mrs. Apple inherits the total property with ACB of \$200K (\$800K unrealized gain).


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Property Transfer Issues
Example of Electing Out of Section 73 - Results – Cont'd

2. Electing out of Section 73 (as part of agreement, Mr. Apple agrees to utilize his capital losses).


a) Mr. Apple - proceeds \$500,000 (FMV)
 - ACB \$100,000
 capital gains 400,000
 capital loss (400,000)
 net capital gain 0

b) Mrs. Apple inherits the total property with ACB of \$600K (\$100K and \$500K) therefore unrealized gain is now only \$400K.

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Property Transfer Issues – Division of Marital Property

Situation	Rollover	Transferor	Recipient
Transfer after divorce – not in settlement of marital rights	No	Income until transfer Capital gain on transfer	Capital gains/income generated after transfer
Transfer after divorce – in settlement of marital rights	Yes	Income until transfer	Capital gains on sale Income after transfer
Transfer after separation in settlement of marital rights - subsection 74.5(3) election filed	Yes	Income until transfer	Capital gains on sale Income after transfer
Transfer after separation in settlement of marital rights – subsection 74.5(3) election not filed	Yes	Income until transfer Capital gains on sale by transferee if sold before divorce	Income after transfer No capital gains on sale unless divorced.

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Property Transfers – Capital Gains Deduction


- Only certain types of property are eligible for utilization of capital gains deduction:
 - a) "qualified small business corporation" ("QSBC") share – generally shares of CCPCs that carry on an active business in Canada with correct asset profile.
 - b) qualified farm property.
 - c) qualified fishing property.
- QSBC share test requires that shares must be owned by taxpayer or person related to taxpayer throughout 24 months preceding the sale.
- Whether test will be met will depend on when shares are transferred as a result of marital breakdown.
- Important issue when shares transferred to spouse and sold prior to spouse holding the shares for 24 months.

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Property Transfers – Capital Gains Deduction – Cont'd

Example:


- Individual and spouse own QSBC shares for 24 months combined and the individual sells the shares while they are separated but prior to owning the shares personally for 24 months.
- Separated spouses are considered "related."
- Therefore, 24 month holding test in QSBC definition would be satisfied and individual able to claim capital gains deduction.

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Property Transfers – Capital Gains Deduction – Cont'd

Example:

- Individual and spouse own QSBC shares for 24 months combined and the individual sells the shares after they are divorced but prior to owning the shares personally for 24 months.
- Even though not related at time of sale the taxpayer was related to the spouse throughout his ownership.
- Therefore, 24 month holding test would be satisfied and capital gains deduction can be claimed on sale.

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Property Transfers – Capital Gains Deduction – Cont'd

Example:

- Individual acquires QSBC shares from spouse after divorce and sells the shares but prior to owning the shares personally for 24 months.
- Spouse not considered 'related' to individual prior to transfer.
- Therefore, property held by someone unrelated to individual during the 24 months preceding sale and the shares would not qualify for exemption.

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Property Transfers – Section 84.1 Transactions

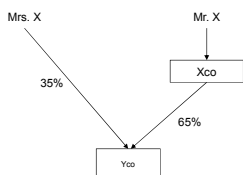
- Section 84.1 applies when a Canadian resident individual disposes of shares of a Canadian resident corporation to a corporation with which the taxpayer does not deal at arm's length and the corporations are "connected" immediately after the disposition.
- If the individual receives proceeds other than shares on the sale (like cash or a promissory note) the individual will be required to report a deemed dividend rather than a capital gain.
- Section 84.1 in effect converts a capital gain into a dividend which prevents the ability to use the capital gains deduction.

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Property Transfers – Section 84.1 Transactions – Cont'd

Example: Sale of Shares on Marital Breakdown:




- Mrs. X sells shares of Yco to Xco for \$500,000 cash as part of marital settlement.
- Mrs. X wants to use her capital gains deduction on the transfer.

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Property Transfers – Section 84.1 Transactions – Cont'd


- If Mrs. X is considered to be at non-arm's length with Xco, then section 84.1 will apply.
- Mrs. X will be considered non-arm's length with Xco if she is related to Xco.
- Mrs. X is related to Xco if she is considered related to Mr. X.
- If transfer occurs while separated Mrs. X is still considered related to Mr. X and section 84.1 will apply. Result = \$500,000 dividend and not a capital gain therefore can not use capital gains deduction.
- If transfer occurs after divorce then question of fact as to whether Mrs. X is considered related to Mr. X and section 84.1 may not apply.

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**Property Transfer Issues
Planning – Use of Paragraph 55(3)(a) Butterfly**

Facts


- Ms. A and Mr. B are married. They have three children.
- After 12 years of living together, they are separated but not yet divorced.
- Mr. B is the sole shareholder of X Ltd. The issued share capital of the company consists of 100 common shares. The paid-up capital ("**PUC**") of these shares is \$100. Mr. B's adjusted cost base ("**ACB**") of these shares is \$100.
- The shares have a current FMV of \$2.5M.
- Court awarded Ms. A 30 common shares of X Ltd. under the terms of the separation.

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**Property Transfer Issues
Paragraph 55(3)(a) Butterfly – Facts**

- FMV = \$2.5M
- ACB = \$100
- PUC = \$100

Mr. B
|
[X Ltd.]

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Property Transfer Issues Paragraph 55(3)(a) Butterfly – Plan

Received 30% of shares on separation but before divorce is final.

Ms. A

Mr. B

30%

70%

X Ltd.

- Mr. B transfers shares to Ms. A under subsection 73(1) of the Act i.e. tax deferral.

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Property Transfer Issues Paragraph 55(3)(a) Butterfly – Plan – Cont'd

Ms. A

Mr. B

100 common
750,000 preferred

Holdco

30 common
FMV = \$750K
ACB = \$30

X Ltd.

70 common
FMV = \$1.75M

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Property Transfer Issues Paragraph 55(3)(a) Butterfly – Plan – Cont'd

Ms. A

Mr. B

Holdco

X Ltd.

Share repurchase


\$749,970 deemed dividend (deductible pursuant to 112(1) - subsection 55(2) should not apply - even with the proposed amendments to subsection 55(2).

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Property Transfer Issues
Paragraph 55(3)(a) Butterfly


- Subsection 55(2) anti avoidance rule prevents capital gain being converted into tax free inter-corporate dividend.
- Paragraph 55(3)(a) exception where the transaction is between "related" parties (however the subsection will not apply as in context of former spouse).
- Definition of "related persons" in paragraph 251(2)(a) includes "individuals connected by marriage or common-law partnership."
- Spouses cease to be "related" when they divorce.
- Common-law partners cease to be "related" 90 days after they cease cohabiting (definition of common-law partner in subsection 248(1)).
- Ms. A and Mr. B will be related until they are considered "former spouses" as such should qualify for paragraph 55(3)(a) reorganization.

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Property Transfer Issues
Common Problems with Property Transfers

- Transfers of property to children – no rollover.
- Directed transfers of property from corporation to people – taxable.
- Corporate repurchase of shares – taxable as a dividend.
- Conditions for section 73 not met – the recipient spouse is not resident in Canada.

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Life Insurance Issues



Life Insurance


- Separation agreements involving support payments frequently include an obligation by the payor to maintain a life insurance policy as security for the support obligation.
- Where obligation is in the nature of child support, the agreement will usually require that the party who received the support payments be appointed as trustee of the insurance proceeds for the benefit of the children.
- Implications of making an irrevocable beneficiary designation (requires consent of the beneficiary should the support obligation end and insured wishes to keep insurance policy).

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Life Insurance – Cont'd


Henry vs. Henry, 30 E.T.R. (2d) 89.

- Lorne Henry, under agreement, was to support his son (Michael) until he was 18 and thereafter as long as son was in school.
- Lorne acquired a life insurance policy to ensure his obligation under the support agreement would be fulfilled.
- The support agreement stated that Lorne's brother (Robert) was beneficiary in trust for Michael for as long as child support was required.
- Lorne failed to qualify Robert's entitlement as a "beneficiary in trust for Michael" under the life insurance contract.
- Michael dropped out of school at age of 19 thereby ending Lorne's obligation to keep insurance policy in place.

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Life Insurance – Cont'd

- Lorne dies – who gets the insurance proceeds?
- In creating the Trust (i.e. Robert to hold insurance policy proceeds "in Trust" for Michael), Lorne failed to indicate what his trustee, Robert, was to do with the insurance proceeds should all or part of the proceeds not be required for Michael's support.
- Michael was no longer a beneficiary of the Trust (as he dropped out of school) and Robert has no beneficial entitlement to the proceeds.
- As the object of the Trust failed a "resulting trust was created where Robert held the insurance proceeds in trust for Lorne's estate."

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Support Payments



Support Payments – Support

- IT-530R.
- *Thibaudeau* case (SCC, 1995).
- Support rules changed in 1997.
- Rules contained in paragraphs 56(1)(b) and (c.2) and 60(b) and (c.2).


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Support Payments – Periodic Payments


- Relevant Factors:
 - Frequency of payments.
 - Indefinite or fixed term.
 - Relation of amount of payments to income and living standard of payer and recipient.
 - Release of payer from future obligations.

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Support Payments – Lump Sum Payments

- Single amount paid at once or in instalments over time.
- Generally not taxable or deductible.
- Payments pertains to period before written agreement do not qualify.
- Can qualify for deductibility if:
 - A series of annual payments for support pursuant to court order or agreement.
 - Payment is for periodic payments in arrears.
 - To prepay future amount (*Jardine* case).
- See section 3.44 of Income Tax Folio S1-F3-C3.

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Support Payments – Child Support

- Pre and post 1997 rules substantially changed.
- Formula in paragraphs 56(1)(b) and 60(b) removes "child support amount" made on or after a "commencement day" from taxability/ deductibility.
- Definition of "child support amount" and "commencement day" in subsection 56.1(4).
- Result: For payments made on or after a "commencement day" child support is not taxable to the recipient and not deductible to the payer.

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Support Payments – "Child Support Amount"

- Defined in subsection 56.1(4)
- Means a "support amount" that is not identified as being solely for support of spouse.
- Effect: all support amounts are "child support" unless clearly identified as spousal support.

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Support Payments – “Support Amount”

- Defined in subsection 56.1(4).
- Recipient must be spouse / common-law partner or former spouse / common-law partner of payer (e.g. payments from estate do not qualify).
- Parties living separate and apart.
- Allowance payable on periodic basis.
- For maintenance of recipient or children, or both.
- Recipient has discretion as to use of amount.
- Pursuant to court order or agreement.
- Lump sum “catch-up” payments qualify for deduction.

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Support Payments – Commencement Day

- Defined in subsection 56.1(4).
- Fixed day in court order or agreement.
- For *post-April 30, 1997* agreements or orders: Commencement Day is the day such agreement or order is made.
- For *pre-May 1, 1997* agreements or orders: Commencement Day is earliest of the following dates (after April 30, 1997):
 - Date specified on T1157 Election;
 - Date first payment of varied amount required to be made;
 - Date of subsequent agreement or order made after April 30, 1997; and
 - Date specified as “commencement date” in agreement or order.
- If no commencement date – then child support continues to be taxable/deductible.

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Support Payments – Spousal Support

- Pre and post 1997 rules largely unchanged.
- Recipient includes in income “support amount” per paragraph 56(1)(b) from which is excluded a “child support amount.”
- Payer deducts from income “support amount” per subsection 60(b) from which is excluded a “child support amount.”
- Definition of “support amount” (56.1(4)).
- Result: Spousal support regime unchanged.

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Support Payments – Third Party Payments (“TPP”)

- Subsections 56.1(2) and 60.1(2).
- TPPs are payments to a third party for the benefit of spouse, former spouse or child.
- Examples: private school tuition, rent.
- TPPs deductible to the payer and taxable to recipient if:
 - Specified in court order or agreement.
 - Both parties agree they are taxable/deductible.
 - Parties specifically refer to subsections 56.1(2) and 60.1(2).
- Non-deductible TPPs:
 - Payments for payer’s residence (mortgage, utilities, taxes, maintenance).
 - Amounts paid for purchase of “tangible property.”

78 


Support Payments – Payments To Non-Residents

- No Canadian non-resident withholding tax on support payments made by a Canadian payer.
- Paragraph 212(1)(f) repealed.

79 


Support Payments – Payments From Non-Residents

- Payments from Non-Resident – taxed in the hands of Canadian recipient only if would have been taxed if recipient were resident of source country (e.g. Canada-U.S. Tax Treaty Art XVIII, paragraph 6(b)).

80 


Support Payments
Canada-U.S. Cross-Border Payments
Canadian Payer – U.S. Recipient

- "Periodic" spousal support deductible in Canada (subsection 60(b)).
- *Internal Revenue Code* § 71(b)(1) excludes support payments from gross income if parties so designate.

81 


Support Payments
Canada-U.S. Cross-Border Payments
Canadian Payer – U.S. Recipient – Cont'd

- Result: Canadian payer gets a deduction; U.S. recipient not taxable.
- Applies to spousal support (not child support).

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Support Payments
Canada-U.S. Cross-Border Payments
U.S. Payer – Canadian Recipient

- "Periodic" spousal payments taxable in Canada (paragraph 56(1)(b)).
- "Lump sum" spousal support not taxable in Canada.
- *Internal Revenue Code* gives deduction for lump sum payments provided certain conditions met.

83 


Support Payments
Canada-U.S. Cross-Border Payments
U.S. Payer – Canadian Recipient – Cont'd

- Result: U.S. payer gets a deduction; Canadian recipient not taxable.
- Applies to spousal support (not child support).
- Caveat re: structuring "lump sum" payments.

84 


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Professional Fees




Professional Fees – Deductibility of Professional Fees


- Legal fees incurred by a *recipient spouse* for the following are deductible for tax purposes:
 - To *obtain* a right to spousal support.
 - To *defend* against a reduction in support.
 - To *obtain* child support.
 - To *enforce* support payments.
- Legal fees incurred by payer spouse to contest/defend in respect of any of the above are **not deductible**.

86 


Professional Fees – Summary As Follows

Legal Fees Deductible	Legal Fees Not Deductible
<ul style="list-style-type: none">• To obtain child support.• To obtain spousal support .• To enforce an existing court order or written agreement to collect spousal or child support.• Challenge a proposed reduction to spouse or child support.• To increase the amount of child or spousal support .• To make child support non-taxable.	<ul style="list-style-type: none">• Relating to the custody of children.• To obtain a divorce.• Relating to the division of property.• To establish, enforce or collect payment of a lump-sum amount in lieu of support.• Legal fees paid by a payor of child or spousal support.

87 


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Miscellaneous




Miscellaneous – Tax Liabilities on Property Transfers

- Rules contained in section 160.
- Joint and several liability on transferor and transferee spouses.
- Different for married and separated spouses.
- Generally, no liability where property is transferred pursuant to court order or agreement.
- However can be a liability in certain circumstances.
- Need to identify risk and cover by indemnities.

89 


Miscellaneous – Child Care Expenses

- Where a breakdown of the marriage or common law partnership occurs in the taxation year, the higher income taxpayer may claim child care expenses during the period that the supporting person with the lower income is living separate and apart from the taxpayer if all of the following conditions are met:
 - The breakdown is for a period of at least 90 days commencing in the year;
 - The parties were living separate and apart at the end of the year; and
 - The taxpayer actually paid the child care expenses.
- See paragraph 63(2)(b) of the Act.

90 


Miscellaneous – Child Care Expenses – Cont'd

- Where separation occurs in the year, the higher-income partner may claim the deductions based on the general limits for the period of separation to the extent actually paid by the higher-income partner.
- Where the parties are separated throughout the year, the payor of the child care expenses may make a claim for an "eligible child" and each parent could claim amounts paid for the same child.
- Where the parties reconcile by the end of the year, the ordinary rules apply and no claim can be made by the higher-income partner just because of the period of separation.

91 


Miscellaneous – Registration of Family Support Orders with CRA

- Use where court order or agreement provides only for payments of spousal support or separate amounts for spousal support and child support.
- Not required for child support payments only.
- Form T1158.
- Provide copy of court order or agreement.

92 


Miscellaneous – Spousal Credit

- If couple is separated throughout the year, no spousal credit is allowed.
- If individual is required to make payments to current or former spouse, and the couple was separated for only part of the year because of breakdown in their relationship, the individual has a choice:
 - claim the deductible support amounts paid, or
 - the spousal credit.which ever is better.

93 


Miscellaneous – Canada Child Tax Benefit (“CCTB”)

- Tax free payment provided to certain families.
- Must apply to the CRA as soon as child is born, adopted, or begins to live with individual.
- Income of both spouses is considered in determining the amount of payment.
- The parent who is primarily responsible for the care and upbringing should notify the CRA if the spouses are separated and have been separated for at least 30 days.

94 


Miscellaneous – Universal Child Care Benefit (“UCCB”)

- Individual may receive UCCB if eligible for CCTB for a child under six years.
- No application is required is the individual:
 - Already received CCTB, or
 - Is eligible for the CCTB and has applied for it but does not receive it because the family income is too high.
- UCCB is not considered income for determining child support amounts.
- Commencing 2010 the UCCB can be designated to be income of the dependent child if the recipient does not have a cohabiting spouse or common law partner.

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Case Study – Summary Facts


- Mr. and Mrs. Apple (ages 45 and 43 respectively) have been married for 20 years and are in the midst of divorce proceedings. They have two children (ages 14 and 12).
- Mrs. Apple was born in New York City and moved to Canada when she was 22 years old.

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Case Study – Summary Facts – Cont'd


3. Mr. and Mrs. Apple own the following assets:

	Mr.		Mrs.	
	FMV	ACB	FMV	ACB
a) Cash	\$500,000	\$500,000	\$1,500,000	\$1,500,000
b) Calgary residence	\$1,000,000	\$200,000	\$1,000,000	\$200,000
c) Phoenix condo	\$300,000	\$500,000	\$300,000	\$500,000
d) Non-registered stocks	\$200,000	\$150,000	\$800,000	\$600,000
e) RRSPPs – spousal	-	-	\$500,000	N/A
f) Shares of XYZ Co. Ltd.	\$5,000,000	\$1	\$5,000,000	\$1
g) Shares of "Holdco"	\$10,000,000	\$1	\$10,000,000	\$1

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Case Study – Summary Facts – Cont'd

- Mrs. Apple was gifted the \$1,500,000 of cash and all of the non-registered stocks from Mr. Apple.
- XYZ Co. Ltd. is a CCPC of which Mr. Apple is the CEO. It manufactures widgets and is very profitable.
- Holdco is a family holding corporation. Most of the assets of Holdco are commercial rental properties and a stock portfolio.
- Mr. Apple is the beneficiary of an estate once her mother passes away. The growth of Mrs. Apple's contingent interest during the Apple's marriage was approximately \$1M.

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Case Study – Summary
Facts – Cont'd

- 8. Mrs. Apple is considering moving back to the U.S. once her divorce is final. Her children have expressed a desire to move with her.
- 9. Mrs. Apple has never filed a U.S. income tax return.

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Case Study – Summary
Issues

- What are some of the tax issues that Mr. and Mrs. Apple should consider?

100 


Case Study – Summary
A Partial List of Tax Issues to Consider

- 1. Mrs. Apple's U.S. tax matters:
 - a) Needs to become compliant with U.S. income tax filing – 1040's, FBARS, 5471, etc.
 - b) Sub-part F income with respect to ownership in Holdco? PFIC?
 - c) How will assets be transferred to avoid U.S. tax?
 - d) Are her kids U.S. citizens? If so, what will her post-divorce estate planning look like?
 - e) Support payments.
 - f) Departure issues when leaving Canada.
 - g) Gift tax on transfer of properties?

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Case Study – Summary
A Partial List of Tax Issues to Consider

2. Paragraph 55(3)(a) planning to divide shares of XYZ and Holdco?
3. Attribution issues – has this been handled correctly in past?
4. Paragraph 74.5(3)(b) filing?
5. How is Mrs. Apple's contingent interest in the trust to be handled?
6. Principal residence issues.
7. U.S. withholding tax issues re: Phoenix property.
8. Spousal RRSP issues.
9. Non-resident trust issues if a trust is used to hold assets for the benefit of Mrs. Apple and the children if they move to the U.S.
10. GST issues?
11. Other?

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Kim G C Moody FCA, TEP
D 403.693.5102
kmoody@moodysgartner.com

Roy A Berg JD, LLM (US Tax)
D 403.693.5120
rberg@moodysgartner.com

Canada
Calgary, AB
Edmonton, AB
Vancouver, BC
Toronto, ON

USA
Buffalo, NY
moodysgartner.com

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