

## TAXATION OF SPOUSAL SUPPORT PAYMENTS

Draft proposal for a position statement by the  
New Brunswick Advisory Council on the Status of Women  
August 2005

### Issue:

- Spousal support is taxable/deductible income. Child support is no longer taxable/deductible income since 1997. A Moncton woman receiving spousal support has called for an end to taxation of these payments.

### Background:

- Spousal support is awarded to a relatively small number of mainly female separated/divorced spouses (married and common-law): about 740 in New Brunswick during 2003-2004, compared to 15,405 cases involving child support payments.<sup>1</sup>
- Spousal support payments can be given:
  - under the federal *Divorce Act*, in the case of married couples who divorce, **or**
  - under the provincial *Family Services Act*, which applies to common-law couples and to married couples who have separated but are not applying for a divorce.Federal and provincial spousal support laws provide factors to consider and aims to pursue, but leaves considerable room for the judge's discretion in the interpretation of the law.<sup>2</sup>
- Payments by the higher-income spouse to the lower-income spouse recognizes that it may be appropriate, at least for a certain period, to help the lower-income spouse cope with the economic consequences of the marriage breakdown.
- According to the federal *Divorce Act*, spousal support orders aim to:
  - recognize any economic advantages or disadvantages to the spouses arising from the marriage or its breakdown;
  - to divide between the spouses any financial consequences arising from the care of any child(ren) over and above any obligation for the support of child(ren);
  - to relieve any economic hardship arising from the breakdown of the marriage;
  - and, as much as practicable, to promote the economic self-sufficiency of each spouse within a reasonable period of time.<sup>3</sup>
- In determining the amount of spousal support, courts are supposed to take into consideration the means, needs and other circumstances of each spouse. Factors to be considered may include the former standard of living of the parties, how long they lived together, if child care responsibilities affected one spouse's earning capacity, the capacity of the dependent spouse to provide for his/her own support, etc.<sup>4</sup> While child support guidelines were introduced by the federal government in 1997, no similar standards determine how much spousal support should be paid, or for how long, although a draft

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<sup>1</sup> N.B. Department of Justice, Court Services Division.

<sup>2</sup> See Section 1.1, *Spousal Support Advisory Guidelines: A Draft Proposal*, January 2005, prepared by Professor Carol Rogerson Faculty of Law, University of Toronto and Professor Rollie Thompson Dalhousie Law School, for Family, Children and Youth Section, Department of Justice Canada, available at <http://canada.justice.gc.ca/en/dept/pub/spousal/project/index.html>

<sup>3</sup> *Divorce Act*, section 15.2 (6), available at: <http://laws.justice.gc.ca/en/D-3.4/index.html>

<sup>4</sup> See *Divorce Act*, section 15.2 (4), (5) & (6), available at: <http://laws.justice.gc.ca/en/D-3.4/index.html> ; and N.B.'s *Family Services Act*, section 115 (6), available at <http://www.qnb.ca/0062/acts/acts/f-02-2.htm>

- spousal support guidelines were recently prepared for the federal Department of Justice, in order to provide a more predictable results.<sup>5</sup>
- Spousal support that is paid on a periodic basis under a written agreement or court order is included in the income of the recipient for tax purposes and is tax deductible to the payor. Other types of spousal support – when it is paid in a lump sum, or not court-ordered - are not taxable nor deductible.<sup>6</sup>
  - Since 1997, child support payments are not included as part of the receiving parent's taxable income and are not deducted from the paying parent's income.<sup>7</sup> Many gender equity-seeking groups had campaigned in favour of that amendment to the *Income Tax Act*. Women and children generally suffer a much greater negative economic impact as a result of a divorce or separation than men. The recognition that child support payments are generally low relative to the costs of raising children was an important argument for making child support payments non-taxable for the receiving parent. The inequity of allowing non-custodial parents (fathers in the majority of cases) who no longer live with the family to deduct the cost of money spent to support their children - a right not granted to parents still living with their children - was also highlighted. There also appeared to be little evidence that the tax savings for the payor were passed on to the recipient through higher support awards or that the tax deduction provided an incentive to make the payments.<sup>8</sup>
  - During the past 20 years, various groups and scholars have called for the reform and repeal of the spousal support tax rules. In 1987, the Canadian Advisory Council on the Status of Women recommended that the deduction be converted to a tax credit and that the inclusion requirement be repealed.<sup>9</sup> Since that time the Ontario Fair Tax Commission and some Canadian legal scholars have called for the outright repeal of the inclusion/deduction system.<sup>10</sup> University of British Columbia law professor Claire Young affirms that the elimination of the inclusion/deduction system as applied to spousal support is a "logical next step" after the abolition of taxation of child support.<sup>11</sup>

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<sup>5</sup> See *Spousal Support Advisory Guidelines: A Draft Proposal*, available at <http://canada.justice.gc.ca/en/dept/pub/spousal/project/index.html>

<sup>6</sup> *Income Tax Act*, sections 56 (1) (b) , 60 (b), available at: <http://laws.justice.gc.ca/en/l-3.3/index.html>

<sup>7</sup> The *Income Tax Act* was amended so that, for new orders and agreements, or for variation of existing orders and agreements made after April 30, 1997, the receiving parent no longer pays tax on the child support received and the paying parent no longer obtains a tax deduction for the amount paid. Parents with a child support order or agreement from before this date can jointly elect to apply the new tax rules without changing the order. However, changing an order means that it automatically falls under the new tax rules.

<sup>8</sup> See for example, Monica Townson, *Tax Facts: What Every Woman Should Know*, Ottawa, Canadian Advisory Council on the Status of Women, 1993; Canadian Advisory Council on the Status of Women, *The Tax Treatment of Child Support: Preferred Policy Options*, Ottawa, CACSW, July 1994; Women and Taxation Working Group, *Women and Taxation* (Working Group Report), Toronto, Ontario Fair Tax Commission, 1992, p. 38. Ontario's Fair Tax Commission was established in September 1991 to provide the provincial Treasurer with advice on how to design and implement a more equitable tax system.

<sup>9</sup> Maureen Maloney, *Women and Income Tax Reform: Background Paper*, Ottawa, CACSW, October 1987.

<sup>10</sup> Ontario Fair Tax Commission, *Fair Tax in a Changing World: A Report*, Toronto, University of Toronto Press/Ontario Fair Tax Commission, 1993; Maureen Maloney, "What is the Appropriate Tax Unit for the 1990s and Beyond?" in Allan Maslove ed., *Issues in the Taxation of Individuals*, Toronto, University of Toronto Press/Ontario Fair Tax Commission, 1994; Claire Young, *What's Sex Got to Do with It: Tax and the "Family"*, Law Commission of Canada Research Paper, May 2000, available at: [www.lcc.gc.ca/research\\_project/00\\_sex\\_2-en.asp#table1](http://www.lcc.gc.ca/research_project/00_sex_2-en.asp#table1)

<sup>11</sup> Young, *What's Sex Got to Do with It*, p. 44.

### Advisory Council position:

The NB ACSW favours changes to the federal *Income Tax Act* to make spousal support payments non-taxable for the recipient and non deductible for the payor. The recommendation is based on the following gender equity and tax policy considerations:

- Women (and children in their care) are in general much worse off financially following separation/divorce than men, usually experiencing a significant decline in standard of living. Through unpaid domestic labour during the marriage/cohabitation, many women contribute to the family income while sacrificing training and career opportunities, independent earnings and other financial benefits. The current tax rules allow mainly male spouses to benefit from a tax deduction and at the same time “impose a significant hardship on many women who find themselves descending into poverty as a result of both their divorce or separation and the impact of the requirement to include spousal support in income.”<sup>12</sup>
- The deduction does not appear to encourage higher support awards. In cases where the payor is in a higher tax bracket than the recipient, the payor gets more income tax back than the tax paid by the recipient. In theory, this allows a higher support award, with the payor passing on tax savings to the support-receiving spouse. But in practice, those who receive spousal support are rarely fully compensated for the tax they pay since the setting and adjusting of spousal support amounts depends on the decisions of judges and negotiations with spouses. Negotiations about spousal support often involve unequal bargaining power and may lead to trade-offs because of other ongoing conflicts regarding child custody and property division.<sup>13</sup>
- The tax deduction does not seem to have the effect of making payors more likely to make the payments. Many support orders remain unpaid or in arrears. “There are many reasons that spousal support orders are in default, including hostility towards one’s ex-spouse and the desire for revenge. It is too simplistic a view to believe that a tax deduction will result in better compliance with spousal support orders.”<sup>14</sup>
- Because spousal support benefits are taxable income, some recipients see their GST tax credit and Canada Child Tax Benefits reduced, since these credits decrease as income increases.<sup>15</sup>
- Spousal support payments do not correspond to the usual definition of taxable income. Legal and tax experts have pointed out the flaws in the current spousal support rules from a tax principle perspective. The income tax system operates on the basis that only earned income (or income with a “source” according to the *Income Tax Act*), such as employment, business or property, is taxed. Unearned income, such as inheritances and gifts, is not taxed. It is therefore not clear why spousal payments should be taxed. Some scholars note that the only reason spousal support is included in income is because it is deductible to the payor.<sup>16</sup>
- The basis for deductibility of the payments has also been questioned. During the marriage, the higher income spouse cannot deduct the cost of money provided to the other spouse for subsistence. The inclusion/deduction system treats two individuals who are no longer spouses as one tax unit, providing for a form of income splitting that is not allowed for spouses during marriage.<sup>17</sup>

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<sup>12</sup> Young, *What’s Sex Got to Do with It*, p. 42, 51.

<sup>13</sup> Young, *What’s Sex Got to Do with It*, p. 42-43.

<sup>14</sup> Young, *What’s Sex Got to Do with It*, p. 43.

<sup>15</sup> Young, *What’s Sex Got to Do with It*, p. 43.

<sup>16</sup> Maloney, *Women and Income Tax Reform*, p. 22; Young, *What’s Sex Got to Do with It*, p. 51.

<sup>17</sup> Maloney, *Women and Income Tax Reform*, p. 22-23; Young, *What’s Sex Got to Do with It*, p. 43-44.

- Finally, different types of spousal support income are treated differently. Lump sum support payments, or those which were not court-ordered, are not deductible nor taxable.<sup>18</sup> Individuals who receive lump-sum payments and those who receive periodic payments should get the same treatment for tax purposes. This equity argument was invoked by the Women and Taxation Working Group in its 1992 report to the Ontario Fair Tax Commission.<sup>19</sup>

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<sup>18</sup> *Income Tax Act*, sections 56.1 (4), 60.

<sup>19</sup> Women and Taxation Working Group, *Women and Taxation*, p. 39.