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Marmer Penner Inc. Newsletter

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Court Sets Aside Separation Agreement For Failure to Account for Reduced Corporate Taxes

In a case decided this year, the Supreme Court of British Columbia set aside a separation agreement where the corporate income tax associated with an asset was later eliminated using provisions under the *Income Tax Act*.

In the case *R.(N.) v. B.(B.)*, 2006 BCSC 595, the spouses entered into a separation agreement where, although all of the assets were disclosed by the spouses, the corporate income taxes related to an asset did not reflect for the availability of the enhanced capital gains deduction that was available to both spouses. The enhanced capital gains exemption is still available on two types of properties:

(1) Qualified farm property; and

(2) Shares of qualified small business corporations.

In this case, the spouses owned equal shares of a company that owned an interest in a dairy farm. The main asset in this company was the milk quota (which is considered capital property subject to capital gains treatment when sold). In the separation agreement, the husband calculated the diminution of value related to the internal tax payable by the company on the ultimate sale of the milk quota by the company. This corporate tax was calculated at $590,000. The parties divided their

assets on the basis of the separation agreement, which included these taxes. On or around the same time that the separation agreement was drafted, the husband's firm of chartered accountants was drafting a tax planning memorandum which suggested how the corporate income tax on the sale of the milk quota could be eliminated by triggering the parties' enhanced capital gains exemption. This enhanced capital gains exemption was in fact triggered following the divorce, after the parties divided their assets. The separation agreement did not include the tax savings associated with this tax planning, which resulted in an understatement of the net worth of the family. Partially as a result of this failure to account for the net tax savings, the separation agreement was found to be unconscionable.

Prior to signing any agreement, lawyers should consider having agreements reviewed by a qualified litigation accountant to ensure that all available tax savings are identified and calculated correctly.

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***.