



CESTNICK

TAX MATTERS

The spousal effect – for better or worse

I attended a wedding last weekend, and reminded the groom not to be surprised when he learns things about his wife that he didn't know before.

People hide things while dating. I think of my friend Karen. Her feet smell worse than anyone I know, but she somehow managed to hide this from her boyfriend Scott. And Scott has a problem with morning breath, but Karen didn't know this before marriage. Both were trying to think of a way to tell the other about their odour issues. On their honeymoon, they woke up one morning staring into each other's eyes, when Scott said, "Honey, I have a confession to make." Karen replied: "Don't tell me – you've eaten my socks, haven't you?"

Having a spouse can also lead to surprises at tax time. Let me share with you some of the benefits and drawbacks of having a spouse, from a tax perspective, for better or worse. This week, I'll focus on the drawbacks. Next week we'll look at the benefits and opportunities.

Your Spouse

The term "spouse" does not solely mean someone to whom you're legally married. A spouse is also a person you've been living with in a conjugal common-law relationship under the same roof for at least 12 months – same gender or not. And by the way, the 12-month requirement is ignored when you're both parents of the same child.

The Drawbacks

While some believe that only good can come out of being a spouse under our tax law, not all is fair in love and taxation. Consider the following drawbacks. While there are others that could be mentioned, these are the key ones:

- Splitting income becomes more difficult. The truth is,

income splitting is most difficult between spouses. If, for example, you attempt to split income by giving cash or other investments to your spouse so that he or she will pay the tax on any income instead, you'll find that all the income generated on those investments will be taxed in your hands – and not your spouse's.

There's an exception to these attribution rules where your spouse uses the transferred property to generate business income, or where your spouse has actually paid fair market value for the property you transferred and has filed a special election to have the transfer take place at fair market value.

- Restricts use of the principal residence exemption. This is one of the biggest drawbacks of being considered a "spouse." Each family unit is entitled to designate just one property as their principal residence each year for the purpose of claiming the principal residence exemption.

It's this exemption that allows Canadian families to sell the home, cottage or other qualifying property on a tax-free basis. As spouses, you're both members of the same family unit for the purpose of this exemption, and you can generally shelter from tax just one property between the two of you. If you weren't spouses, you'd each have your own exemption.

- Superficial losses can arise easily. It's easier to be caught by the superficial loss rules when you have a spouse. Here's what those rules say: Where you have disposed of property (usually investments) at a loss, and you or a person affiliated with you (including your spouse) re-acquires the property within a certain time frame, then the loss will be denied. That time frame is 30 days before and 30 days after your disposition – a 61-day window in total. If, for example, you owned shares in XYZ Inc., sold them at a loss, and your partner purchased XYZ Inc. within that 61-day window, your loss would be denied as a superficial loss. The moral of this story is to make sure you have a knowledge of each other's investment activity if you're going to be "spouses" under the Income Tax Act.

- Benefits tested by family income could be reduced. A number of benefits, including the GST credit, Canada child tax benefits, and certain provincial tax credits, are paid – or not – based on the family's income. As spouses, your income will be combined for the purpose

of calculating the level of these benefits. The clawback of Old Age Security benefits is based on individual income, but don't be surprised if this changes in future, to provide a clawback based on family income.

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