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Marmer Penner Inc. Newsletter

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Oft Forgotten V-Day Tax Liabilities

A great many liabilities at a valuation date are income tax related. The obvious ones are accrued capital gains or the income tax on wind-up of a business. But the title spouse will be done a disservice if some of these liabilities are omitted:

a) Stub Period Income Tax on 1995 Reserve – The 1995 stub period reserve remains a liability for anyone who was self-employed in 1995 with a non-calendar year end. By April 30, 2005, this liability should become a relic only considered at date of marriage.

b) Income Tax in Excess of Instalments Paid in Year of Separation – Taxpayers whose income in the year of separation exceeds that of the previous year will likely have an income tax liability that exceeds instalments paid.

c) Capital Gains Reserves – The tax on a capital gain can be spread over as many as five years if debt is taken as consideration by the vendor. So, this liability can exist years after an asset is sold.

d) Tax on Wind-Up of Tax Sheltered Partnerships – Most film tax shelters, for example, require a significant repayment of tax about ten years after the initial tax refund.

e) Recaptured Depreciation on Assets That May Not Have Increased in Value – Even if no capital gain is realized, the sale of depreciable property, such as a building, may result in recaptured depreciation which is taxed at higher rates than capital gains.

f) Accrued Gain on Goodwill of Unincorporated Business or Professional Practice – A common example is the goodwill of a dental practice which is taxed at rates akin to capital gains. However, don't forget to consider the tax-reducing impact of a balance in the eligible capital account or a 1994 election to bump up the cost base.

g) GST Liability – For self-employed persons, check the GST return filed after the valuation date to see if a liability may have existed at separation.

h) Tax on Unreported Income – Where a spouse earns unreported income, it may be recommended that a voluntary disclosure be made to Canada Revenue Agency. This may create a liability at the valuation date which reduces the spouse's net family property ("NFP") and may also diminish the likelihood of application of an income tax gross-up in determining income for support purposes.

In most situations, nobody wants to be the bearer of bad news such as having to advise a client about a new-found income tax liability. However, when it comes to preparing an NFP statement, bad news becomes good news and the one who delivers it may be praised not buried!