Vol. 21 No. 4 July 2018

2 Bloor Street West, Suite 2603, Toronto, Ontario M4W 3E2
Telephone: (416) 961-5612 Fax: (416) 961-6158
E-mail: valuators@marmerpenner.com

Marmer Penner Inc. Newsletter

Written by Steve Z. Ranot, CPA, CA•IFA, CBV
Edited by Anna M. Barrett, BSc, CPA, CA, CBV, CFF

Should Excluded Property Impact Net Family Property?

Generally, a gift or inheritance received by one spouse during the marriage and neither co-mingled with other assets or used to repay debts will be excluded property to that spouse to the extent that it can be traced to an asset held at date of separation. And, excluded property should not impact that spouse's net family property, right? Not necessarily. We have seen two situations where gifts or inheritances appear to impact net family property unfairly while remaining excluded. You be the judge.

In one case, the husband had saved about $500,000 in his RRSP while the wife had saved half as much, or about $250,000, during the marriage. Also, during the marriage, the husband inherited shares of a family business worth about $3 million but fully excluded. The wife calculated the contingent income tax on winding up her RRSP based on an expected future average tax rate of 25% on retirement. Conversely, the husband argued that, because of his inherited wealth, he would be taxed at an average rate of 46.41% on retirement. If the $3 million asset is not to be shared, is it fair to consider the related disadvantages, in this case the higher income tax it might create for the purpose of lowering the husband's net family property?

In a second case, the wife inherited shares of an investment holding company worth a few million dollars. The marriage contract excluded these shares as well as the income therefrom which amounted to about

$100,000 in annual dividends to the wife. The wife diligently reinvested these $100,000 annual dividends in the company to facilitate the tracing of this excluded property. Accordingly, after ten years, she had received $1 million in dividends and loaned them back to the company so she owned excluded shares as well as an excluded $1 million shareholder loan to the company. All of the couple's other assets and liabilities were shared. Does this seem fair to you? Every year, the wife received her $100,000 taxable dividend from the excluded corporation and paid about 35% tax thereon, or $35,000/year, from a joint bank account. The after-tax value of each excluded dividend was really just $65,000 ($100,000 less 35% tax) but, somehow, the wife can point to a much higher excluded value for her shareholder loan. Is it fair to let her exclude this higher value? More clearly, is it fair to let this occur when the husband effectively paid half of the $350,000 of income tax it created?

We are unaware of any decisions that have dealt with such issues.