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Marmer Penner Newsletter

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Child Support Guidelines

With a very short while to go before the new Child Support Guidelines and the new tax rules related thereto take effect, there is still much uncertainty. If one of the two certainties of life is taxes, let's try to get at least that much in order.

Under the proposed legislation, the ability to deduct child support paid and the requirement to include child support received as income ceases for agreements entered into or orders dated after April 30, 1997. Orders and agreements made before May 1, 1997, remain subject to the previous rules permitting deduction and inclusion of the child support amounts. Existing orders and agreements can be made subject to the new rules by filing an election which can take effect *any* time after April 30, 1997. Any variation to an existing agreement or order after April 30, 1997, will be subject to the new rules. Once the terms of a pre-May 1, 1997 agreement are abandoned, in order to opt into the new system, there is no return to the old system of taxation and deduction.

For spouses and former spouses with significantly different marginal rates of taxation, the advantage of taxation and deduction should not be ignored, however, as spousal support remains taxable, any spouse receiving both spousal and child support will already have some taxable income to report and, accordingly, this lessens the impact of potential income-splitting through child support.

For parties who have decided to maintain the status quo, due perhaps to the tax advantages, consideration should be given to reviewing their agreements before May 1, 1997 to ensure it can adapt to changes in circumstances without requiring a variation which would end its nature as a pre-May 1, 1997 agreement. Where existing agreements and orders remain in force, no new tax forms have to be completed.

Where an existing agreement with respect to child support is to remain unchanged, except that both parties elect to opt into the new system whereby the payments become non-taxable and non-deductible, Form T1157 must be completed, signed, and forwarded to Revenue Canada Taxation. The form does not indicate whether it is to be included with next year's personal income return. It appears as if Revenue Canada wishes the forms filed immediately.

Given that the number of payors who are willing to continue to pay the same child support with the deduction no longer available is not so large, this form will not be required as much as Form T1158, which is described below.

Form T1158 is for those orders and agreements entered into after April 30, 1997, with some spousal support element. If an agreement or order calls for child support only, no form is required. Form T1158 is also to be completed for agreements or orders pre-dating May 1, 1997, where the agreement calls for both spousal and child support and the new tax rules apply because the child support is either increased or decreased after April 30, 1997, or the order or agreement calls for the child support to become non-taxable at *any* time after April 30, 1997.

Where either Form T1157 or T1158 is required, it should be completed and signed (where necessary) at the time of signing the written agreement, as are other tax agreements such as the agreement to cease attribution of capital gains between spouses, and the designation of a property as a principal residence.

It should be noted that agreements can be made prior to May 1, 1997, to permit child support to remain taxable to the recipient and deductible to the payor, until any particular time after April 30, 1997, and thereafter it shall commence to be paid and received as child support on a non-taxable basis. Such an agreement may be prudent where for, say, 1997 and 1998 the payor is expected to be taxed at a higher marginal rate than the recipient. If it is expected that in 1999 the situation will reverse and remain as such, the agreement can include the election to opt into the new system after December 31, 1998, or, the two parties may decide to wait until that time and vary the agreement, thus automatically falling under the new rules.

Where support payments for a spouse and child(ren) are made pursuant to a court order or written agreement that does not clearly indicate a separate amount for spousal support, the whole amount will be treated as child support. While most final orders distinguish between the two, many interim orders do not and this may require adjustment before May 1, 1997, to maintain any tax advantages.

Where support payments are made to third parties, such as mortgage payments, they may be treated as taxable and deductible if the provisions of subsection 56.1(2) and subsection 60.1(2) of the *Income Tax Act* ("the Act") are followed. Where these third party payments are not specifically identified in the agreement or order, as pertaining to spousal support, they will be deemed to be child support. It is unclear how payments such as mortgage payments on a home for a spouse and children are to be allocated, if at all, between spousal and child support, but it is known that in the absence of any allocation, all is considered child support.

One positive aspect to the new rules is that where a payor is in arrears with respect to both spousal and child support, the payments made are deemed first to be

applied to child support. Accordingly, this minimizes the tax burden to the recipient and the tax savings to the payor until the arrears are paid.

Payors and recipients of child support should consider that the change to non-taxable child support will affect both party's taxable income and net income. The effect of the change to taxable income should be clearly understood by all. However, the hidden effects of the changes to net income include possible benefits to the recipient with respect to eligibility for:

- GST credits
- Ontario tax credits
- Child tax benefits
- Guaranteed Income Supplement
- Claiming medical expenses

Conversely, earned income for RRSP purposes is reduced for the recipient as taxable child support is a component in calculating this amount.

Payors of child support with shared custody of children were in the past denied the ability to claim the equivalent to spouse credit as support could not be claimed for a dependent for whom this credit was also claimed. Where the child support is non-deductible, the payor in this situation is no longer restricted from claiming this credit worth almost $1,400 in tax savings.

Does this mean that after April 30, 1997, all options with respect to making child support taxable expire? Not necessarily. Rumours have been circulating that some sort of window exists to extend the old rules to December 31, 1998. This window to the end of the next calendar year brings to mind the provisions of subsection 56.1(3) and 60.1(3) of the Act. The provisions allow payments of support paid prior to the signing of a written agreement or making of an order to be deemed to have been made pursuant to that agreement for payments made in the year of the agreement or order, or in the previous calendar year. Under proposed amendments to 56.1(3) and 60.1(3), where these provisions apply, the agreement or order is deemed to have been made at the time of the first payment included as support. Accordingly, an agreement or order dated as late as December 31, 1998 can be deemed to be dated pre-May 1, 1997. Remember that for this extension to apply, actual support payments must have been made before May 1, 1997.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper tax planning. The professionals at Marmer Penner will be pleased to assist you with any matters that arise.