

LIVING SINGLE/LIVING TOGETHER

Living together as single people may be great but be careful. The CRA may see you as a married couple.

One of the most contentious issues faced by tax preparers when completing clients' personal income tax returns is whether a couple is simply living together — or living together in a manner treated by the Canada Revenue Agency (CRA) as "married". This delicate area of personal beliefs can generate legal and income tax problems with a long-term impact on the individuals in the relationship.

The source of the problems is usually the belief by the parties in the relationship that they cannot be treated as married if they do not have a signed marriage certificate.

In Canada, it is true that there is no such thing as common-law marriage; no relationship matures into marriage merely by the passage of time, as some people believe. In Ontario, a couple must have "cohabited" for three years, which means they must satisfy certain conditions other than merely living together before they are classified as common-law spouses; periods in other provinces vary between two and three years. Cohabitation is defined by the following seven factors established in *Moldowich v Penttinen*:

Shelter: Was accommodation shared by the unmarried couple?

Sexual and Personal Behaviour: Was the relationship intimate and perceived to be so by others?

Services: Did the couple share the traditional functions of a family?

Social: Did partners present themselves as a couple to the outside world?

Societal: How was the couple treated by their community?

Economic Support: Were the unmarried parties economically interdependent?

Children: Did the couple see children as part of their home and interact as parents with each others' children?

How the CRA Sees It

Couples who have cohabited for more than 12 months but less than the statutory period that would establish them as common-law spouses in their province of residence are often surprised to find the CRA has categorized them as "common-law partners" and thus treats them as "married" for tax purposes. The CRA's website defines common-law partners as follows:

"A common-law partner applies to a person who is not your spouse with whom you are living in a conjugal relationship, and to whom at least one of the following situations applies.

He or she:

** has been living with you in a conjugal relationship for at least 12 continuous months;*

** is the parent of your child by birth or adoption; or*

** has custody and control of your child (or had custody and control immediately before the child turned 19 years of age) and your child is wholly dependent on that person for support.*

This is essentially a summary of the definition found in the *Income Tax Act*.

Common Law Changes Tax Status

The significance of retaining "single" taxpayer status should not be dismissed lightly. Putting aside other legal issues, consider the following tax issues, both positive and negative, regarding common-law relationships for tax purposes:

A single parent can claim child care expenses. In a common-law relationship the person with the lower income must claim child care expenses.

A single parent can claim equivalent to spouse for their child. In a common-law relationship this is not possible.

A common-law couple can only have one principal residence per family unit. Thus, if each individual owns a residence before union, one of the principal residences could incur tax on capital gains when one of the properties is sold.

RRSP contributions may be made by one person for the benefit of another in a common-law relationship; the contributor is allowed the tax deduction. The same would not be true for individuals not in a common law relationship contributing to each other's RRSP.

When an individual within a common-law relationship dies, for the most part investments and RRSP amounts transfer to the survivor without immediate tax consequences. When an individual dies without a common law survivor, the estate of the deceased is taxable on the value of the RRSP at death.

Medical expense receipts and charitable donations are creditable to the individual who incurs them. In many instances the expenses and/or donations do not aggregate to a total that is useable by the single taxpayer. Within a common-law relationship such expenditures are transferable from one taxpayer to the other to allow some income tax relief.

An individual who earns income from investments, whether interest or dividends, must claim 100% of the amount for tax purposes. Assuming that a common-law couple shares the investments, the total income earned could be split between the investors if proper arrangements are made.

Similarly with capital gains or losses, both taxpayers within a common-law relationship should be able to use the gains or losses to mutual benefit depending, of course, upon other investment gains or losses within their individual portfolios. Individuals within a common-law relationship must be aware that superficial loss rules apply to them as a couple in the same manner as the loss rules apply to an individual. That is, if an investment is sold at a loss to apply against gains but the other spouse repurchases the stock within 30 days of the original sale, the loss would not be permitted.

This'n That at Logan Katz

We welcome James Bush to our Financial Reporting Services Department. James is a graduate of John Molson School of Business, majoring in finance. He is now working on getting his C.A. designation.

We would also like to welcome back Yusuf Abdi. Yusuf was at the University of Ottawa completing his bachelor of commerce, specializing in accounting.

Last but not least Alain Gagnier will be away studying from now until mid-September for his C.A. exams. We wish him the best of luck!

If one partner dies while employed, an employer may allocate a \$10,000 death benefit to the common-law partner. This amount would be tax free in the hands of the recipient. A tax free benefit is not allowed to others unless the recipient is a child of the deceased.

In addition to the specific areas covered above there are many other related income tax, goods and services tax, and tax-credit issues (both federally and provincially) that change when individuals decide to live common law.

Consider:

The universal child care benefit transfers as taxable income to the spouse with the lowest income.

The Canada Child Tax Benefit paid to eligible families for children under 18 will transfer to the individual that is primarily responsible for maintaining care of the child. Thus, individuals with a child who earn less than \$40,726 will receive \$100 of non-taxable income. Live common law and have a combined income in excess of \$40,726 and the non-taxable benefit will be reduced by 2% for one child and 4% for two or more children for net family income exceeding the \$40,726.

Individuals who receive the GST amount because they fall below an earnings threshold may find the amount starts to diminish when their combined family income is greater than the individual threshold.

Similarly the National Child Benefit supplement payable will start to erode as the combined family net income starts to exceed the current threshold of \$23,710. By way of explanation:

If each single parent earned \$23,710 income individually, they would receive \$278 per month on the NCB program. Should the relationship become common law the combined income earned would double to \$47,420 and the supplement would drop to \$93 per month. (It should be noted that the Province of Alberta provides child benefit supplements that differ from the National program).

An Audit May Change Your Status

There are undoubtedly taxpayers who are living in a conjugal relationship but still file as individuals. Many will receive benefits and tax credits they would not be permitted if their relationship were classified as common law. Taxpayers should be aware that should an audit determine they are living common law, the taxpayers will undoubtedly be required to repay the taxable benefits received because they filed as single. Should the taxpayer decide to object to the audit findings it will be up to the taxpayer(s) to prove that they were not in a common-law relationship.

Know Where You Stand

There are many tax issues associated with living common law versus living separately. There are equally as many legal issues, and most are more expensive than the tax benefits or losses resulting from going from single to common-law status with CRA. Thus, regardless of personal convictions, taxpayers contemplating living together either as a common-law couple or as a support mechanism for each other would be well advised to seek both tax and legal advice as to the best means of avoiding future conflict with each other and with the CRA.