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Marmer Penner Inc. Newsletter

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How New Non-Taxable Spousal Support in the US Affects Canadians

Until the end of 2018, the United States and Canada both generally treated spousal support, referred to as “alimony” south of the 49th, as taxable to the recipient and deductible to the payer and child support as non-taxable and non-deductible. There was an exception if both spouses elected for US tax purposes only to treat the alimony as non-taxable and non-deductible. That spousal support similarity has now changed as a result of the new Tax Cuts and Jobs Act (“TCJA”). This old taxable/deductible treatment continues for alimony payments made under pre-2019 divorce agreements. But for payments made under post-2018 agreements, the rules change. For payments required under divorce or separation instruments that are executed after December 31, 2018, the new law eliminates the deduction for alimony payments. Recipients of these alimony payments will no longer be required to include them in taxable income regardless of any joint election.

This TCJA treatment of alimony payments will apply to payments that are required under divorce or separation instruments that are either executed after December 31, 2018 or modified after that date if the modification specifically states that the TCJA treatment of

alimony payments (non-deductible to the payer and non-taxable to the recipient) now applies.

Now, all of this applies only to US taxpayers. For them, it is either a taxable or non-taxable event for both. The treatment is consistent. But, what happens if one of the parties is a Canadian resident, where spousal support remains taxable and deductible? We were recently asked what happens if the support-payer moves to the US while the recipient remains in Canada? Will there be a situation where the support is paid in after-tax dollars by the US payer but still subject to Canadian tax to the recipient? That would be very problematic.

We checked Article XVIII paragraph 6(b) of the Canada-US Tax Convention because the purpose of tax treaties is to eliminate tax inequities that may arise from cross-border issues. This particular provision states that no support paid in state #1 is taxable in state #2 if it wouldn't be taxable in #1. So, if the US payer is unable to deduct the support in the US, it cannot be taxable to the Canadian recipient. Seems like a simple answer to this new wrinkle.

However, in the course of our research on this new issue, we came across an article by Canadian and US CPAs and tax specialists who wrote (emphasis in italics is ours):

“Alimony payments made pursuant to divorce or separation agreements executed before December 31, 2018 will continue to receive the pre-2017 Act tax treatment. However, if the existing agreement is modified post December 31, 2018, the payments will no longer be deductible by the US payer. Furthermore, it will be important to establish where the “right to alimony” arose when the recipient is a resident of Canada, otherwise the result could be punitive. Subparagraph XVIII(6)(b) provides some relief by excluding alimony payments from

Canadian taxable income, if the right to receive alimony payments arose in the US, i.e., *if the agreement was executed in the US. However, if the separation or divorce agreement was executed in Canada and therefore, the right to receive alimony arose in Canada, the support payments will remain taxable in Canada. If the payer is a US resident, a deduction for alimony payments will not be permitted in the calculation of US taxable income.*”

We see nothing in the tax treaty that relates to where the separation or support agreement was signed. We understand that a payment “arises” where the payer resides not where the piece of paper was signed.

That should calm nerves of cross-border payers and recipients.

Marmer Penner Inc. is pleased to announce that Mr. Patrick Chhen, has joined our firm. Patrick has passed the CPA examination and is completing his work experience requirement to qualify as a CPA. Patrick has practiced in the areas of accounting, personal and corporate income tax at a GTA accounting firm as well as working at a Fortune 500 company since 2011. Patrick will shortly enrol in the CBV program and his hourly rate is \$145.

This newsletter is not intended to substitute for proper professional planning. It is intended to highlight areas where professional assistance may be required or enough to discuss at the next hoedown. 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.