

Common-law (including same-sex) partners taxation information

Under the Income Tax Act, all common-law relationships, either opposite or same-sex, are treated equally.

Common-law partners

Same-sex common-law partners are treated the same as opposite-sex common-law partners. Same-sex common-law partners are eligible for the same tax benefits, and are subject to the same obligations as married couples and opposite-sex common-law couples. Same-sex partners who meet the definition of being in a conjugal relationship (see sidebar on page 2) for more than 12 months are required to declare themselves common-law partners on page 1 of the Personal Income tax return by checking off the “living common-law” box. Note that this definition encompasses both opposite-sex and same-sex common-law relationships. This means that same-sex common-law partners who do not correctly declare their status, for example, to avoid losing benefits that are based on the combined net income of both partners, can be reassessed and asked to repay the benefits. This is currently true for legally married or opposite-sex common-law couples who can be reassessed if they collect benefits they are not entitled to because they fail to correctly identify their status as married or common-law.

Conjugal relationship

The question has arisen as to how the Canada Revenue Agency (CRA) will know if same-sex partners are living in a “conjugal relationship,” as married persons have their status legally registered in a public document, the marriage certificate, whereas same-sex partners do not. The same issue arises currently with common-law opposite-sex couples whose status is not registered anywhere. The CRA proceeds exactly as they have proceeded in the past with opposite-sex common-law couples. The CRA has a self-assessment system in which taxpayers are expected to tell the truth and in which persons who make false statements on their tax returns can be penalized. Whether or not two persons (opposite-sex or same-sex) are living in a conjugal relationship is a question of fact, and this can include whether or not the couple presents

For tax purposes, same-sex common-law couples are referred to as “common-law partners,” which is defined as two persons, regardless of sex, who:

- cohabit in a conjugal relationship and have done so for a continuous period of at least 12 months, or
- are parents of a child together, and
- have not been living separate and apart for a period of at least 90 days because of a breakdown of their relationship.

itself publicly as a conjugal couple and has claimed the status of a couple for purposes of a pension or health plan, etc.

In determining whether two people are in a conjugal relationship, the issues in the sidebar are examined.

Tax considerations

The most significant tax issues that impact common-law investors will be discussed below.

Transfers of property to a common-law partner

Transfers of capital property made to a spouse or common-law partner automatically “roll over” at the adjusted cost base, although a spouse or partner can “elect out” of the rollover on his or her tax return and request a transfer at the fair market value.

Note, however, that the attribution rules also apply to same-sex partners (see below).

Income splitting and the attribution rules

Income attribution rules generally block attempts to shift income from a higher-income person to a lower-income person by attributing the income back to the higher-income earner.

Generally, where an individual has transferred or loaned property to or for the benefit of the individual’s spouse or common-law partner, any income (loss) from the property and any capital gain (loss) on the disposition of the property will be attributed back to the individual.

Common-law partners may consider the strategy of having the higher-income partner pay all the household expenses, thus preserving the lower-income partner’s income, which can be used solely for investing, as any returns on such investments would then be taxed in the hands of the lower-income partner.

Common-law partner loans at prescribed interest rates

One of the exceptions to the preceding attribution rules applies where an individual makes a loan to a spouse or common-law partner to allow the spouse or partner to invest. As long as interest is charged on the loan at a rate at least equal to the CRA’s prescribed interest rate at the time the loan was made, the attribution rules will not apply. The interest, however, must be paid each year or within 30 days after the end of the year for the attribution rules not to apply.

Conjugal relationship?

1. Shelter: Do the parties live under the same roof and what are the sleeping arrangements?
2. Sexual and personal behaviour: Do the parties have sexual relations and do they maintain an attitude of fidelity to each other?
3. Services: What is the conduct and habit of the parties in relation to domestic services such as preparing meals and performing household maintenance?
4. Social: Do the parties participate together in social activities?
5. Societal: How does the community view the parties, both individually and as a couple?
6. Support (economic): What are the financial arrangements of the parties in terms of their relationship?
7. Children: What is the attitude and conduct of the parties concerning any children?

Spousal RRSPs and RRIFs

Contributions made to a spousal RRSP are deductible by the contributing spouse or common-law partner within the applicable contribution limits. When funds are withdrawn, they will be taxed in the hands of the annuitant spouse or partner.

Even though the term “spousal RRSP” continues to be used throughout tax literature, the rules certainly permit a common-law partner to take advantage of this significant income-splitting opportunity. A spousal plan generally makes sense where one partner’s income is significantly higher than the other’s and therefore the higher-income partner can claim the deduction for the contribution on his or her return. The lower-income partner may pay little or no tax on the ultimate withdrawal of the funds from the RRSP or its successor (an annuity or RRIF).

Note, however, that the spousal attribution rules for RRSPs or RRIFs also apply to common-law partners. These rules state that if the annuitant spouse or partner withdraws any funds from a spousal RRSP or withdraws more than the minimum amount from any spousal RRIF within three years of any contribution being made to any spousal RRSP, the withdrawal will be attributed back and taxed to the contributing spouse or partner.

Superficial loss

A capital loss is generally deemed to be superficial if, during the period that begins 30 days before and ends 30 days after the disposition of a property, the taxpayer, their spouse or common-law partner acquires substituted property that is identical to that disposed and; at the end of that period, the taxpayer, their spouse or common-law partner owns or has a right to acquire the substituted property. The denied loss is added to the adjusted cost base of the acquired property.

Principal residence exemption

A principal residence is generally a residence that is owned by a taxpayer and was inhabited during the year by the individual or certain family members. A gain on the sale of a principal residence is exempt from tax. Married or common-law couples can designate only one property between them as a principal residence.

Home Buyers’ Plan (HBP)

The HBP is a plan that permits first-time home buyers to withdraw funds from an RRSP for the purchase of a home, without the withdrawal being included in income. A first-time home buyer is an individual who has not occupied a principal residence owned either by him/her or by his/her spouse or common-law partner during the period that begins January 1 five years prior to the year of withdrawal, and ends 31 days before the withdrawal.

Estate planning

Generally, upon death, an individual is deemed to dispose of all of his or her capital property at fair market value. The main exception to this rule is that any property that is left to a spouse or common-law partner may be transferred at its adjusted cost base without incurring a capital gains tax liability upon death.

Transfers under the refund of premium rules of a deceased’s RRSP to a spouse or common-law partner shift the income inclusion from the deceased to the spouse or partner. The spouse or partner may obtain an offset for this income inclusion by investing the proceeds into his/her own RRSP or RRIF. This opportunity is available to common-law partners who can avoid the significant tax burden often levied on the fair market value of the RRSP or RRIF upon death. Common-law partners should carefully review their RRSP or RRIF beneficiary designations to ensure that, where appropriate, their partner is named as the beneficiary on the plan.

Finally, the first \$10,000 of a death benefit, which is an amount paid by a former employer after an individual's death, usually in recognition of the former employee's service, can be received tax-free by a spouse or common-law partner.

Testamentary spousal trusts

The ability to achieve post-mortem income splitting is also available to common-law partners. A partner who is planning to leave money to his or her partner (who is also earning income) can take advantage of an extra set of graduated tax rates to accomplish post-mortem income splitting.

Scenario one – Outright inheritance

In 2004, Jack inherited his partner's investment portfolio. Last year the portfolio generated \$100,000 of income. Jack's marginal tax rate is 40%. Looking only at the investment income from the inherited portfolio, his tax bill is approximately \$40,000.

Scenario two – Inheritance placed in a testamentary trust

Tom inherited his partner's investment portfolio. Under the terms of his will, Tom's partner set up a trust and instructed that the portfolio be placed in it. Tom is also at a 40% marginal tax rate, but the tax payable on the annual income of \$100,000 can be taxed in the trust, applying the graduated taxation rates used by individual taxpayers in their personal income tax returns. This results in tax payable by the trust of approximately \$30,000.

The savings in tax dollars between the two scenarios is approximately \$10,000 each year.

Alter ego and joint partner trusts

An estate planning opportunity exists allowing an individual to establish a trust to help meet his or her various estate planning objectives while minimizing the tax implications. The strategy involves the transfer of assets to an alter ego trust or joint partner trust,

primarily to avoid probate tax on the value of assets that pass to a surviving spouse or partner.

The joint partner trust is available to same-sex partners who may wish to transfer all of their assets to a trust. The legislation allows a tax-free transfer to a joint partner trust. On the death of the last survivor of the two partners, the assets in the trust will be deemed to be disposed of at fair market value, and tax will be payable at that time on capital gains realized because of the deemed disposition.

A joint partner trust requires that it be set up by an individual who is at least age 65 and that the individual and the individual's partner, together or separately, are entitled to receive all of the income of the trust until the last partner dies. Also, during the time the trust is in effect, no one else is entitled to receive or have access to any income or capital growth of the trust.

Once assets have been placed in either an alter ego or joint partner trust, those assets no longer form part of the estate, and therefore are not subject to probate tax.

For more information on alter ego and joint partner trusts, please see our *Alter ego and joint partner trusts* Tax & Estate InfoPages.

Deductions, tax credits and benefits

There are a number of deductions, credits and benefits that are based on the "family income of both partners."

Goods and Services Tax Credit and Child Tax Benefit

The Goods and Services Tax Credit and the Child Tax Benefit are determined by reference to the combined net income of both spouses or partners. A household in which both partners earn income may result in a reduction or elimination of either of these benefits. Before 2001, this was not a concern for same-sex partners, as their net incomes did not have to be combined to determine eligibility for these benefits.

Married or common-law partner credit

A married or common-law partner credit is available if an individual lives with and supports a spouse or common-law partner. This credit is reduced based on the net income of the other partner.

Equivalent to married credit

The ability of one person in a relationship to claim an equivalent to married credit for a child is no longer available to same-sex partners who are considered to be common-law partners.

Child care expenses

Where both parents earn income and child care expenses are incurred, the spouse or partner with the lower-income must claim those expenses.

Transfers of credits

A partner can transfer to another partner any part of the following credits: the age amount, pension income amount, disability amount, tuition and education amounts if he/she does not need the credits to reduce his/her federal income tax to zero.

Medical expenses

An individual can claim medical expenses for both him/her and his/her partner. Thus, the partner with the higher net income will generally claim the medical expense credit and achieve a greater level of tax savings than the partner with a lower net income, provided both partners each have sufficient income so that the 3% net income test does not affect them. Otherwise, the lower-income earner should claim the expenses.

Charitable donations

One partner can claim charitable donations made by either partner. Thus, the partner with the higher net income will generally claim the donation and gift tax credit and achieve a greater level of tax savings than the partner with the lower net income.

Provincial tax credits

Provincial tax credits generally take into account the total of both partners' net income in determining the amount of the credits available.

Family law issues must be considered

Each province in Canada has legislation granting rights to partners in a marriage or spousal common-law relationship when that relationship ends, whether because of relationship breakdown or the death of one of the partners. This legislation may also extend to same-sex relationships. To find out more about property rights, support rights and family law in general, obtain a copy of our *Family Law and Estate Planning Tax & Estate InfoPage*.

For more information about this topic, contact your advisor,
call us at **1.800.874.6275** or visit our website at **www.aimtrimark.com**.

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