



Wealth
Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Attribution rules on relationship breakdown

If there's a breakdown in your relationship, you and your spouse may need to determine how to divide up your assets. Dividing your assets might involve transferring certain property to your former spouse as part of a written agreement or court order. There are specific tax rules called the attribution rules that usually apply when you transfer property to your spouse — they are designed to prevent income splitting. However, the attribution rules generally cease to apply upon a relationship breakdown. This article discusses the situations in which the attribution rules cease to apply in the event of separation or divorce and identifies the situations in which attribution may continue to apply even after a relationship breakdown.

What is a spouse or common-law partner for tax purposes?

A spouse is a person you are legally married to. A common-law partner is a person you are living with in a conjugal relationship for a continuous period of at least 12 months or a person who is the parent (or has custody and control) of your child by birth or adoption. For tax purposes, a spouse includes a common-law partner. As such, any reference to a spouse in this article includes a common-law partner, except where specifically stated.

Also for tax purposes, spouses as well as common-law partners are considered to be separated if they've been living separate and apart for at least 90 days as a result

of a breakdown in the relationship and have not reconciled during this time. Although a common-law relationship is terminated once you have been separated for 90 days or more, a marriage is ended only through legal divorce, regardless of how long you've been separated.

When do the spousal attribution rules apply?

According to the attribution rules, if you transfer or loan property to your spouse (or a trust of which your spouse is a beneficiary) any income (e.g. interest and dividends) as well as capital gains and losses earned from that property will generally be attributed back to you and taxed in your hands.

Attribution can also occur when you withdraw funds from a spousal registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) where you are the annuitant and your spouse contributed to the plan either in the year of the withdrawal or in one of the two taxation years immediately preceding your withdrawal.

When do the spousal attribution rules cease to apply?

The attribution rules will cease to apply following a divorce judgment for married couples or a separation agreement for common-law partners, as long as both individuals remain separated throughout the year.

In the case where a divorce judgment or separation agreement hasn't yet been attained, the attribution rules are suspended for spouses and common-law partners who are living separate and apart as a result of a breakdown in their relationship. For the purposes of these rules, common-law partners are considered to be living separate and apart because of the breakdown of their relationship if, from a social and economic perspective, they are no longer part of a single family unit. The CRA has stated that for the purposes of these rules, there is no particular minimum time (i.e. 90 days) that a couple must be separated for there to be considered a breakdown of their relationship.

While this suspension happens automatically on the attribution of income, a joint election is required to stop the attribution of capital gains and losses during the period that spouses and common-law partners are living separate and apart.

This joint election, signed by both spouses, can be made in the tax year the spouses separate or in any future tax year following the separation. Once made, the election will apply for the year the election is filed and every subsequent year. There is no prescribed form for the election and it should be filed with the transferor spouse's personal income tax return. If either spouse is resident in Quebec, an election must be copied to Revenu Québec.

An example

Consider Finn and Sam, a separated couple applying for divorce. As part of their separation agreement, Sam is to transfer a GIC as well as a portfolio of RBC shares to Finn.

All interest income generated from the GIC after the date of transfer would be taxed in Finn's hands, as long as they remain separated throughout the year. After the transfer of RBC shares, Finn decides to sell the portfolio and realizes a capital gain. Since Sam and Finn are separated but not yet divorced, the capital gain will create a tax liability for Sam unless he and Finn jointly elect for the attribution rule for capital gains to not apply.

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Conclusion

Knowing when the spousal attribution rules continue or cease to apply after a relationship breakdown is important in achieving the optimal tax result when dividing up assets with a former spouse. Consulting with a qualified tax advisor can provide you with the proper tax support you need during a separation or divorce.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



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