Tax & Estate

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

Under the *Income Tax Act* (Canada), 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 below) for more than 12 months are required to declare themselves common-law partners on page 1 of the Canada Revenue Agency (CRA) Income Tax and Benefit Return form 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.

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.

Conjugal relationship

The question may arise as to how the CRA will know if common-law couples (opposite-sex or same-sex) are living in a "conjugal relationship," as there is no legally registered public document such as a marriage certificate. The CRA has a self-assessment system in which taxpayers are expected to tell the truth. Persons who make false statements on their tax returns can be penalized. Whether two persons (opposite-sex or same-sex) are living in a conjugal relationship is a question of fact, and this can include whether the couple presents itself publicly as a conjugal couple and has claimed the status of a couple for purposes of a pension, health plan, etc.

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

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?

Tax considerations

The most significant tax issues that impact common-law investors are 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.

Tax-free savings accounts (TFSAs)

Contributions to a spouse's TFSA are not subject to the attribution rules. As well, on death or separation, a TFSA may be transferred and continues being tax-sheltered in the receiving spouse's hands.

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.

Spousal or common-law partner registered retirement savings plan (spousal RRSP)

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 RRSP 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 spousal RRSP or its successor, i.e., an annuity or spousal registered retirement income fund (spousal RRIF).

Note, however, that the spousal attribution rules for spousal RRSPs or spousal 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.

Home Buyers' Plan (HBP)

The HBP is a plan that permits first-time homebuyers to withdraw funds from an RRSP for the purchase of a home without the withdrawal being included in income. A first- time homebuyer is an individual who has not occupied a principal residence owned either by him or her or by his or 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.

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 or his or her spouse or common-law partner acquires substituted property that is identical to that disposed and, at the end of that period, the taxpayer or his or her 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.

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 or 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.

Common-law partnerships are not recognized under intestacy law in all provinces and territories in Canada. If an individual passes away without drafting a Will, his or her common-law partner may not be extended the right to inherit the deceased's property. The only recourse for a common-law partner may be made via a constructive trust claim or a dependant's relief claim.

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 2014 Federal Budget introduced a top-bracket-rate taxation regime on every dollar of income for testamentary trusts for taxation years after 2015. Beginning in 2016, the taxation year of testamentary trusts must be the calendar year. For any testamentary trusts with a non-calendar tax year, these trusts will have two year-ends in 2015; the first being the end of the non-calendar year and the second being December 31, 2015.

Graduated rate estates (GREs)
One of the main exceptions to the more stringent rules for testamentary trusts is the continued preferential tax treatment for GREs. Generally, an estate is a trust for tax purposes, and the trust can designate itself as a GRE up to the first 36 months following the individual's death. Provided that the trust files annual T3 trust returns and designates itself as a GRE, it will be taxed at graduated rates. No other estate may designate itself as a GRE, and the Social Insurance Number of the deceased must be provided. Note that the CRA has commented that an individual may only have one estate that encompasses all of the deceased individual's worldwide property owned at death.

Once 36 months have elapsed, a year-end will be deemed after which the trust will no longer be considered a GRE. Thereafter the trust will be taxed at the highest marginal rate, and it will have calendar year-ends. A testamentary trust in existence on January 1, 2016 may qualify as GRE until the third anniversary of the individual's death.

Implications to testamentary trusts
To reiterate, after 2015 testamentary trusts will no longer be entitled to graduated tax brackets and instead will be subject to the highest marginal tax rate. Federally, the highest tax rate is 33%, and it can be expected that the provinces and territories will amend their rules similarly (and some have already done so). As well, testamentary trusts will be required to use a calendar year-end, will not be able to claim the basic exemption for the alternative minimum tax (currently at $40,000), will now be required to make quarterly tax instalment payments and will no longer be entitled to an extended period for filing a notice of objection to a tax assessment.

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 *Tax & Estate InfoPage* titled "Tax planning using alter ego and joint partner trusts."

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 (GST) credit and Canada Child Benefit (CCB)
The GST credit and the CCB are determined by reference to the combined net income of 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 and tuition amounts if he or she does not need the credits to reduce his or her federal income tax to zero. The 2016 Federal Budget proposes to eliminate the education and textbook tax credits. This measure does not eliminate the tuition tax credit. Changes will be made to ensure that other income tax provisions – such as the tax exemption for scholarship, fellowship and bursary income – that currently rely on eligibility for the education tax credit, or use terms defined for the purpose of the education tax credit, will be unaffected by its elimination.

This measure applies as of January 1, 2017. Unused education and textbook credit amounts carried forward from years prior to 2017 will remain available to be claimed in 2017 and subsequent years.

Medical expenses

An individual can claim medical expenses for both oneself and his or 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

Either spouse or common-law partner can claim the tax credit regardless of which one made the charitable donation. As the dollar amount of the tax credit is the same for both, it doesn't matter which taxpayer claims the credit.

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 governing rights and obligations of 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. Same-sex couples are included in the definition of common-law couples and are therefore entitled to the same rights to property and to make a dependent's relief claim.

For more information about this topic, contact your advisor, call us at 1.800.874.6275 or visit our website at invesco.ca.

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