Support Issues with Backlash:

Sometimes Misunderstood Tax Implications of Support Awards

Presented at the National Family Law Conference in
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Introduction:

Frequently in the family law area, support issues are resolved without regard for the tax implications of the arrangements that have been made, or with a misunderstanding of those implications. The desired, expected or agreed upon outcome may not be achieved if it contravenes the provisions of the *Income Tax Act (ITA)*. Without a general understanding of the relevant provisions of the *ITA*, including deductions, credits, benefits and subsidies, the parties to the support award (child, spousal, or both) may be disappointed to find that they did not get what they bargained for. Their counsel may have liability issues to address and the Court may inadvertently make Orders with unintended results.

For most spouses, the bottom line is what they will have left in their pockets at the end of the day after the payment or receipt of support. Our tax system plays a very large part in determining how much that will be. Most realize that tax law has an impact on spousal support in terms of the net amount one spouse will receive or the other spouse will pay, due in large part to the income tax inclusion and deduction rules that apply to most spousal support payments. The interrelated effects of other components, such as benefits and subsidies, appear not to be as well understood.

With respect to child support under the *Federal Child Support Guidelines* (Guidelines) and the provincial and territorial counterparts, the income tax inclusion and deduction rules no longer apply so there is often a misconception that this support will not be affected by tax issues. While tax does not have the same direct effect on the net amount of support retained by the recipient, nonetheless, the *ITA* does have a significant impact on the necessary calculations. For example:

- The definitions of income in the Guidelines use the *ITA* as a starting point.
- Many of the adjustments to income in Schedule III of the Guidelines are taken from the *ITA*.
- Child support related to special expenses in Section 7 of the Guidelines must be calculated net of tax and benefit considerations.
- The calculation of household income ratios in Schedule II of the Guidelines requires the incorporation of actual taxes payable.
- Where income is imputed from cash based sources, a backwards tax calculation may be necessary to determine a reasonable pre-tax equivalent.

All of these areas are affected by current tax laws.

Limitations and Constraints:

Tax can be very complex. This paper will cover selected tax areas and is intended to provide insight into certain issues only. In any particular case, many more areas may be involved or greater detail may be required, and researching the actual section(s) in the *ITA* is recommended. To reference sections, the same is readily available through links from the Canada Revenue Agency's (CRA) website, even though the *ITA* is not the most user friendly document to read. This website also provides interpretation bulletins and information circulars outlining CRA's policies on a variety of tax issues. Information is also available by contacting CRA, although CRA is not bound by any opinions that it gives, unless they are in the form of an advance tax ruling. Advance tax rulings may only be obtained for situations that are anticipated, but have not yet happened, and the rulings are only binding on CRA to the extent that the facts of the situation have not changed from those for which the ruling was made. If you are in doubt about the tax implications of a situation, then it may be well worth your while to consult a tax specialist, or have your client do so directly. This would not only be for your client's sake, but also in relation to potential liability for you if your client's expectations regarding benefits or net dollars do not match reality due to a misunderstanding of the tax treatments.

Tools, such as computer software programs, are available to aid in the calculation of both child and spousal support. But one should not be lulled into complacency by the use of these tools or assume that the software will some how "take care" of the tax complexities. Software cannot read minds; it can only do what it is told to do. A software program will either have input fields for the required tax parameters, such as indicating whether a spouse is remarried or living common law, or it will make an assumption that will deal with the issue. Either way it is critical that the software user understand the effect of the tax treatment on the calculations being made. In the first instance, the user must know how to answer the questions or set the tax parameters in the program for each case that is done. In the second instance the user must know what assumptions the program is making (e.g.: all spouses are single) in order to know whether the results may be relied upon. If assumptions are involved and even identified, it is still necessary to know how those assumptions may be affecting the results. None of this is possible without a basic understanding of the potential tax issues. How does the user know if the right or complete data has been entered into the software program if the user doesn't understand what is required to begin with? How does the user know that the software has produced the appropriate answer if there is no understanding of what is involved? Regardless of who inputs the data, how can a decision based on the computer output be made if the decision-maker does not know what data was input or what assumptions were made? And how can the results of the calculations possibly be explained to anyone else – the client, opposing counsel, or the Court?

Tax rules and amounts change regularly. Software that calculates tax effects must be updated to stay abreast of these changes. Regardless of the tools used, it is important that they be current.

Does this mean everyone has to be a "tax expert" in order to calculate child support or effectively analyze spousal support alternatives? No. But the results, and their potential limitations, will not be understood if there isn't at least a basic understanding of the necessary input. Further, the right questions will not be asked to obtain the information needed to do the calculations or analysis if there is no understanding of the basic, potential tax parameters.

The tax courts have made it very clear that misunderstanding the provisions of the *ITA* does not give anyone the ability to vary from or circumvent those provisions. Parties cannot agree that a certain party will claim the eligible dependent credit or collect the Child Tax Benefit if that party does not qualify under the appropriate legislation. Regardless of what an order from a family court says, provisions which conflict with the *ITA* can not be enforced. This fact is clearly expressed in any number of tax court cases. As an example, Tardif J., in Clark vs MHR [Tax Court of Canada, January 18, 2002, Docket: 2000-3983 (IT)], says at paragraph 14:

> "An agreement, no matter how clear, has no effect against the Minister if it contains provisions contrary to the *Act's* provisions; in other words, an agreement that binds the signatories does not bind the Minister against whom it cannot be raised. In the case at bar, although the appellant's former spouse waived rights under the *Act* through an agreement, this had no effect on the Minister's obligation to pay him all the benefits resulting from the *Act*. The Minister could not ignore or disregard reality…."

Spousal Support:

Currently there is no fixed formula for the determination of spousal support. Depending upon the circumstances, roles, and length of the marriage in question, an analysis of disposable incomes (or cash flows) may be considered when setting amounts. Spousal support payments, which fall within the *ITA* definition of "support", will be affected by the income inclusion and deduction rules in Sections 56 and 60 of the *ITA*. This means that anything that affects the individual's income tax position will affect the tax and benefit components of the disposable income analysis. Omissions or errors could produce inaccurate tax results, distort the analysis and lead to unintended results. All of the major tax components discussed later could affect a spousal support analysis. Further, spousal support has an interrelated effect on child support under Section 7 of the Guidelines and on other areas, such as hardship analysis and income imputation. As well, other unconventional payments, as discussed under the heading "Specific purpose and third party payments", such as mortgage payments, will only be awarded the beneficial tax treatment if the Orders are worded to comply with the provisions of the *ITA*.

Child Support:

With the advent of the *Federal Child Support Guidelines* and the corresponding adoption by most of the provinces and territories of those Guidelines, there appears to be a misconception that there is no longer a need to consider the income tax implications when dealing with child support issues and calculations, because the taxation and tax deductibility of child support has been removed from the our tax system. Simplicity was the sales pitch. However, when all the areas of the Guidelines requiring computations are considered, the only amount not directly affected by current tax law is the support amount in Section 3 pursuant to the Guideline tables.

Often the ability to provide equity and fairness under the Guidelines is found in Sections 7 and 10 of the Guidelines, as this is where a child support amount may be "fine tuned" to meet the specific needs of a family. Both these sections require calculations that incorporate extensive tax criteria. In particular, with respect to special expenses, Section 7(3) of the Guidelines states:

> "In determining the amount of an expense referred to in subsection (1), the court must take into account any *subsidies, benefits or income tax deductions or credits relating to the expense*…"

The standards of living test found in Schedule II of the Guidelines, to support a claim of undue hardship under section 10, requires the computation of "actual taxes payable" for each member of the household. Even the determination of income, which is the foundation of all calculations under the Guidelines, *including the table amount*, may require an understanding of tax and tax calculations. How can these requirements be fulfilled if there is no understanding of which tax parameters may affect a particular Section 7 expense, or the extent to which they may change the ratios that open the door to Section 10, or affect the analysis of income?

Tax implications of income determination under the Guidelines:

Under our Canadian tax system, different sources of income are taxed differently. In developing the Guideline tables, the assumption of employment or self-employment income was made. Many of the adjustments to income found in Schedule III of the Guidelines have been taken directly from the *ITA*, complete with the tax act definitions. If the tax terminology and implications are not properly understood, then the correct assessment and reasonable adjustments under the Guidelines may not be made in a particular circumstance. Further, when imputing income under Sections 17, 18, and/or 19, "grossing up" cash-based amounts for deemed tax effects may be required.

Section 7 – Special Expenses:

Due to the direction in Section 7(3) to “take into account any *subsidies, benefits or income tax deductions or credits relating to the expense*”, the fact that tax will have an impact on this area of child support is obvious; however, the type of tax effect is not as clear.

As explained in greater detail under “Tax Deductions vs. Tax Credits”, the *type* of tax effect an expense will have is dependent on whether it creates a tax deduction or a tax credit. The *amount* of the tax effect of an expense is specific to the tax position of the individual who has initially incurred the expense. For example, if the individual’s tax liability is already zero, the addition of a tax *deduction* to the calculation will not have any impact on that tax liability. If the individual has income that is being taxed in one of the higher tax brackets, a tax *deduction* will produce greater tax savings than if that income was only being taxed in the lowest bracket.

Of the six specific types of expenses detailed in section 7(1) of the Guidelines, all have potential tax effects, except 7(1)(f) “extraordinary expenses for extracurricular activities.” The tax effects of the other five areas will be discussed in detail under the headings of the related tax areas as follows:

- Child Care Expenses for 7(1)(a) - child care expenses,
- Medical Expenses for 7(1)(b) - medical and dental insurance premiums and 7(1)(c) - health related expenses,
- Medical Expenses and Donation Credits for 7(1)(d) – extraordinary expenses for primary or secondary school education, and
- Tuition and Education Tax Credit for 7(1)(e) - post secondary education.

Major Tax Areas:

Tax areas of particular concern when dealing with support issues include:

- the concepts of tax deductions and credits, and their effect on support calculations,
- the definition and claim criteria of the "spouse or common-law partner amount" tax credit (formerly the "spousal" or "married" credit),
- the eligibility criteria for receiving the Child Tax Benefit (CTB),
- the definition and claim criteria of the "amount for eligible dependent" (AED) tax credit (formerly the "equivalent to spouse" or "equivalent to married" credit),
- the definition and claim criteria of "child care expenses" for income tax purposes,
- the definition and claim criteria of the "medical expense" tax credit,
- the definition and claim criteria for the "donation" tax credit related to certain primary or secondary school fees,
- the definition and claim criteria of the "tuition and education" tax credit, and
- the definition and claim criteria of "support" for income tax purposes.

Tax Deductions vs. Tax Credits:

Often items that are allowed for tax purposes are described as "deductions" without considering the question: "Deductions from what?" There is a significant difference between tax <u>*deductions*</u> and tax <u>*credits*</u>. In simplified terms, ***tax deductions reduce income*** and therefore reduce the base that the taxes, and perhaps other items such as benefits, are calculated on. For example, the person claiming the deduction may now qualify for a higher amount from a particular subsidy or benefit program. Further, the <u>*type of income*</u> that a deduction is applied to may be very important in determining the overall effect of the deduction. Remember, "income" is not a generic term. There are *many* *different definitions of income* and it is important to know which one is used for a particular purpose.

If someone says "My "income is $50,000" he or she may be referring to any one of a number of definitions of "income", such as:

1. Income for purposes of the table amount in Section 3 of the Guidelines,
2. Income for purposes of Section 7 of the Guidelines,
3. Income described as "total *income* per line 150 of a personal income tax return",
4. Income described as "net *income* for income tax purposes",
5. Income described as "taxable *income* for income tax purposes",
6. Income that is equivalent to available cash (i.e.: disposable *income*), or
7. Income under some other definition.

Each one of these types of "income" is significantly different from the others and is used in a specific way in support calculations. For example, the definition of "total *income* per line 150 of a personal income tax return" is not the same as "*income* for purposes of the table amount in Section 3 of the Guidelines" because it does not include the adjustments under Schedule III of the Guidelines, nor does it include amounts imputed or adjusted pursuant to Sections 17, 18, or 19 of the Guidelines. Are there instances where the amounts (after applying the definitions) are the same? Certainly. Income for purposes of determining the Guideline table amount may be the same amount as total income per line 150 if all the other adjustments required by the Guidelines are zero. Can it be assumed that they will always be the same? Absolutely not. How tax parameters will affect "income" will depend entirely on which definition of "income" is being used.

With regard to tax considerations and support calculations, tax deductions may reduce either "total income" (definition #3, above) in determining "net income" (definition #4, above) or "net income" in determining "taxable income" (definition #5, above). For example, "child care expenses" under Section 7 of the

Guidelines may create a tax deduction that would reduce "total income" in determining "net income." Spousal support paid may also be a tax deduction that has the same effect. This is significant as the definition of "net income for tax purposes" often governs the amounts to be dispersed through our various social programs such as the CTB, the GST credit, and provincial components to the CTB initiative. Therefore, tax deductions that reduce total income in determining net income often increase the amount received from these social programs. In so far as the calculation of child support is concerned, this has a direct bearing on the application of the Section 7(3) directive to take into account any subsidies and benefits. Tax deductions that reduce <u>net</u> income in determining <u>taxable</u> income would not have an effect on the amounts received from these social programs at all, unless the program specifically included consideration of the deduction in the benefit calculation.

In contrast to tax deductions, ***tax credits do not change "income"*** amounts. They only offset taxes otherwise payable and in some cases may produce a refund. Therefore, the effect of a tax credit is generally limited to income tax savings without the added benefit of an increase in amounts from subsidy or benefit programs. Items such as medical expenses or post secondary tuition costs do not reduce total income, net income, or taxable income, and will not change the amount received from a particular social program, unless the program is designed to factor in the tax credit. However, tax credits may change the ultimate amount of tax owing, but normally the balance owing cannot fall below zero, unless the particular tax credit is refundable. For example, the federal refundable medical credit may produce a refund over and above reducing income taxes owing to zero.

Eligibility to Claim:

Section 7(3) of the Guidelines states that the courts must take into account

> "…any ***eligibility to claim*** a subsidy, benefit or income tax deduction or credit relating to the expense" (emphasis added).

How should "eligibility to claim" be interpreted? Does this phrase have a different meaning under the Guidelines than it does for tax purposes? The fact that a certain expense may provide a tax deduction or credit under the *ITA*, does not mean that all taxpayers incurring such an expense are "eligible" to claim the amount for income tax purposes. For example, the fact that an individual paid daycare expenses does not necessarily make him or her "eligible" to claim a tax deduction for that expense if it was incurred so someone else could go out to work. Similarly, if a child care expense is incurred, which would otherwise be "eligible" for a tax deduction, but a receipt is not obtained, clearly, the tax criteria is not met, but does this also mean the "eligibility" criteria is not met for purposes of the child support calculation? As explained later under the heading "Child Care Expenses", to be deductible for tax, child care expenses must be supported by receipts issued by the payee. In "Laviolette v Koe" [[1998] N.W.T.R. 337, [1998] N.W.T.J. No. 42], Vertes J. determined at paragraph 20 that "eligibility to claim" under Section 7(3) of the Guidelines meant:

> "…it is irrelevant if the applicant does not claim the day care expense as a deduction because of the lack of receipts. The ***availability*** of such a deduction must be taken into account. If the respondent is responsible for any portion of this expense, then it must be based on the after-tax cost to the applicant" (emphasis added).

On the other hand, Gass J. in Mundle v Mundle [2001 NSSF 15, 14 R.F.L. (5^{th}) 364, 192 N.S.R. (2d) 297, 599 A.P.R. 297] stated that:

> [12] "…In other words, it would not be fair to apportion the full cost of child care when in reality the full cost is not actually incurred. Conversely where there is no deduction to the claimant, it would not be fair for the

> payor to pay only that portion of after tax cost when in reality the claimant is responsible for the actual full amount of child care costs for their child.
>
> [13] Here I have considered the ***availability*** of the deduction and conclude that there is no deduction available and there is no eligibility to claim the deduction because there are no receipts provided" (emphasis added).

"Availability" in *Laviolette* was not tied to the actual criteria required by the *ITA*; whereas, in *Mundle* it was. The different treatment in caselaw may be rationalized by the notions of choice and reasonability, having regard to the premise, under the Guidelines, that the support amount must be "fair." In *Mundle*, even though the child care provider would not provide receipts, it was determined that this was the best choice of care for the children. This resulted in a lack of "availability" for the tax deduction pursuant to the *ITA* criteria. The payor was thus required to pay his proportionate share of the actual cost incurred by the recipient spouse. In other cases, however, the Court has found that there was *potential "availability"* that could be realized by the support recipient if he/she elected to obtain receipts. The choice not to obtain receipts was not reasonable in the particular circumstances. Thus, for purposes of determining the additional amount of child support, the amount was calculated as though the availability was realized. It is therefore important that the necessary enquiries be made to determine whether there is *actual availability* for tax purposes and if not, why not. Is it due to the choice of the recipient spouse or a condition imposed by the child care provider? While this unrealized potential can make a difference to the Guideline child support, the decision in a support analysis will not change the reality of the tax outcome. If there is no receipt there will be no tax deduction.

If an amount is characterized as a "reimbursement" and tax law precludes a claim for a reimbursed amount (as it does in virtually all circumstances), the individual is not "eligible" to claim that portion of the amount for tax purposes, and it, arguably, should not be included in the tax impact for Guidelines purposes either. Even establishing "eligibility" does not necessarily determine the amount of the tax effect. In tax calculations the sum of the parts may be greater than the whole. Individuals may have many credits and deductions available to them, but may only be able to use a portion of them due to their income levels.

Spouse or Common-law Partner Amount:

In a support situation, the fact that one or both of the parties is remarried or living in a common-law relationship may impact the income tax and benefits calculations. If the quantum of spousal support is based on an assumed after tax amount, calculated as if the recipient was single, the actual after tax amount may be different if the recipient is considered to have a spouse for tax purposes. For example, where the person had a child, the fact that he or she now had a common-law spouse would preclude the ability to shelter income with the "amount for eligible dependent" tax credit (discussed later) and result in a larger portion of the spousal support being taxed; thus less being retained on an after tax basis. With respect to child support, having a spouse will not change the table amount of support under Section 3 of the Guidelines unless it changes the analysis of income, but it could change the results of the net amount of Section 7 expenses, or the household income ratio in an undue hardship argument. It could even change the result that would be determined where a cash-based source of income was grossed up to a pre-tax amount.

The fact that an individual is remarried or living common-law may also affect support analysis and calculations through the impact this situation has on the eligibility to receive benefits, such as the GST credit or the CTB and related provincial/territorial programs. The income limitations in most social programs are based on a concept of "family net income." In addition to increased taxes, thousands of dollars may be foregone because the individual no longer qualifies for benefits that would have been available had he or she been single. For example, a single parent earning less than $22,000 per year, with one child, will receive approximately $2,958 from the CTB program in 2004/2005 ($4,611 if the child is disabled) and the amount will increase if there are more children. When a new spouse's income is considered in the determination of "family net income", the entitlement may quickly drop. If this is not considered in support calculations, outcomes may be misleading. For example, disposable income may be overstated in a spousal support analysis where the party would receive more CTB if there were no new spouse. In a child support calculation, where the new spouse has income, the net tax effects in Section 7 applied to child care expenses may be wrong because the individual now receives fewer benefits and has less tax-sheltered income due to the new spouse.

Where there is a new spouse, there may be the potential for claiming the "spouse or common-law partner amount" for tax purposes. This claim:

- would reduce the tax amount used in the analysis of disposable incomes for spousal support consideration,
- would change the household income ratio determined under Schedule II of the Guidelines by reducing the tax amount used. This is in addition to the change in household composition used in that calculation, and
- could change the tax effect of special expenses, such as child care, medical, or post-secondary expenses, in the calculation of child support under Section 7 of the Guidelines.

The criteria for claiming the "spouse or common-law partner amount" is found in Section 118(1)(a) of the *ITA* under the heading "married status." It is a non-refundable tax credit available to a taxpayer who, <u>at any time in the year</u>:

(a) is married or in a common-law partnership,

(b) supports the spouse or common-law partner, and

(c) is not living separate and apart from the spouse or common-law partner by reason of a breakdown in their relationship.

The spouse or common-law partner must have "net income for tax purposes" (for 2004) of $7,484 (or less) for federal tax purposes, as the maximum credit is $6,803 and begins to be reduced when "net income for tax purposes" is greater than $680. The income level for the corresponding provincial or territorial credit varies depending on the province or territory. This credit is subject to indexation federally and in most provinces and territories, so the amount of income it may shelter from tax is increasing each year. For 2004, the provincial/territorial credit ranges from $6,055 for Newfoundland and Labrador to $14,337 for Alberta.

What constitutes a "common-law partnership" may vary depending on the legislation being applied. For income tax purposes, "common-law partner" is defined in Section 248(1) of the *ITA* and means a person who:

(a) <u>cohabits</u> at that time <u>in a conjugal relationship</u> with the taxpayer, **<u>and</u>**

(b) has so <u>cohabited</u> with the taxpayer for a <u>continuous period of at least one year</u>, **<u>or</u>**

(c) would be the <u>parent of a child of whom the taxpayer is a parent</u>.

In order to end a common-law partnership for tax purposes, once it is established per the rules above, the taxpayer and person must be living separate and apart for a period of at least 90 days, including the time in question, because of a breakdown in their conjugal relationship. In applying the definition of "common-law partnership" it is important to note that the *ITA* has the benefit of hindsight, whereas the Guidelines operate on a prospective basis.

Child Tax Benefit:

The CTB is a government program designed to assist low and low-middle income families with the cost of raising children. It provides tax free benefits based on family size and income levels. CRA issues an excellent guide called "Your Canada Child Tax Benefit" (T441), which outlines the federal and many of the related provincial and territorial programs. The federal portion of the program has three components:

- the basic benefit,
- the National Child Benefit Supplement (NCBS), and
- the Child Disability Benefit (CDB).

The last component is the most recent change and is available for "qualified dependants" (as defined below) for whom a disability credit may be claimed. It is effective as of July 2003 and payments were to have begun by March 2004.

In situations where the child(ren) reside primarily with one parent, the ability for one party to meet the CTB eligibility criteria discussed below is relatively straight forward. However, in a growing number of cases, the Court is awarding, or parties are agreeing to, a ***shared*** arrangement with time and responsibility falling equally on both parents. Unfortunately, the eligibility criteria for receiving the CTB and related programs does not easily accommodate shared parenting arrangements. Administratively, it is CRA's position that true "equality" rarely exists when it comes to parenting situations, and on balance, one parent expends more than the other parent with respect to the factors listed in point (c) below.

In support calculations, CTB may affect any analysis of disposable incomes and will impact the calculation of net child care expenses used in determining Section 7 child support. However, there will be no affect on the household income ratios per Schedule II of the Guidelines because that calculation does not include any consideration of benefits and subsidies.

The following summarizes the criteria that must be met to receive the CTB:

(a) the person must be an "eligible individual" as defined by Section 122.6 of the *ITA*, which means all of the following conditions must apply:

- the person must reside with the "qualified dependant" (referred to hereafter as "child" for simplicity). "Qualified dependant" is also defined by Section 122.6 of the *ITA* and will be discussed later.
- the person must be the parent that primarily fulfils the responsibility for the care and upbringing of the child. Note the presumption described in (b) below.
- the person must be resident in Canada or establish sufficient residential ties to Canada to be considered a resident. Employees, their families and servants, of another country who reside in Canada are specifically excluded.
- the person or the person's spouse or common-law partner must be:
  (i) a Canadian citizen;
  (ii) a "permanent resident" per the *Immigration and Refugee Protection Act (IRPA)*;
  (iii) a "protected person", per the *IRPA*; or
  (iv) a "temporary resident", per the *IRPA,* who has live in Canada throughout the last 18 months.

(b) where the child resides with the female parent, the female parent is presumed to fulfill the responsibility for the care and upbringing of the child. This is not mentioned in the CRA guide, but is in the definition of "eligible individual."

(c) Regulation 6302 of the *ITA* lists the factors that constitutes "care and upbringing" as follows:

- the supervision of the daily activities and needs of the child,
- the maintenance of a secure environment in which the child resides,
- facilitating medical care for the child on a regular basis and as required,
- facilitating educational, recreational, athletic or similar activities for the child,
- attending to the hygienic needs of the child on a regular basis,

- providing guidance and companionship to the child on a general basis, and lastly
- the existence of a court order in respect of the child that is valid in the jurisdiction in which the child resides.

(d) per Regulation 6301 of the *ITA*, the presumption in (b) above **does not** apply where:

- the female parent declares in writing to the Minister that the male parent fulfills the responsibility for the care and upbringing of the child,
- the female parent, is herself a “qualified dependant” of an “eligible individual” and both file notices with the Minister with respect to the same child,
- there is more than one female parent of the child who resides with the child and each files a notice with the Minister with respect to the same child, or
- more than one notice is filed with the Minister with respect to the same child and each person who filed lives at a different location than the others who filed.

Where more than one (otherwise qualifying) person applies for the CTB for the same child, the Minister will determine the “eligible individual” based on an assessment of the factors described in (c) above. Given the factors, there are rarely any circumstances where more than one person meets the criteria to the same degree. For example, often only one of the parties has a job or lifestyle that allows for tending to the child at a moment’s notice.

(e) a “qualified dependant” is defined as:

- a person under 18 years of age,
- whose spouse, if there is one, has not claimed the “married” credit, and
- is not a person for whom a special allowance is payable under the *Children’s Special Allowances Act*.

In situations where it is determined that a person has been paid the CTB in error, the legislation considers the person's eligibility status at the beginning of the month or months in question per Section 122.61. Where there is a change in status mid-month, the change would not apply until the beginning of the next month. If the person has become eligible to receive the CTB, he or she has up to eleven months from the end of the month he or she became eligible to notify the Minister. Payments retroactive to the first full month of eligibility will be made. On the other hand, if a person ceases to be eligible, the Minister must be informed by the end of the following month. Unfortunately, when relationships break down and the child moves from one parent to the other, parents often fail to notify the Minister. The issue comes to light when the other parent applies for the CTB and by then a significant amount of overpayment may have accumulated. Because the amounts may be significant there is an incentive for the other parent to apply. Even if the parent, with whom the child is now living, agrees not to apply for the CTB, the first parent no longer qualifies to receive the money.

The amount of the CTB basic entitlement is based on the number of children with supplements for three or more children and for children under the age of 7. The supplement for children under the age of 7 is reduced by 25% of the <u>total</u> child care expenses claimed. This will have a very direct effect on the calculation of net child care expenses under Section 7(1)(a) of the Guidelines, as discussed later. In most provinces and territories the base amount is the same for each child; however, in Alberta, the base amount increases with the child's age.

The NCBS provides decreasing amounts for the first, second and three or more children, in addition to the basic entitlement discussed above. The CDB provides a flat amount per disabled child, which is added to the other two components.

Since the CTB is designed to primarily benefit low income families, all three elements of the entitlement are also reduced at specified income levels. In this regard, the definitions of "adjusted income" and "base taxation year" are important. Under Section 122.6 of the *ITA*, "adjusted income" means the total of all amounts which would be income for the year for the taxpayer or the taxpayer's spouse or common-law partner (as defined previously). Generally this equates to "family net income" and most of the CTB forms and guides refer to it as that. However, Section 3 of the *ITA* discusses income in positive terms and 3(f) deems a negative amount to be zero; therefore, one spouse's loss can not be used to reduce the other spouse's income.

For CTB purposes, the income used in the calculation is determined by the "base taxation year" which creates a lag in the income effect. The "base taxation year" is defined as:

- the taxation year ending on December 31 of the second preceding calendar year, where the benefit entitlement is for any month between January and June, and
- the taxation year ending on December 31 of the preceding calendar year, where the benefit entitlement is for any month between July and December.

Essentially, this results in the income reduction being based on the last filed tax return. For example in 2004 the "base taxation year" for January to June is 2002 and for July to December is 2003. Where a spouse dies or the spouses are living separate and apart for a period of at least 90 days due to a break down in the relationship, the benefit will be recalculated to exclude that spouse's income, upon notification to the Minister.

In terms of the effect of support awards, the amount of CTB entitlement will potentially be reduced by taxable spousal support received and increased by taxable spousal support paid. This is a direct effect of the income reductions being based on "net income" and spousal support being taxable/tax deductible. With respect to child support under the Guidelines, there is an interrelated effect on a claim under Section 7(1)(a) – child care expenses. As discussed later, "child care expense" is a potential tax deduction that reduces net income and may increase an individual's CTB entitlement as a result. Where there are children under the age of 7, this entitlement may be reduced due to the erosion or loss of the supplement for children under age 7, discussed previously. In calculating the Section 7 amount "net of subsidies, benefits…" these factors will come into play and directly affect the amount on which the pro-rata sharing, per Section 7(2) of the Guidelines, is based.

The following chart outlines the maximum CTB amounts for 2004:

	January to June		**July to December**	
Basic Benefit	$ per child		$ per child	
• standard benefit	$1,169.00		$1,208.00	
• supplement for 3 or more	$82.00		$84.00	
• supplement for under 7	$232.00		$239.00	
base income amount		$33,487.00		$35,000.00
reduction for amount over base		2.5% (1 child) 5.0%(> 1 child)		2.0% (1 child) 4.0%(> 1 child)
NCBS				
• first child	$1,463.00		$1,511.00	
• second child	$1,254.00		$1,295.00	
• three or more	$1,176.00		$1,215.00	
base income amount		$21,529.00		$22,615.00
reduction for amount over base		12.2% (1 child) 22.7% (2 children) 32.6% (>2 children)		12.2% (1 child) 22.7% (2 children) 32.5% (>2 children)

CDB				
• standard benefit	$1,600.00		$1,653.00	
base income amount		$33,487.00***		$35,000.00***
reduction for amount over base		12.2% (1 child) 22.7% (2 children) 32.6% (>2 children)		12.2% (1 child) 22.7% (2 children) 32.5% (>2 children)
***The CDB base is determined by the total number of children for whom the CCTB is being received, not just the disabled child(ren). The threshold shown is for families with one child.				

Amount for Eligible Dependent:

The "amount for eligible dependent" (AED) tax credit is one of the most common personal tax components that should be considered in the calculation and analysis of support, as its availability is often triggered by a breakdown of the family relationship. Federally, and in most provinces and territories, it is also one of the largest tax credits. Not only will this credit impact the tax components of support calculations, but the wording of a support order may have a direct impact on an individual's ability to claim the credit.

Per Sections 118(1)(b), 118(4) and 118(5) of the *ITA* this credit is available if <u>all</u> of the following provisions are met:

(a) a claim has not been made for the "spouse or common-law partner amount" by the taxpayer (as discussed above),

(b) the taxpayer, <u>at any time in the year</u>:

- is unmarried and does not live in a common-law partnership, <u>or</u>
- is married or in a common-law partnership but <u>does not</u> support or live with that spouse or common-law partner and is not supported by that spouse or common-law partner.

In other words, the person must be single.

- <u>maintains and lives</u> in a "self-contained domestic establishment" and <u>actually supports, in that establishment</u>, an individual who:
  (i) is resident in Canada, unless it is a child of the taxpayer,
  (ii) is wholly dependent on the taxpayer (and perhaps others) for support,
  (iii) is related to the taxpayer, <u>and</u>
  (iv) is under the age of 18 or dependent by reason of mental or physical infirmity, except in the case of a parent or grandparent of the taxpayer.

(c) the taxpayer <u>may only make one claim</u>, regardless of how many individuals meet the description above.

(d) only one claim per "domestic establishment" is allowed.

(e) only one taxpayer may make a claim for the individual described above.

(f) where more than one taxpayer may be entitled to make a claim for an individual described above, the claim will be denied to all if they cannot agree on which one will make the claim. This means that if there is only one child and both parents meet all the criteria, neither will be able to claim the credit if they cannot agree on who will make the claim.

(g) this credit may not be combined with a claim for the "in-home care of relative" credit or the "infirmed dependent" credit.

(h) this credit may not be claimed if the taxpayer is required to pay "support" (as defined by subsection 56.1(4) of the *ITA* and discussed later) for the individual described above. Note that regardless of whether support is actually paid the fact that there is an Order describing an obligation to pay is enough to disqualify the taxpayer. If the order or agreement creates an "offset" situation, as may be seen in "shared" custody arrangements (per Section 9 of the Guidelines), both parties to the order may be seen as being "required to pay" even though a net payment from one to the other may result. This will effectively prevent either party from claiming the AED for any of the individuals with respect to whom payment is implied. With regard to the tax interpretation of the wording of the order or agreement, such things as details of the offsetting amounts, or the use of the word "net" or similar terminology, may be interpreted as a requirement that both parties are to pay and unintentionally prevent either party from claiming this credit. Only CRA or the tax courts can provide a definitive answer.

The AED amounts are the same as the "spouse or common-law partner amount." To recap, the dependent must have "net income for tax purposes" (for 2004) of $7,484 or less for federal tax purposes, as the maximum credit is also $6,803 and begins to be reduced when "net income for tax purposes" is greater than $680. The income level for the corresponding provincial or territorial credit varies depending on the province or territory and is subject to indexation federally and in most provinces and territories, so the amount of income it may shelter from tax is also rising each year. For 2004, the provincial/territorial credits range from $6,055 for Newfoundland and Labrador to $14,337 for Alberta. When combined with the "basic personal exemption" this credit has a significant tax impact for low income earners, as shown in the Appendix A. Income of at least $14,815 will be sheltered from federal tax. This amount may be more when the tax credits for CPP and EI are added. The amount sheltered from provincial/territorial tax ranges from $13,465 in Newfoundland and Labrador to $28,674 in Alberta.

Child Care Expenses:

For personal tax purposes, child care may be a <u>*tax deduction*</u> that is deducted from "total income" in arriving at "net income for income tax purposes." As noted previously, this means that not only will it have the effect of reducing the income base that income tax is calculated on; it will also reduce the income base for the calculation of certain subsidies and benefits.

In a child support order, an amount may be requested to cover child care expenses per Section 7(1)(a) of the Guidelines, if the expense has been "incurred as a result of the custodial parent's employment, illness, disability or education or training for employment." Since the criteria for claiming a child care expense for personal tax purposes is not the same as that outlined in Section 7, the net amount established by applying 7(3) for the pro-rata sharing in 7(2) may differ significantly depending on who pays the child care expense initially. To claim child expenses for income tax purposes, <u>all</u> of the following criteria found in section 63 of the *ITA* must apply:

(a) the amount claimed <u>must have been paid</u> by the taxpayer or a "supporting person" of the "eligible child." Amounts which are payable but not yet paid do not qualify. Child care expenses paid by employers, corporations, or by family members, other than a "supporting person" as defined in the *ITA*, would likely not qualify for the deduction. "Supporting person" is defined in subsection 63(3) of the *ITA* and means:

- a person, other than the taxpayer, who resided with the taxpayer at any time during the year and at any time within in 60 days after the end of the year, and
- is the parent of the "eligible child",
- the taxpayer's spouse or common-law partner, or
- any other individual who claimed the "eligible child" as an eligible dependent (formerly called equivalent to spouse or equivalent to married).

(b) the amount must be paid, <u>as or on account of</u> "child care expenses". For example, A and B each require child care for C, every other week. If B pays the full amount to the child care provider and A pays B 50% of the amount "on account" of those expenses, A <u>*may*</u> be able to claim a deduction for the amount paid to B, providing all the other required criteria is met.

(c) "Child care expenses" are defined in subsection 63(3) of the *ITA* and <u>must be an expense incurred in the year</u>, in Canada (with a possible exception for those living on the Canada/US border) for child care services to enable the taxpayer or "supporting person" to:

- be employed,
- carry on a business either alone or as an active partner,
- carry on research or any similar work in respect of which a grant is received,
- attend a designated educational institution or secondary school and be enrolled in a program of at least three consecutive weeks duration that requires at least 10 hours per week or 12 hours per month on the course, <u>and</u>

the services must be provided by a resident of Canada (again with a possible exception for those living on the Canada/US border) but not by:

- the child's father or mother,

- a “supporting person” of the taxpayer,
- a person who is under 18 and related to the taxpayer, or
- a person who is claimed as a dependent for tax purposes by the taxpayer or “supporting person.”

(d) the amount must be for child care expenses incurred for <u>services rendered in the year</u>. The amount paid may only be claimed in the taxation year the services were rendered.

(e) the amount must be in respect of an <u>“eligible child”</u> of the taxpayer. Per subsection 63(3) of the *ITA*, this means:

- a child of the taxpayer or the taxpayer’s spouse or common-law partner, or
- a child who is dependent on the taxpayer or the taxpayer’s spouse or common-law partner and whose income does not exceed the basic personal exemption,

if, at any time during the year, the child

  - was under the age of 16, or
  - dependent on the taxpayer or on the taxpayer’s spouse or common-law partner and had a mental or physical infirmity.

(f) the amount <u>has not</u> been deducted by another individual.

(g) the taxpayer <u>is not entitled to a reimbursement</u> or other form of assistance of the amount. If the court order says that A will ***<u>reimburse</u>*** B for A’s proportionate share of the child care expense then the amount paid by A to B may not be claimed by B as part of B’s child care expense tax deduction.

(h) the amount must generally be claimed by the taxpayer or “supporting person” with the <u>lower “earned income”</u>. The specific exceptions to this rule include situations where the lower income earner is a student in attendance at a designated educational institution or secondary school, certified by a medical doctor as incapable of caring for children due to a mental or physical infirmity, or was in prison for at least two weeks during the year. "Earned income" as defined in subsection 63(3) of the *ITA* includes:

- all amounts reported as income from an office or employment, including taxable benefits and tips, and amounts that would otherwise be statutory exemptions, such as employment income earned by a treaty Indian living and working on a reserve,
- exempt income of volunteer emergency personnel,
- amounts allocated under an employees' profit sharing plan and benefits received under a stock option plan,
- disability pensions received under CPP or QPP and other qualifying provincial plans,
- earnings supplements provided under certain Government of Canada sponsored projects, as well as, financial assistance amounts under Part II of the *Employment Insurance Act* and other similar programs, and
- net research grants and the taxable portion of scholarships, bursaries etc.

(i) the payment must be <u>supported with the proper form (T778) and a receipt(s)</u> issued by the payee with the payee's valid social insurance number if the payee is an individual. This means that a person (A) who has "reimbursed" another individual (B) for child care expenses paid by B must still obtain a receipt from B before the being able to claim a tax deduction for the child care expense.

(j) The amount claimed must be the lesser of:

- 2/3 of the claimant's "earned income" for the year,
- the total of the annual child care expense <u>paid</u> in respect of the "eligible child(ren)" of the taxpayer, and
- the annual maximums, defined as "annual child care expense amount" in subsection 63(3) of the *ITA*. These currently are $7,000 for a child age 6 and under, $4,000 for a child age 7 to 16, and $10,000 for a disabled child, regardless of age.

In a child support situation, can the tax effect potentially flow through to the other party? It must be recognized that both parties are receiving a benefit, even though only one party may be entitled to the tax deduction. The other party receives a benefit due to the reduced amount that is used in the calculation of the pro-rata sharing per Section 7(2) of the Guidelines.

Is there potentially a more direct tax effect for the other party? This will depend on whether the result of a calculation under Section 7 of the Guidelines, is considered ***child support*** or a ***reimbursement*** of expenses for tax purposes. The distinction is important. In applying the Guidelines, establishing whether the result is child support or an expense reimbursement is critical in determining the amount of the tax effect, since the reimbursed portion of an expense should not be claimed in determining the tax effect to begin with, as discussed in (f) above. This means that the "reimbursement" must be determined before the tax effect may be calculated, but the tax effect will determine the amount of "reimbursement."

Added to this is the fact that within the concept of pro-rating, as described by the Guidelines, there is an implication of reimbursement. The whole process is often described in terms of calculating the other party's "share" of the expense(s) in question. It is curious, however, that the same confusion does not arise with the application of the table amount, although, there too an obligation to cover living expenses is translated into dollars based on respective income levels. Perhaps this is because the expenses that the table amount is meant to cover, are not specifically identified.

The changes made to the *ITA* with the advent of the Guidelines, Section 60(b) in particular (as detailed later under "Tax deductible support"), make it clear that the intention was to remove the tax deductibility of child support amounts. If the CRA considers amounts calculated under Section 7 of the Guidelines as reimbursements, due to the wording of an Order, it may create unintended tax consequences for the parties involved. Unfortunately, the basis for calculating the other party's support obligation often doesn't meet the tax criteria for a deduction or credit. The end result will often be the denial of some, or all, of the amount to both parties. Taking child care expense as an example, the following would be a potential effect of treating the calculated result as a reimbursement instead of child support:

> A and B are separated and have one child – C. A has C from Friday evening to Monday morning every second weekend. C is with B the rest of the time. A and B both work regular 9 to 5 jobs during the week. C is in daycare during weekdays and B pays 100% of the daycare cost. The child support order provides that A will pay B the appropriate table amount plus A's "share" of child care expense. That "share" was calculated based on the tax effect the child care expense would normally have for B. A feels the additional amount of support (over and above the table amount) constitutes payment of the child care expense and wants to claim the amount as a tax deduction. If A's "share" is a reimbursement, B cannot claim a tax deduction for that portion of the daycare cost, so the amount the A's "share" was calculated on was understated by the tax and benefits breaks that B will not receive. B is not "eligible" to claim a deduction for reimbursed amounts. On the other hand, A will not be able to claim a tax deduction even though the order may imply that A is paying "on account of child care expenses", as A does not meet the rest of the tax criteria, including having C during the work week and paying the amount in order to be able to work, run a business or attend school.

As illustrated, making one party ineligible to claim a tax deduction or benefit does not necessarily transfer that tax deduction or benefit to the other party.

Regardless of the intention of the parties, the wording of the court order may determine how CRA interprets the matter. And while wording may create confusion as to whether an amount is child support or an expense reimbursement, the fact that Section 7(3) of the Guidelines requires a determination of tax effects, only adds to the problem. If the Section 7(2) pro-ration was based on gross amounts, a calculation based on the reimbursement concept would be feasible.

Medical Expenses:

Section 7 of the Guidelines has three separate categories where tax creditable medical expenses may come into play:

- 7(1)(b) medical and dental insurance premiums – private health care insurance premiums may be part of a taxpayer's overall medical claim, as noted above and described in Section 118.2(2)(q) of the *ITA*.
- 7(1)(c) health related expenses – anything in this category that falls within the tax definition of medical expense should qualify,
- 7(1)(d) primary and secondary school fees - certain components of expenses related to primary or secondary schooling for a disabled child may qualify as a tax creditable medical expense.

When considering medical expenses in a child support calculation, it is important that each item being claimed is only claimed in one category, so there is no duplication of expenses. However, when determining the income tax effect it is critical to look at the total qualifying medical expenses of the party because of the nature of the tax calculation. Individual amounts may not produce a credit because they are less than the income threshold (described in (c) of the tax definition below) that must be overcome before a claim is triggered. However, when they are added to the individual's other medical expenses, a tax credit may result. Also, for both Guideline and tax purposes only the amounts net of reimbursement (e.g. from insurance plans) may be claimed.

Under Section 118.2 of the *ITA*, a taxpayer may claim a tax credit for certain medical expenses. The criteria may be summarized as follows:

(a) the amounts must have been incurred in a twelve month period ending in the year, unless the taxpayer died and then the amounts must be claimed within a 24 month period that includes the date of death,

(b) the amounts must be paid, not payable,

(c) the total of the amounts claimed must be greater than 3% of the taxpayer's net income to a maximum prescribed amount; currently $1,813 federally for 2004 and ranging between $1,614 in Newfoundland and Labrador and $1,865 in Alberta. This amount is indexed federally and in most provinces and territories.

(d) unless otherwise provided for in the *ITA*, the payments must be made to a:

- medical practitioner,
- dentist, or
- registered nurse

who is qualified to practice under the laws of the province (or applicable foreign law, if relevant) where the expenses were incurred. This would include licensed pharmacists filling prescriptions issued by one of the above.

(e) the amounts must have been incurred for a "patient" which is defined in Section 118.2(2) as:

- the individual,
- the individual's spouse or common-law partner, or
- the individual's dependant per Section 118(6) as anyone who is dependent on the taxpayer for support at any time in the year and is:
  - (i) the child or grandchild of the individual or the individual's spouse or common-law partner, or
  - (ii) the parent, grandparent, brother, sister, uncle, aunt, niece or nephew of the individual or the individual's spouse or common-law partner, if resident in Canada at any time in the year.

This means that for purposes of the medical claim the dependant does not necessarily have to reside with the taxpayer, only be dependent on the taxpayer for support at some time during the year.

(f) where medical expenses are incurred on behalf of a dependant (other than a spouse or common-law partner) and the dependant has income in excess of the basic personal amount, the <u>total medical expense claim</u>, net of the income threshold, must be reduced. The allowable claim is 68% of the calculated credit, after applying the lowest tax bracket percentage.

(g) the list of acceptable expenses is extensive, including (but not limited to):

- most prescription medications,
- <u>private</u> health care premiums,
- artificial aids such as limbs, wheel chairs, braces, eyes, hearing aids, etc.,
- prescribed diagnostic procedures,
- ambulance charges to or from a hospital,
- reasonable travelling expenses using commercial or private conveyances, if incurred under certain conditions,
- cost, training, and care of an animal to assist a patient who is blind, profoundly deaf, or has a prolonged impairment that markedly restricts the use of the patient's arms or legs,
- amounts for the care and training of a patient at a school institution, or other appropriate place, with the special equipment, facilities or personnel the patient needs, due to the patient's mental or physical handicap. The need must be certified by a qualified person.

When in doubt, the actually wording in the *ITA* in 118.2(2) and information bulletin IT-519R2 (Consolidated) should be checked.

(h) expenses, such as attendant care expenses, cannot be claimed again, if they have been claimed as part of another tax expense.

(i) the portion of an expense that has, <u>or will be</u>, reimbursed cannot be claimed. This again creates a circular calculation problem if amounts determined by Section 7 of the Guidelines are considered to be "reimbursements."

Donation Credit related to Religious Schools:

While qualifying donations, in general, may be included in the calculation of a taxpayer's tax liability and may potentially affect all the areas of a support calculation that are impacted by tax considerations, there is one specific type of donation that may have a direct impact on the calculation of child support under Section 7(1)(d) of the Guidelines. This is the donation credit related to fees paid to

- religious schools, or
- secular schools, with identifiable costs for a religious component of their curriculum

provided the school is a registered Canadian charitable organization as defined in the *ITA*. In these situations, there may be a donation tax credit that directly relates to the amount of primary or secondary school fees being claimed for child support purposes. While the ability to obtain a donation credit for fees paid for religious study is not specifically addressed in the *ITA*, it has been established by case law and a number of income tax bulletins and circulars issued by CRA. These publications imply that religious studies are considered to be charitable in nature; however, in "R. v McBurney", [Federal Court of Appeal, September 25, 1985, D.T.C. 5433], in particular, the Court confirms the Minister's policy, set out in Information Circular 75-23, for calculating the "donation" portion of amounts paid to schools with both religious and academic components in their curriculum. Unless the costs of providing the religious component of the curriculum are segregated in the school's records, only the amount paid in excess of the school's total operating cost per child will be allowed.

Once the fact is established that there is an amount that qualifies as a donation credit, it is calculated in the same manner as any other donation credit. The first

$200 of the total, of <u>all</u> the individual's donations, is credited at the lowest rate of personal tax; currently 16% federally and varying from a low of 4% for Nunavut to a high of 11% for Saskatchewan for 2004. The remainder would be credited at the highest personal tax rate; currently 29% federally and varying from 11.16% for Ontario to 18.02% for Newfoundland and Labrador. Since Alberta has a "flat tax" system, it uses a deemed rate of 12.75% for this credit only.

Tuition and Education Credit:

The rules for the tuition and education tax credit must potentially be considered when either party to a support application is a student, as this credit will affect the individual's tax situation and any consideration of disposable income. The rules are also important in the situation where child support is being sought under Section 7(1)(e) of the Guidelines. First and foremost, it is important to realize that the <u>tax credit belongs to the student</u>, not to the person who may have paid for the education. Unused amounts may be carried forward by the student and not necessarily transferred to any other party. Where a transfer is available, the amount is limited, as discussed below, and the student has the choice as to who will receive the tax credit.

For personal tax purposes, an amount may be claimed for qualifying <u>post</u>-secondary tuition fees. To claim this credit the following must apply:

(a) the student must be enrolled in an educational institution <u>in Canada</u> during the year that is

- a university, college, or other educational institution providing courses at a post-secondary level, or
- certified by the Minister of Human Resources Development to be an educational institution providing courses that will furnish a person with skills, or improve that person's skills, in an occupation. For example, a trade school.

(b) in the case of a university, college etc. the fees must be in respect of courses at a post-secondary level. Where such institutions also provide high-school upgrading or equivalency courses, those courses generally do not qualify.

(c) in the case of a trade school, the student must be 16 years of age or older and the course(s) must provide or improve the student's skills in an occupation.

(d) the fees paid must be paid in respect of the calendar year they are being claimed.

(e) the fees must be in excess of $100 per educational institution.

(f) the fees cannot be claimed if they are reimbursed by the student's employer, unless the reimbursement is included in computing the student's income.

(g) the fees claimed cannot include such items as:

- student association fees,
- property to be acquired, such as books and supplies.

(h) in addition to the tuition credit, an education credit may also be available where the student is enrolled in a qualifying educational program at a designated educational institution.

(i) the education credit is calculated as the number of months of qualifying full or part-time attendance multiplied by the current rate. For 2004, the full-time rate federally is $400 per month and the part-time rate is $120 per month. The related provincial and territorial amounts vary from a low of $200 and $60 for full and part-time, respectively, to a high of $445 and $133.

(j) the unused portion of the current year's tuition and education tax credit may be carried forward by the student for future use, or transferred, at the discretion of the student, to the student's spouse, common-law partner, parent or grandparent, depending on the circumstances. A parent or grandparent is defined by default in the *ITA* through the definition of "child" in Section 252(1) and by the relationships described in Section 252(2).

They include the parent or grandparent of the student's spouse or common-law partner.

(k) the student must use all of the credit possible to eliminate tax before any amount may be transferred to the student's spouse, common-law partner, parent, or grandparent.

(l) if the student's spouse claims the student for purposes of the spousal credit or claims any spousal transfers from the student, transfer of the unused tuition and education tax credit is not available to a parent or grandparent of the student.

(m) amounts that have been carried forward from a previous year may not be transferred.

(n) the amount that may be transferred is the lesser of:

- the unused tuition and education tax credit for the current year, and
- $5,000, federally and in all provinces and territories except Ontario, where the maximum is indexed to $5,562 for 2004.

Applying the effect of this credit in the calculation of the net Section 7 amount effectively reduces the obligation of the other parent to contribute to the child's education through the child support calculation. If the party who paid the education amount initially did not receive any benefit from the tuition and education tax credit, it is debatable whether the other's obligation should be artificially reduced.

Support - defined:

The rules covering "support" receipts and payments are found in Sections 56 and 60 of the *ITA*. Section 56.1(4) specifically defines support as an amount with all of the following characteristics:

(a) it is payable or receivable as an allowance on a periodic basis. "Periodic" means a series of payments, although the frequency may vary.

(b) it is for the maintenance of the recipient (spousal support), children of the recipient (child support), or both.

(c) the recipient has discretion as to the use of the amount. Certain third party payment exceptions are discussed below, and

(d) either

- the recipient is the spouse or common-law partner or former spouse or common-law partner of the payer, and
- the recipient and payer are living separate and apart because of the breakdown of their marriage or common-law partnership, and
- the amount is receivable under an order of a competent tribunal or written agreement,

(e) or

- the payer is the natural parent of the 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.

A “child support amount” is defined under the same section and, simply put, means any “support amount” (as defined above) that is not identified as being solely for the support of the recipient.

Under these definitions, payments made directly to the children will not qualify as “support” amounts, because they are not being paid to the spouse. In addition, lump sum payments that can not be traced back to the “periodic” support amount will not be treated as “support” amounts. Case law and CRA policy has indicated that lump sum payments that may be traced directly to the “periodic” amounts in arrears may be accorded “support” treatment under the *ITA* if they can be shown as merely a timing difference between when the support was owing and when it was paid. For example, A has been ordered to pay B $500 per month in spousal support. A has been delinquent in making the payments and has outstanding arrears of $9,000. A pays B $5,000, reducing the arrears still owing to $4,000. This lump sum payment equates to ten periodic payments and does not change or extinguish A's obligation. As such, the $5,000 payment should qualify as a "support" amount and be taxable to B and deductible to A.

On the other hand, if the amount paid releases the payer from arrears, or extinguishes a future obligation, or both, the payment will not qualify as "support" because it is not being paid for the maintenance and support of the recipient and/or child(ren); it is being paid to release the payer from an obligation.

Specific purpose and third party payments:

Generally, specific purpose and third party payments do not meet the "discretion" criteria discussed in (c) of the support definition above. Sections 56.1(2) and 60.1(2) of the *ITA* operate to deem such payments as being payable to and receivable by the recipient, and deem the recipient to have discretion as to the use of the amounts where the order or written agreement provides that these *ITA* sections will apply. While it is preferable that the order or agreement specifically refers to these sections in order to ensure the desired tax treatment, the tax courts have extended this treatment in cases where the wording of the order or agreement clearly stated that the parties understood the payments would be taxable to the recipient and deductible to the payer. This means that, in a properly worded order, payments made on behalf of the recipient for a mortgage or utilities, would be accorded "support" treatment for tax purposes as if they had been paid directly to the recipient and could be used at his or her discretion. Having said this however, Sections 56.1(2) and 60.1(2) specifically exclude the following:

(a) expenditures on a "self-contained domestic establishment" in which the <u>payer resides</u>,

(b) expenditures on tangible property <u>unless</u> it is on account of the following deductible expenses:

- medical or educational expenses,

- expenses incurred for the maintenance of the dwelling where the recipient resides. This could include property taxes, utilities etc,
- expenditures for the purchase or improvement of the dwelling in which the recipient resides. The maximum deduction is 20% of the original principal that was financed in respect of the expenditures.

Reimbursed or repaid support amounts:

In situations where the “support” amount is reimbursed or repaid under a court order, Section 56.1(2) of the *ITA*, for reimbursements, and Section 60.1(2), for repayments, effectively ensure that the original treatment of the receipt or payment is reversed. If the original support amount was included in income then any repayment may be deducted. If the original support amount was deducted from income then any reimbursement must be included in income.

Taxable support:

The amount of support that must be included in income is determined in Section 56(1) of the *ITA* by the following formula:

A – (B + C)

where:

A is

- the total of all support amounts (as defined above) received after 1996 and before the end of the year, by the taxpayer from a particular person,
- the taxpayer must have been living separate and apart from that person at the time the amount was received.

B is

- the total of all child support amounts that became receivable, by the taxpayer from that person,

- the child support amounts must be <u>receivable under an agreement or order on or after its "commencement day"</u> (as defined below) and before the end of the year, and
- the period of support must have begun on or after its "commencement day."

C is

- the total of all support amounts received by the taxpayer from that person after 1996 and previously included in the taxpayer's income.

Tax deductible support:

The corresponding deduction is found in Section 60(b) of the *ITA* and is calculated by the following formula:

A – (B + C)

where:

A is

- the total of all support amounts (as defined above) <u>paid</u> after 1996 and <u>before the end of the year</u>, by the taxpayer to a particular person,
- the taxpayer must have been <u>living separate and apart</u> from that person <u>at the time the amount was paid</u>.

B is

- the total of all <u>child support</u> amounts that became <u>payable</u>, by the taxpayer to that person,
- the child support amounts must be <u>payable under an agreement or order on or after its "commencement day"</u> (as defined below) and before the end of the year, and
- the period of support must have begun on or after its "commencement day."

C is

- the total of all support amounts <u>paid</u> by the taxpayer to that person after 1996 and previously <u>deductible</u> in computing the taxpayer's income.

Effectively, these formulas take the total amount of "support" received or paid and reduce it by the child support receivable or payable. As a result, there will be no income inclusion or tax deduction if there are child support arrears. Payments after 1996 are specifically identified because that is when the Guidelines came in and the tax laws were changed with respect to the treatment of child support. Pre–May 1997 orders that do not have a "commencement day", as defined below, will still receive the tax inclusion/deductible treatment for the child support component. Part C of each formula ensures that amounts previously reported are not included twice.

The "commencement day" of an order or agreement is defined by Section 56.1(4) of the *ITA* and means:

(a) the day the order or agreement was made if it is made after April 1997.

(b) if the order or agreement was made before May 1997 then it is the earliest day after April 1997 (if any) that is:

- specified as the "commencement day" in a joint election filed with the Minister by the payer and recipient,
- where the order or agreement is varied after April 1997 to change the child support amounts payable to the recipient, the first day the varied payment is required to be made. This does not include changes due to a reasonable formula or index that was included in the original order or agreement, such as applying a cost-of-living index to the periodic amount,
- where a subsequent order or agreement is made after April 1997 which changes the total child support amounts payable to the recipient by the payer, the day of the first such subsequent order or agreement, and
- the day specified in the order or agreement, or any variation thereof, as the commencement day of the order or agreement for purposes of the *ITA*.

Triggering a "commencement day" will remove the tax inclusion and deductibility of a child support order made prior to May 1, 1997.

Payments made prior to the date of the order or agreement:

Where payments have been made prior to the date of an order or agreement, Section 56.1(3), for payments received, and Section 60.1(3), for payments made, allow the order or agreement to deem the receipts/payments to have been received or paid under the order or agreement for *ITA* purposes. Such treatment may apply to payments made in the year or preceding taxation year. Further, to accommodate the definition of "commencement day", the order or agreement is deemed to have been made on the day which the first amount was received or paid, except where the order or agreement is made after April 1997 and it varies a child support amount. In such cases, these sections deem the "commencement day" to be the day the first payment of the varied amount is or was required to be made.

Conclusion:

Clients have become more sophisticated. Through readily available, low-cost resources, such as the internet, they have access to a wealth of information and <u>misinformation</u>. However, they do have a vested interest in getting the right answers. And while they may not understand the intricacies of the issues there is a greater awareness that the issues exist. Misunderstanding those issues may lead to expectation gaps. The more you are able to help your clients avoid unintended tax results when dealing with their support issues, the more you may have shrunk the expectation gap and the more value you will have provided.

Appendix A: Summary of Tax Credits

	Federal	AB	BC	MB	NB	NL	NS	NT	NU	ON	PE	SK	YK
Basic Personal Amount	8,012	14,337	8,523	7,634	7,756	7,410	7,231	11,415	10,495	8,044	7,412	8,264	8,012
AED	6,803	14,337	7,298	6,482	6,586	6,055	6,140	11,415	10,495	6,830	6,294	8,264	6,803
Total	14,815	28,674	15,821	14,116	14,342	13,465	13,371	22,830	20,990	14,874	13,706	16,528	14,815

** Quebec has special rules that are not comparable to the other provinces and territories, and therefore have not been included in the above summary.

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Susan Roberts – Biography

Susan Roberts is currently the president of ChildView Inc., a company that specializes in the development, manufacturing and distribution of software that focuses on the calculation and analysis of child and spousal support in Canada.

Susan obtained her Bachelor of Commerce degree (with distinction) from the University of Alberta in 1988 and joined Gardiner Karbani Audy + Partners, Chartered Accountants, upon graduation. In 1996 she worked with Barry Gardiner, FCA, on an analytical project with respect to the (then proposed) Federal Child Support Guidelines (Guidelines) and then became involved with the development of software focusing on the Guidelines. As ChildView Inc. developed she assumed the role of general manager in 1998 and president in 2001, adding the company's federal and provincial income tax research to her agenda in 1999. In 2000 she did a research project for the Department of Justice Child Support Team in Ottawa on alternative models for the standards of living test. Since 1997 she has done numerous workshops across Canada for justice departments, family law practitioners, and others on the intricacies of calculations within the Guidelines, and the interrelationship between the Guidelines and the *Income Tax Act*.