

# Tax Consequences in Family Law

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## Introduction

Most lawyers hold the opinion that tax law is a complex area best left to accountants and those in our profession brave enough to become tax lawyers. While it is ALWAYS a good idea to defer to an expert in taxation when issues arise, family law practitioners need to have a basic understanding how the *Income Tax Act* affects their clients.

The issues that arise upon the breakdown of a marriage or common-law partnership are complicated, and may at times seem overwhelming to our clients. The tax consequences that arise upon the breakdown of a marriage or common-law partnership are even more complicated, and may seem overwhelming to the lawyers hired to assist their clients navigating through this area of law!

The concepts of fairness and equity pervade family law. As the late Justice John Sopinka of the Supreme Court of Canada said: “Fairness and Equity have nothing to do with tax law”. So how do family law practitioners reconcile family law and tax law issues in a fair and equitable manner in the best interests of their clients? They start with a basic understanding how the provisions of the *Income Tax Act* Chapter 1 (5<sup>th</sup> Supp.), R.S.C. 1985, as amended, impact any resolutions or orders regarding property and support.

This paper is not intended to be a complete index of the tax issues in family law, nor is it a complete review of all the relevant case law in this area. There is simply too much case law regarding interpretations of the Act, and its application to various family law issues that can arise to include a thorough review of every case. Further research should be completed when specific tax issues arise in relation to a specific file.

I would like to take this opportunity to thank Richard Olsen, of Olsen Joly LLP Chartered Accountants, in Red Deer, for his invaluable assistance with this paper.

# General Matters

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There are several concepts that are used throughout this paper. The following is an explanation of the terms as they are used in this paper and defined in the *Income Tax Act* Chapter 1 (5<sup>th</sup> Supp.), R.S.C. 1985, as amended, “*An Act respecting Income Taxes*” (the “Act”). Unless otherwise stated, all section references to this paper refer to the Act.

From the perspective of the Canada Revenue Agency (“CRA”), and the purposes of this paper, the following terms have these meanings:

“**Child care expense**” (s. 63) means an expense incurred for services rendered in a taxation year for the purpose of providing child care services for any eligible child of a taxpayer if the services were provided to enable the taxpayer or a supporting person of the child for the year:

- to perform the duties of an office or employment;
- to carry on a business either alone or as a partner actively engaged in the business;
- to carry on research or any similar work for which the taxpayer or supporting person received a grant; or
- to attend a secondary school or designated educational institution where the taxpayer is enrolled in a full-time or part-time educational program.

“**Common-law Partner**” (s. 248(1)) with respect to a taxpayer at any time, means a person who cohabits at that time in a conjugal relationship with the taxpayer and

(a) has so cohabited with the taxpayer for a continuous period of at least one year, or

(b) would be the parent of a child of whom the taxpayer is a parent, if the Act were read without reference to paragraphs 252(1)(c) and (e) and subparagraph 252(2)(a)(iii),

and for the purposes of this definition, where at any time the taxpayer and the person cohabit in a conjugal relationship, they are, at any particular time after that time, deemed to be cohabiting in a conjugal relationship unless they were not cohabiting at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship.

“**Dependant**” (118(6)), for the purposes of paragraphs (d) and (e) of the description of B in subsection 118(1) and paragraph 118(4)(e), means a person who at any time in the year is dependent on an individual for support in a taxation year and is

(a) the child or grandchild of the individual or of the individual’s spouse or common-law partner; or

(b) the parent, grandparent, brother, sister, uncle, aunt, niece or nephew, if resident in Canada at any time in the year, of the individual or of the individual’s spouse or common-law partner.

“**Order**” is a decree, order, or judgment from a competent tribunal.

**“Separation Agreement” (s. 248(1))** includes an agreement by which a person agrees to make payments on a periodic basis for the maintenance of a former spouse or common-law partner, children of the marriage or common-law partnership or both the former spouse or common-law partner and children of the marriage or common-law partnership, after the marriage or common-law partnership has been dissolved, whether the agreement was made before or after the marriage or common-law partnership was dissolved.

**“Spouse” and “Former Spouse” (s. 252(3))**, has its ordinary meaning of an individual who is the legally married to another, and in addition, for the purposes of paragraph 56(1)(b), section 56.1, paragraphs 60(b) and (j), section 60.1, subsections 70(6) and (6.1), 73(1) and (5) and 104(4), (5.1) and (5.4), the definition "pre-1972 spousal trust" in subsection 108(1), subsection 146(16), the definition "survivor" in subsection 146.2(1), subparagraph 146.3(2)(f)(iv), subsections 146.3(14), 147(19), 147.3(5) and (7) and 148(8.1) and (8.2), the definition "small business property" in subsection 206(1), the definition "qualifying transfer" in subsection 207.01(1), subparagraph 210(c)(ii) and subsections 248(22) and (23), means the “spouse” and “former spouse” of a particular individual and shall include another individual who is a party to a void or voidable marriage with the particular individual.

**“Support Amount” (s. 56.1(4))** means an amount payable or receivable as an allowance on a periodic basis for the maintenance of the recipient, children of the recipient or both the recipient and children of the recipient, if the recipient has discretion as to the use of the amount, and

(a) the recipient is the spouse or former spouse of the payer, the recipient and payer are living separate and apart because of the breakdown of their marriage and the amount is receivable under an order of a competent tribunal or under a written agreement; or

(b) the payer is a natural parent of a child of the recipient and the amount is receivable under an order made by a competent tribunal in accordance with the laws of a province.

**“Supporting Person” (s. 63(3))** means an individual who resided with the taxpayer at any time during the year and at any time within 60 days after the end of the year and who is:

- the child’s parent (paragraph 252(2)(a) provides an extended meaning of parent for the purposes of the Act);
- the taxpayer’s spouse or common-law partner; or
- any other individual who claimed a tax credit under section 118 for the child for the year.

Any references to an “Agreement” in this paper include a Separation Agreement, Minutes of Settlement, a Divorce and Property Contract, or any other written agreement that involves the resolution of support and/or property division issues.

It is important to note that the majority of references to spouses in the Act include common-law partners. However, a legal marriage has three phases: married, separated, and divorced; while a common-law relationship has only two phases: common-law or not common-law. While the termination of a marriage involves the decree nisi, the termination of a common-law relationship only requires a cessation of cohabitation for a period of at least 90 days. This distinction is most important with respect to certain tax planning options that are time sensitive.