

# Marmer Penner Newsletter

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## Child Support - It Can Still Be Made Deductible!

With the passing of the April 30, 1997 deadline, we have entered the new era of non-deductible/non-taxable child support. As most readers are aware, the new rules affect written agreements and orders made after April 30, 1997. Those predating May 1997 remain taxable and deductible to the recipient and the payor respectively if the two parties do not vary the terms or make any elections to alter the taxable nature of these payments. Does this mean all agreements entered into after April 1997 must automatically be governed by the new rules which came into effect on May 1, 1997?

The last paragraph of our April 1997 newsletter refers to the window of opportunity open until December 31, 1998. This window exists as a result of amendments made to subsections 56.1(3) and 60.1(3) of the Income Tax Act. As a result of the numerous requests we have received for further clarification, we are following up with a more detailed explanation.

Prior to the amendments made as a result of the 1996 Federal Budget, subsections 56.1(3) and 60.1(3) provided for the inclusion in income and deductibility of "prior

payments" of support. The subsections permitted the written agreement or order to consider prior payments made in the year of the agreement or order and the previous calendar year to have been made pursuant to said agreement or order, thus permitting retroactive taxability/deductibility of these amounts that were actually paid in the past.

As a result of the 1996 Federal Budget which contained the revised tax rules regarding child support, each of subsections 56.1(3) and 60.1(3) have been amended with a paragraph (b) such that where these provisions apply

to prior payments the “agreement or order is deemed...to have been made

The significance of this amendment is that the new child support rules do not affect agreements or orders entered into prior to May, 1997. The new deeming provision contained in 56.1(3)(b) and 60.1(3)(b) permits the agreements or orders to have been entered into at the time of a payment prior to May 1997 when the parties were separated.

Since the prior period can extend back to the previous calendar year, the window to travel back to pre-May 1997 is open until December 31, 1998.

Let us consider an example:

*Frank and Kathie Lee separated in March, 1997. As Kathie Lee maintained custody of their child, Cody, Frank commenced paying informal child support prior to May, 1997. In November 1998, Frank and Kathie Lee agreed to sign an agreement providing for monthly child*

*on the day on which the first such amount was paid”.*

*support of \$3,000. As Frank is a high-rate taxpayer and Kathie Lee has little other taxable income, it is tax advantageous to have the child support both taxable to Kathie Lee and deductible to Frank.*

*As a result of the operations of paragraphs 56.1(3)(b) and 60.1(3)(b), it is not too late to gain this tax advantage. As the first payment was made prior to May 1997, the agreement can include this amount as a prior payment paid pursuant to the written agreement thus allowing the entire agreement to be deemed to have been entered into prior to May 1997. As a result, all of the subsequent child support payments are subject to the child support tax rules in effect prior to May 1997.*

It should be further noted that periodic child support per se does not have to be paid prior to May 1997 for this window to be open. Subsections 56.1(2) and 60.1(2) permit

third party payments in certain circumstances to be considered an allowance payable on a periodic basis. Accordingly, even if Frank had not paid any child support prior to May 1997 but instead paid for Cody's tuition in April 1997, the combination of all of the above subsections can be used to achieve an agreement deemed to have been entered into prior to May 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.*