The Law Society of Upper Canada

Le Barreau du Haut-Canada

ERRORS & OMISSIONS

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"Prior Payments" of Support may be in tax limbo

As a result of recent amendments to the *Income Tax Act* (ITA), a serious problem has arisen in connection with the tax treatment of support payments between separated spouses. While the Department of Finance is aware of the problem and has verbally expressed an intention to fix it, the prudent practitioner may not wish to rely on such assurances and may instead wish to take precautionary steps in his or her practice to deal with the problem.

It is common knowledge among family law practitioners that if certain criteria are met, **voluntary** periodic support payments between separated spouses (that is, payments made before a separation agreement or court order is in place) will be deductible to the payor and taxable to the payee. The ITA sets out two requirements:

(a) A separation agreement or court order must be procured, either in the same taxation year as the payment in question is made or in the immediately following taxation year.

(b) The separation agreement or court order, as the case may be, must expressly state that the "prior payments" are to be considered as having been made pursuant to the separation agreement or court order.

Although the recent ITA amendments continue that general principle, there is a "glitch" in the relevant "coming-into-force" provisions leading to results which may render such prior payments neither deductible to the payor nor taxable to the payee, **notwithstanding clear language expressing a contrary intention in the separation agreement or court order, as the case may be.** The problem arises where the marriage breakdown takes place before January 1, 1993 but the court order or separation agree-

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Motor Vehicle Limitation Dates: Infants and Mental Incompetents

The Supreme Court of Canada, with reasons released September 2, 1993, has reversed the Court of Appeal decisions in *Murphy v. Welsh* and *Stoddard v. Watson.* While it is still advisable to commence action within two years under the *Highway Traffic Act* and that you keep up to date on threshold cases and Bill 64 (likely to come into force January 1, 1994) there is relief for claims of infants and mental incompetents brought outside of the two-year period.

The Supreme Court of Canada's succinct reasons bring certainty as to when the limitation period in motor vehicle cases operates as against infants and mental incompetents. The *Highway Traffic Act* two-year limitation period does not start to run until infants come of age or mental incompetents come of sound mind.

"Piggybacking"

However, an injured adult's claim cannot be piggybacked to the claim of an injured

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ment, as the case may be, is made on or after that date.

What To Do

Where you are acting for a client who separated from his or her spouse before January 1, 1993, and who has been making support payments without having a court order or agreement in place until on or after January 1, 1993, it is suggested that you advise the client that if the defect in the income tax legislation is not amended with retroactive effect, these "prior payments" will not be tax deductible even if a subsequently procured court order or agreement purports to give that retroactive tax treatment.

In the context of negotiating a separation agreement or addressing the court, as the case may be, you may wish to consider some form of relief of the payor spouse respecting any prior payments. That relief may be in the form of an indemnity given by the payee to the payor if the tax deduction claimed for prior payments is denied, or perhaps an offset against the amount of future support paid, in recognition of the windfall to the payee represented by the non-taxable prior payments.

The Explanation

Before the ITA Amendments: Formerly, paragraphs 56(1)(b) and 60(b) (dealing, respectively, with the taxation and deductibility of periodic support payments) required the spouses to be living apart and separated pursuant to a divorce, judicial separation or written separation agreement at the time the payment was made and throughout the remainder of the year. Obviously, this requirement was problematic for a spouse making **voluntary** support payments following separation. Happily, however, that requirement was deemed to have been met as a result of subsections 56.1(3) and 60.1(3) (dealing, respectively, with taxation and deductibility of such "prior payments") where a subsequently obtained court order or separation agreement provided that such prior payments were to be considered as having been paid and received pursuant to the order or agreement, as the case may be.

After the ITA Amendments: New paragraphs 56(1)(b) and 60(b) no longer require the spouses to be living apart and separated pursuant to a divorce, judicial separation or written separation agreement at the time the payment was made and throughout the remainder of the year. Consequently, **new** subsections 56.1(3) and 60.1(3) no longer deem that condition to have been met.

These changes would be unobjectionable if they came into force simultaneously. But they do not. New paragraphs 56(1)(b) and 60(b) are effective **for marital breakdowns occurring after 1992,** whereas new subsections 56.1(3) and 60.1(3) are effective **for agreements or court orders made after 1992.** Thus, where the marriage has broken down in 1992 or earlier but no agreement or court order is in place until 1993 or later, old paragraphs 56(1)(b) and 60(b) and **new** subsections 56.1(3) and 60.1(3) are applicable. It is this mis-match of old and new that creates the problem: the requirement referred to in old paragraphs 56(1)(b) and 60(b) must still be satisfied, but new subsections 56.1(3) and 60.1(3) do not deem that requirement to have been made.

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...Limitation Dates cont'd

infant, unless action has been commenced within two years on behalf of the infant and there are special circumstances. In *Murphy v. Welsh,* no action was commenced within two years. A party can only be added back to the date of issuance of the Statement of Claim. The adult's claim was dismissed.

FLA Claims

It was also held by the Supreme Court of Canada that an infant's derivative FLA claim cannot be pursued if the adult's claim is barred.

Again, be mindful of the two-year limitation period. However, the S.C.C. decision, s. 47 of the *Limitations Act* and the Court of Appeal's reasoning in *Papamonolopoulos v. Toronto Board of Education* (1986), 56 O.R. (2d)1 make it clear that the time set out in most if not all limitations statutes in Ontario will be extended in favour of infants and mental incompetents.

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