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Marmer Penner Newsletter

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Capital Property – Does It Include The Right to Receive Support?

In 1997, the Tax Court of Canada released its decision in Fortino v. the Queen (97 DTC 55)(TCC). In that case, the shareholders of Fortino's, chain of grocery stores, sold its shares to Loblaw's and agreed to sign a non-competition agreement. The shareholders reported a portion of the proceeds paid to them as a sale of shares and the remainder was allocated to the payment for the non-competition agreement. The Tax Court agreed with the taxpayer that receiving proceeds not to compete was not a taxable transaction. This decision was the background to a more recent case, which may have implications in family law.

Tod Manrell ("Manrell") was a shareholder in a plastics business. In June 1995, Manrell sold the shares of this business and signed a non-competition agreement in return for proceeds of $980,000 to be paid in four annual installments of $245,000. Manrell reported a $980,000 capital gain on his 1995 personal income tax return and deducted a reserve for the $735,000 unpaid portion. He subsequently included in his personal income $245,000 of capital gains in 1996 and 1997. When he became aware of the decision in Fortino's, Manrell changed his position and re-filed his personal income tax returns reporting a reduced capital gain.

Manrell argued that the right to compete did not constitute "property". And if he did not dispose of property, there could be no capital gain.

Manrell's appeal was dismissed on the grounds that "property" is defined as "property of any kind whatsoever . . .". The Court found that the right to

compete is property and that in this case, Manrell disposed of his right to make plastic products in competition with the purchaser of his shares. The Court's decision was explained as follows:

> "The Appellant disposed of his right to compete through the means of a covenant restricting his actions. A right can generally not be disposed of in any other way. To restrict the definition of 'disposition' in the ways suggested by the Appellant would have the effect of finding that, although rights are included as property, this property could never be disposed of pursuant to the *Act*."

What the Court appears to be saying is that the receipt of a payment in exchange for foregoing a right is considered to be a disposition of that right. Family lawyers are familiar with the concept that lump sum spousal support is non-taxable. It has been considered non-taxable as support payments are taxable *as income* only when the payments are periodic. However, as a result of the Manrell decision, it may be viewed that the receipt of lump sum support, while not taxable as income, may be taxable to the recipient as a capital gain. After all, lump sum support is paid to an individual in exchange for that individual's right to periodic support. Applying the Court's rationale in Manrell, this right is property and the payment for this right represents a disposition of property.

It will be interesting to see if Canada Customs and Revenue Agency seizes upon this decision to begin reassessing other dispositions of rights.

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.