


# Divorce and The Tax Return

*Helping Clients Wade Through The Jungle*

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## Divorce And The Tax Return

*Why It All Matters*

- Avoids additional conflict
- High conflict negotiation non-agreement
- Agreements may be in breach of Tax Act
- A great deal of money may be at stake




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## Definition of Separated: CRA v. Family Law

*When are you really separated? Family Law v. Canada Revenue Agency*

- ◆ Each advises clients within scope of profession's rules
  - Family Law
    - Date of Separation is date when one or both spouses decide to no longer live together as spouses.
    - If relationship has ended but both spouses/partners are still living in the same home, they often are usually still considered to be living separate and apart if they are no longer behaving as though they are married.
    - Clear evidence that spouses/partners are no longer sharing responsibilities, or social and family events is required if they continue to live in the same house.
  - Canada Revenue Agency
    - You are separated when you start living separate and apart from your spouse or common law partner because of a breakdown in the relationship for a period of at least 90 days and you have not reconciled.
    - If you continue to reside in the same household and continue to share parenting and financial responsibilities, CRA will *not usually* consider a separation to have occurred.
    - Should file an RC65, *Marital Status change form*




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### Why file the RC65 ' Marital Status Change Form?

❖ Why does CRA want to know if your marital status changes?

- ❑ Affects the benefits and credits that you may be eligible for.
- ❑ Based on one parent's income if single rather than family income.
- ❑ Make sure to inform CRA of your parenting arrangement as well.
- ❑ When parents separate, they are both eligible to apply for CCTB benefits; if they qualify and are a primary parent, they will receive full benefits. If they qualify and are in a SHARED PARENTING arrangement, the otherwise full benefit will be CUT IN HALF. Rotating benefits and deferring all benefits to one parent are no longer available options.
- ❑ Clients should update direct deposit info as well.




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### \* Understanding How You Are Taxed \*

Federal tax rates – 2016 tax year

- Income \$0 to \$45,282 @ 15%
- to \$90,563 @ 20.5% (was 22%)
- to \$140,388 @ 26%
- to \$200,000 @ 29%
- > \$200,000 @ 33% (was 29%)

What is Marginal Tax Rate?

- Rate at which tax will be paid on the next dollar of income.




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### Understanding Your Tax Return

#### Tax Deductions vs. Tax Credits

- ❖ Tax Deductions
  - Reduces your taxable income (Examples: Spousal Support Paid, Child care expenses, RRSP Contribution, Legal Expenses)
- ❖ Non-Refundable Tax Credits
  - Reduces your tax payable (Examples: Children's Arts credits, Tuition and education amount)
- ❖ Refundable Tax Credit
  - Refunds you \$ regardless if income and tax payable situation (Example: Children's Fitness Amount)




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### The Amount for an Eligible Dependent

❖ Who is *really* eligible?

- ❑ Must be a single parent and support a qualified dependent in your home.
- ❑ Child lives with parent for most of year, even if away at school.
- ❑ In year of separation only, can claim the spouse amount (for ex-spouse) or AED but not both.
- ❑ The parent is not making child support payments for the child.
- ❑ Federal credit was worth \$1,699 in savings in 2015; provincial credit also available.

UNLESS

- ❑ Child is in a shared parenting arrangement and both parents earn income and therefore have child support obligations (OFFSET).
- ❑ ITA subsection 118(5.1) enacted in 2007.
- ❑ Ochitwa v. The Queen.
- ❑ Legal agreement must be properly worded.




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- Only one child?  
If both parents are eligible to claim the eligible dependent amount for the same dependent, they must agree upon which of them will make the claim since the claim cannot be made twice and since the claim cannot be split between taxpayers; they can also alternate odd/even years of making the claim. There is nothing that stops parents from agreeing that whoever makes the claim will pay half of its value to the other
- More than one child?  
Where there are two children, and one living with each parent or each child living part of the year with each parent and if both parents are eligible to make the claim, each parent can claim the eligible dependent amount for one of the children, but agreement should be reached on which parent is claiming which child and included in the legal agreement
- CRA Assessment request




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### Other Non-Refundable Tax Credits in Separation and Divorce

- Spouse Amount
  - May be claimed if a taxpayer had a spouse or common-law partner at any time in the year of separation and if the taxpayer supported him or her at any time while married or in a common law partnership.
  - In year of separation a taxpayer can claim the Spouse Amount or a Spousal Support deduction but not both.
  - The rule that you must take into account your spouse's entire income for the year when calculating your spousal amount *does contain an exception* if you are separated by reason of marriage breakdown (and were not reconciled) during the tax year. Provided you are separated at year end, you need only include your spouse's income for the part of the year prior to separation in the calculation of the spouse / common law partner credit amount.




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### Other Tax Credits That Are Section 7 Expenses

- ❖ Refundable:
  - ❖ Children's Fitness Amount (Refundable)
- ❖ Non-Refundable:
  - ❖ Children's Arts Amount (Non-Refundable)
  - ❖ Tuition and Education Amount
  - ❖ Disability Amount Transferred from a child
  - ❖ Eligible Medical Expenses
- ❖ Extraordinary Expense Sharing
  - ❖ When calculating each Parent's share of a particular extraordinary expense it is important to share the after tax cost.




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### Deductions in Separation and Divorce

- ❖ Legal Fees
  - Since children have a pre-existing right, arising from legislation, to support or maintenance, legal costs to obtain an order for child support are deductible.
  - Legal costs incurred to enforce pre-existing rights to interim or permanent support amounts are deductible.
  - Legal expenses incurred to defend against the reduction of support payments are deductible since the expenses do not create any new rights to income.
  - A person who incurs legal expenses is not entitled to deduct them when they are incurred in connection with the receipt of a lump sum payment which cannot be identified as being a payment in respect of a number of periodic payments of support amounts that were in arrears.
  - From the payer's standpoint, legal costs incurred in negotiating or contesting an application for support payments are not deductible since these costs are personal or living expenses.
  - Legal fees in respect of filing for divorce, a separation agreement or establishing custody.




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### Deductions in Separation and Divorce

- ❖ Spousal Support
  - Spousal support (support for a spouse or common-law partner) means support payments pursuant to a court order or written agreement that are **only** for the recipient's maintenance.
  - An amount paid before a court order or written agreement is signed or comes into effect is recognized if the order or agreement states that any amount previously paid is deemed paid under the order or agreement; however, payments are only deductible for the current year and the preceding year, if an agreement is signed no later than Dec.31 of the current year.
  - Would be taxable to the receiver and deductible to payor.
  - Proof required
  - Year of separation
  - Both should adjust tax withheld at work
  - Reasons for retroactive claim (Work together for net benefit)
  - When are lump sums taxable and deductible?
  - What about Non-resident payors




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**Deductions (con'd)**

- ❖ Child Care Expenses
  - How much can each parent claim?
  - Limits are now per household



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