

Marmer Penner Inc. Newsletter

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Support Payments – Special Situations II

Lump sum support payments may or may not be taxable to the recipient and deductible to the payor depending on their nature. If taxable, the timing of the income recognition may result in unexpected tax burdens. These issues are discussed below.

LUMP SUM SUPPORT

A lump sum support payment in lieu of future entitlement is non-taxable as it is viewed as capital in nature. A lump sum support payment on account of arrears takes on the attributes of the payments had they been paid on time. Accordingly, if an agreement or order had called for periodic spousal support payments and instead one lump sum paid the arrears thereon, the lump sum is treated as a group of taxable periodic payments all in one taxation year. If a lump sum payment is made on account of child support after April 1997 and relates to pre May 1997 arrears, the amount is taxable if there has yet to occur a commencement date, that is, a date on which the child support payments were varied or agreed to be made non-taxable.

In order to satisfy arrears support, the parties may agree to transfer an asset other than cash. A tax-free RRSP transfer is permitted between spouses to settle rights arising out of the breakdown of a marriage or common law partnership if the transfer is pursuant to an agreement or order and the spouses are living separate and apart. No income is taxed and no deduction is permitted for the transfer of RRSPs if done on this pre-tax basis.

There have been a number of cases where a payor has transferred an interest in the matrimonial home to settle arrears support. Equitably, this should be treated as lump sum support and deductible if a cash payment would otherwise have been deductible. The courts have flip-flopped on this, with the issue being whether a transfer on a house meets the definition of "paid".

TAXATION OF ARREARS SUPPORT

A major problem with the payment of arrears support in a lump sum is related to the timing of the taxation. The tax on \$30,000 of income is about \$5,000. Accordingly, a court may have ordered this level of support to provide the recipient with \$25,000 per year of after tax spousal support. However, if a payor is delinquent for five years, a recipient may be forced to report \$150,000 of taxable support all in one taxation year. This leaves the recipient with less than \$100,000 of after-tax support. As a result, the recipient paid over \$50,000 in income tax instead of \$25,000 (\$5,000 per year for five years). The Department of Finance corrected this inequity in a recent federal budget by allowing the recipient the option of reporting the arrears income either in the year actually received or the year it was originally intended to be paid. The support recipient must elect under the *Income Tax Act* to have CCRA calculate the tax both ways and assess the recipient under the lower tax scenario. The delinquent payor may also face a tax problem if the extraordinarily high payment results in tax deductions at unexpectedly low tax brackets. The delinquent payor gets no pity from the department of finance and cannot make the same type of election.

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.