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94 Cumberland Street, Suite 200, Toronto, Ontario M5R 1A3
Telephone: (416) 961-5612 Fax: (416) 961-6158
e-mail: valuators@marmerpenner.com

Marmer Penner Newsletter

Written by Anita Auerback, CA
Edited by Steve Z. Ranot CA•IFA/CBV, CFE and Michael S. Penner, BBA, CA•IFA/CBV, ASA, CFE

CHILD SUPPORT AND CROSS-BORDER ISSUES

A new layer of complexity is added in determining income for the *Child Support Guidelines* when the payor spouse lives outside of Canada. As the payor's income for child support is based on the Canadian personal income tax return, it is necessary to restate the payor's foreign income tax return in Canadian terms. In the case of a US resident paying child support to a Canadian resident, it is not simply a matter of converting the numbers on the US return to Canadian dollars. This article addresses some of the factors that must be considered in this cross-border scenario.

Tax Rate Differences

The court may impute income to a spouse as it considers appropriate if the spouse lives in a country that has effective rates of income tax that are significantly lower than those in Canada. Essentially, the US payor's income must be "grossed-up" to yield the same after-tax income as a Canadian.

In general, US tax rates are lower than Canadian tax rates. Furthermore, the top Canadian (Ontario resident) marginal rate of 46.4% is triggered when taxable income exceeds approximately $105,000, whereas the top marginal US rate of 38.6% (for a single individual or a joint filer) is not triggered until a level of approximately US$300,000 is reached. To further complicate matters, the differential varies from state to state. For example, if the payor lives in Texas or Florida where there are no state taxes, the gross-up will be much higher than if the payor lives in New York City, where he is subject to both state and city taxes.

For example, we will assume that the taxpayer earns $200,000 of investment income. Based on 2002 rates, at this income level, an Ontario resident would pay tax of approximately $77,000. On the same income, a New York City resident would pay tax of approximately $72,000 and a Dallas resident would pay tax of approximately $57,000.

New York may have a higher cost of living. This might impact the court's view of a taxpayer's disposable income.

Filing Position

In the US, a husband and wife may file a joint return to take advantage of preferential tax rates. Consequently, when calculating child support where the payor spouse has subsequently remarried, it is necessary to ensure that only the payor's income is considered in calculating income for the *Guidelines*.

Wages and Salaries

Line 7 of the US Tax Return reports wages net of the 401(K) contribution (the US equivalent of an RRSP contribution). So, if Mr. Jones' salary was $100,000 and he made the maximum 401(K) contribution in 2002, his net salary of $89,000 would appear on the tax return. Accordingly, an adjustment would need to be made to net earnings to add back the 401(K) contribution.

Tax Exempt Interest

Line 8b of the US return indicates any tax-exempt interest that has been earned in the year. This includes interest from state and municipal bonds. As the name suggests, this interest is not subject to federal income tax, but it may be subject to state and city taxes. However, for the purpose of calculating child support, it is necessary to add the income back.

US Dividends

When calculating child support, US dividends should simply be treated as other investment income. There is no dividend gross-up for which to adjust.

Capital Losses

On the US return, a taxpayer may claim capital losses up to $3,000. If a taxpayer incurs capital losses in excess of $3,000, the capital loss is limited to $3,000, the balance of which can be carried forward to be used against future capital gains. Therefore, when calculating the *Guidelines* income, it is important to confirm the actual capital loss as it may be in excess of the $3,000 claimed on the return. Likewise, it is necessary to ensure that no capital loss carryforwards are included in the capital gains amount.

Taxable US Items Non-Taxable in Canada

There are certain items taxable in the US, which are not taxable in Canada. These include state and local tax refunds and lottery winnings. In calculating the child support, these items should be excluded.

Rental Property

In general, a Canadian taxpayer may claim capital cost allowance on the rental property. However, a loss may not be created or increased by claiming the capital cost allowance. For US tax purposes, depreciation is always claimed even if the property is in a loss position. Therefore, even if the US taxpayer has rental losses, it is necessary to add the depreciation back.

Employment Expenses and Carrying Charges

For US tax purposes, the taxpayer may be limited in a claim for employment expenses or carrying charges if the taxpayer's income exceeds a certain threshold. Therefore, in calculating income for *Guidelines* purposes, the actual employment expenses and carrying charges incurred by the taxpayer should be deducted, not the amount claimed on the US return.

This article has highlighted some of the complexities in cross-border scenarios. In addition to complexity, cross-border situations may also offer income tax advantages due to the differences in taxation of support among different jurisdictions. These situations should always be reviewed by experts experienced in cross-border matters.

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 will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.