Volume 16, Issue 1
January 2010

THE VALUATION LAW REVIEW

Family Law Decisions

The Valuation Law Review is a joint publication of the Canadian Institute of Chartered Business Valuators and Harrison Pensa LLP and this issue summarizes family law decisions of interest to business valuators. The Valuation Law Review is not intended to provide legal advice and readers should not act on information in the publication without seeking particular advice on matters that are of concern to them. Readers are cautioned against relying upon the decision abstracts contained herein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court.

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(2009), 61 R.F.L. (6th) 1 (Ont. C.A.)

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(2009), 62 R.F.L. (6th) 137 (Alta. Q.B.)

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In determining the justice and equity of a distribution order, the court can take into account the absence of contribution of a party as a homemaker and parent.
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Contingent assets or liabilities must be valued according to the contingencies that exist on the valuation date. The court may not employ "hindsight" evidence.

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The calculation of income under the *Spousal Support Advisory Guidelines* is to be calculated in the same fashion as under the *Federal Child Support Guidelines*. Thus, the court may attribute all or a portion of a corporation's pre-tax profits to the shareholding spouse.

It is prudent that a shareholding spouse call expert evidence relating to the retention of corporate profits. A court will be "cautious" in relying on the evidence of the spouse standing alone.

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(2009), 64 R.F.L. (6th) 54 (B.C.C.A.)

A payor of child support who does not increase his or her child support payments with his or her increasing income may face a retroactive child support claim.

Normally, a retroactive child support award should not pre-date the first "notice" given by the recipient.

"Notice" does not require formal notice. All that is required is that the topic of child support be "broached".

If the support payor has engaged in "blameworthy conduct", a court may look back beyond the date of notice in making a retroactive child support award.

There is "an emerging presumption" that all of the corporate income will be available for child support. Thus, the onus will fall upon the shareholder to prove corporate need.

The court can attribute the "pre-tax corporate income" to a shareholder in an appropriate case. Judges should not confuse "pre-tax income" with "retained earnings".

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(2009), 62 R.F.L. (6th) 286 (N.B.Q.B.)

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Section 18(1) of the Guidelines is limited to the attribution of corporate profits within the most recent or current taxation year.

Judges must distinguish between corporate pre-tax profits and retained earnings. A failure to do so may lead to an incorrect analysis which could undermine a corporation's operations.

VALUATION - FAMILY LAW

By Terry Hainsworth

A post-separation change in value is a factor that can be legitimately considered under s. 5(6) of Ontario's *Family Law Act.*
In Ontario, the court has no choice in the selection of the valuation date. It is prescribed by statute.
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Once the threshold of unconscionability is met, the court should pronounce an order that is fair, just, and equitable in the circumstances.

***Serra* v. *Serra* (2009), 61 R.F.L. (6th) 1 (Ont. C.A.)**

The decision in the Court of Appeal in Serra v. Serra raises several new and interesting concepts under Ontario's *Family Law Act* and in relation to the concept of constructive trust.

The facts were quite simple. The parties were married in 1976. They separated, 24 years later, in 2000. Mrs. Serra commenced court proceedings in late 2002. Those proceedings were not resolved until February of 2007.

Mr. Serra's principal asset was his shareholding in a company known as Ajax Textiles. At the date of separation, his shares were worth between $9.5 million and $11.25 million. However, by the time of trial, the value of his shares had dropped by approximately $8 to $9 million. Their trial date value was between $1.875 million and $2.6 million. The parties' other major asset was a property in Florida that was valued at $2.2 million. It was equally-owned.

The trial judge found that Mr. Serra's equalization obligation amounted to $4.2 million. After having given him credit for approximately $850,000 as prepayments against the equalization payment, he was ordered to pay approximately $3.3 million as an equalization payment. This amount exceeded the value of *all* of his assets.

Two significant events occurred during the course of the litigation. First, Mrs. Serra claimed that Mr. Serra did not beneficially own *all* of the shares registered in his name. She alleged that certain of the shares were held in trust by him for her in light of the contributions that she had made to the business. This claim (known as a "constructive trust" claim), the Court of Appeal noted, effectively precluded him from disposing of the shares. Second, Mrs. Serra had also obtained an interim preservation order which prohibited Mr. Serra from dealing with the shares (without her consent or court order).

In the course of the litigation, Mr. Serra admitted that his wife was entitled to her constructive trust claim. At trial, however, Mrs. Serra attempted to abandon her constructive trust claim realizing that she did not want to own shares that had significantly declined in value. The court refused to allow her to withdraw her claim. The trial judge held that she would determine the trust issue. Ultimately, her determination was that Mrs. Serra did not have a constructive

trust interest in the shares. Thus, she concluded that Mr. Serra was the sole beneficial owner of all of the shares.

There was one final matter of significance arising out of the interim orders pronounced while the action was pending. Mr. Serra was ordered to pay $7,500.00 monthly interim support, a further $7,500.00 monthly to be characterized as property or support at a later date, and to maintain the expenses of a Florida condominium (amounting to approximately $60,000.00 annually). While the monthly interim support was tax-deductible, the maintenance costs of the Florida property and the $7,500.00 monthly payment was not. Ultimately, the trial judge concluded that the latter payments (totalling $850,000) were capital and credited such payments against the equalization payment that Mr. Serra otherwise owed to his wife.

The Statutory backdrop

Ontario's marital property regime does not call for a division of matrimonial property. Property rights are unaffected by the parties' marriage, separation, or divorce. Simply put, it is similar to the European Marital *aquets* scheme. A calculation is made of the increase in each spouse's net worth that occurs during the marriage. The spouse with the higher increase in net worth will be obliged to pay the other spouse an amount equal to one-half of the difference in the increases in their net worth during the marriage. This is called an "equalization payment". The equalization payment creates a debtor/creditor relationship between the spouses.

Under the equalization scheme, the value of assets and liabilities are calculated (in the absence of claims brought upon the death of a spouse) on the very date that the parties separated. Thus, in the ordinary case, market risk inures to the benefit or detriment of the party owning the asset.

The court has very limited jurisdiction to depart from making an "equalization payment". It may order an amount which differs from one-half the difference in the parties' respective net worths only if equalization would be "unconscionable". The court's jurisdiction to make an unequal award is further circumscribed by several specified circumstances. In this case, the only circumstance under consideration was a "blanket clause" which allowed the court to consider:

> "(h) any other circumstance relating to the acquisition, disposition, preservation, maintenance or improvement of property".

The issues before the Court

The court divided the issues into several categories. They were:

1. Can post-separation changes in value affect equalization?
2. What constitutes "unconscionability?"

3. What is the proper quantum of the award?
4. How may the award be satisfied?
5. Did the trial judge correctly deal with the trust issues?

Appeals relating to the quantum of support and post-judgment interest were dismissed as being matters within the discretion of the trial judge.

Post-separation changes in value

The first issue that the Court of Appeal had to determine was whether a change in value, occurring after the valuation date, was a factor which could be legitimately considered under s. 5(6). Ontario had deliberately chosen a fixed valuation date approach. Under the legislation, the court has no choice in the selection of the valuation date and may not vary the valuation date. The "fixed valuation date" approach carried with it the objectives of the statute, namely, the promotion of certainty, predictability, and finality. Until *Serra*, the court had limited the inquiry to cases where the misconduct of the respondent had impacted the value of the asset following separation.

The court concluded that the "conduct exception" did not close the door where post-separation changes in value occurred. An overall view of the circumstances of s. 5(6) made it clear that the concluding or "basket" clause was not limited to cases of misconduct. Moreover, s. 5(7) of the Ontario statute which sets out the "purpose" of the equalization rules was expressly rendered to be "subject to the equitable considerations of subsection (6)".

What constitutes "unconscionability"?

Having considered that a post-separation decline in value of a spouse's assets could be considered as a factor, the court had to then consider whether the changed value constituted, legally, "unconscionability". The court took pains to distinguish between what may be a factor on the road to a finding of unconscionability and what was, as a matter of legal conclusion, unconscionability.

In so doing, the court noted the very high threshold established by the word "unconscionability". It referred to prior decisions which had held that circumstances which are "unfair", "harsh", or "unjust" alone did not meet the test. The court noted that a prior decision had held that the circumstances must "shock the conscience of the court".

The court held that the circumstances of this case qualified as Mr. Serra would be obliged, otherwise, to pay more than his total net worth as an equalization payment due to the post-separation downturn in the value of his corporate holdings. He had no control over the decline in value of his shares. He had large interim payments to make, the source of which would be his continuing

association with Ajax. He could not sell the shares because of the interim preservation order. From a practical standpoint, he was precluded from any attempt to sell the shares by virtue of his wife's trust claims.

The court issued a caveat as to the nature of post-separation changes in value. The court stated "This case is not about whether a significant post-separation drop in the value of an individual's stock portfolio, precipitated by a deep but temporary recession, will amount to unconscionability."

What is the proper quantum of the award?

The court noted that it could apply a rather simplistic test. Since the threshold for an unequal division of net family property was unconscionability, one could argue that the appropriate disposition was to simply roll back the award to the point where it was just shy of being "unconscionable".

The court, however, rejected the simplistic approach. Such an order would, by virtue of the definition of "unconscionability" mean that the order remains unfair, unjust, and inequitable. Courts do not make such orders deliberately.

The court concluded that once the threshold of "unconscionability" was crossed, the court should exercise its discretion in the normal fashion. It should craft an order that is fair, just, and equitable in the circumstances. This is consistent with the purpose of the statute set out in s. 5(7) which talks about the "equitable considerations" set out in s. 5(6) itself and the preamble of the Act which calls for the "orderly and equitable settlement of the affairs of the spouses upon the breakdown of the partnership".

Once again, the court rejected the simplest approach. The simplest approach was to simply take the differences in the net worth of the parties at the date of trial, divide by two, and subtract from that amount the interim payments made by Mr. Serra. The court rejected the approach which would simply change the separation-date valuation to a trial-date valuation. Instead, the court made certain equitable adjustments which took into account the possibility of a change in fortunes for Ajax, the lengthy duration of the parties' marriage, and the principle of dividing what was acquired during the marriage equally.

A pure separation-date value would require a payment of $656,000. The court held that $900,000 fairly reflected the circumstances mentioned above.

Having arrived at the equalization amount, the court then had the task of crafting an order which would satisfy Mr. Serra's obligation. Amongst the assets that the parties owned was a Florida condominium which had a trial date value of approximately $2.2 million. Mr. Serra suggested that he would simply convey his undivided half interest to his wife in satisfaction of his obligation.

The court held that it lacked the jurisdiction to force such a property transfer

upon a non-consenting party. Thus, the most the court could do was provide Mrs. Serra with an option of accepting the transfer. The court also noted, in passing, that it did not have evidence as to any disadvantages or other implications that could be created in dealing with an asset subject to foreign law.

The court also considered the transfer of shares to Mrs. Serra and a reduction of the equalization payment to reflect the value of the shares transferred. This proposition was also rejected by the court. She would be forced to accept property in a form that she did not necessarily want (having abandoned her constructive trust claim). It would leave her in the position of a minority shareholder in the business. There was no evidence as to the value of such a minority interest. There was no evidence as to what limitations or restrictions should be made upon either of the parties considering the closely-held nature of the business.

In the end, the court pronounced an optional judgment in the following terms:

1. Mrs. Serra could accept the transfer of the half-interest in the Florida condominium in full satisfaction of her husband's equalization obligation. She would have to notify him of her decision by a fixed time and date; or
2. Mr. Serra could pay the equalization obligation in three equal instalments, the first of which would be payable almost immediately and the second and third of which would be payable at nine month intervals.

Did the trial judge correctly deal with the trust issues?

As mentioned earlier, until the very eve of trial, Mrs. Serra alleged a constructive trust in relation to Mr. Serra's shareholding. A constructive trust claim is a claim advanced by a non-titled person against the title-holder for a declaration that the title-holder holds title to certain property as a trustee on behalf of both of them. Thus, Mrs. Serra was asserting that her husband was not the *sole* owner of the shares but that he held some of those shares as a trustee for her in her own capacity as a beneficial owner. As mentioned above, realizing that the shares had declined, significantly, in value, she attempted to abandon that claim at trial in the face of Mr. Serra's admission that he did hold the shares in trust. The trial judge held that Mrs. Serra could not withdraw the admission and that she would determine the constructive trust issue on the merits. On the merits, the trial justice held that there was no constructive trust. While the Court of Appeal spent considerable time analysing the various rules of court, the message appears to be clear. A court has the right to control its own process, particularly in family law matters. A party who makes a claim which is ultimately admitted by the other side, will be hard-pressed to withdraw the claim if she or he later discovers that the claim is disadvantageous.

In Ontario, the court can order a party to cover part or all of the expenses of carrying on the case including lawyers' fees.
The primary purpose of an interim expenses order is "to level the playing field".
Awards of interim expenses are discretionary. The applicant must demonstrate the necessity of the expense and a meritorious claim.

***Ludmer* v. *Ludmer* (2008), 56 R.F.L. (6th) 499 (Ont. S.C.J.)**

The wife moved for an interim order requiring the husband to advance $200,000 to enable her to continue the litigation. Such advance orders, once known as interim disbursement orders, are authorized by Ontario Family Rule 24(12). By the Ontario rule, the advance is not limited to the disbursements or expenses of carrying on the case, but can include a lawyer's fees. She sought leave to mortgage their matrimonial home (to which she was the sole registered title-holder) to do so.

The facts of the case were striking. She had already paid a former lawyer $312,000. She owed her current lawyer $163,000 and estimated that the cost to complete the action would be $335,000. The trial had began several months earlier but had not been completed. Matters, undisclosed by the judge's reasons, delayed the scheduling of the conclusion of the trial.

The judge carefully reviewed the principles governing the award of interim expenses. She noted that the typical award was to enable a spouse to engage an expert to analyze the other spouse's complex financial situation. They are to "level the playing field" where there is a risk that a spouse with a meritorious claim may not be able to pursue it without resources. Such awards are discretionary – requiring the applicant to demonstrate the necessity of the expense and a meritorious claim.

On the facts, the claim was dismissed. The claim appeared to be one to fund the lawyer – but he would not be allowed to withdraw services in the middle of the case. Secondly, the magnitude of the costs were out of proportion to the entire amount claimed.

Under Alberta's *Matrimonial Property Act,* property acquired during the marriage is to be distributed equally between the spouses "unless it would not be just and equitable".
Normally, the distribution order speaks from the date of trial.
In determining the justice and equity of a distribution order, the court can take into account the absence of contribution of a party as a homemaker and parent.
Where a spouse owns shares in a closely-held corporation, the most appropriate order is for a money-payment as opposed to a share transfer.
In applying a "notional" tax discount to the value of the husband's shares, the court applied a median rate between the capital gains rate and the dividend rate.

***M. (J.J.)* v. *M. (C.D.) Estate* (2009), 62 R.F.L. (6th) 137 (Alta. Q.B.)**

The husband and wife began to live together in 1993 and married in 1995. They separated in 2004. The wife had two daughters from a prior marriage. The parties' marriage produced a son.

The marriage was beset by difficulties. The wife had serious behavioural difficulties, expensive spending habits (relating to a series of purchases, renovations and unprofitable sales of matrimonial homes), and drug and alcohol dependencies. At one point after the separation, the parties had orally agreed to settle the case by the husband transferring a one-third interest in the company to the wife. It was never carried out, however. The wife died during the course of the litigation. Thus, the litigation was continued by her estate – the primary beneficiaries being her daughters – both of whom were deeply estranged from the husband.

Under Alberta's *Matrimonial Property Act*, property acquired during the marriage is to be distributed equally between spouses "unless it would not be

just and equitable". In s. 8 of the Act, a checklist sets out a number of factors that the court may take into account in determining the justice and equity of a particular case. Normally, the distribution order speaks from the date of trial. [The reader will immediately recognize the dramatic difference between the "distribution legislation" of Alberta and other provinces and the "valuation legislation" of Ontario. In Ontario, "property" is not "distributed". Rather, it is valued and a debtor-creditor relationship is established. In Ontario, only assets existing at the date of separation are taken into account. After-acquired assets are not. In Ontario, the "valuation date" is prescribed as the date of separation or death – whichever first occurs].

By separation, the parties had few assets other than the husband's 67.5% interest in an active business corporation and a LIRA that represented a pre-marriage pension. By trial, he made additional contributions to RRSP's and had $400,000 in savings that represented an employment bonus he took out of the company two years after separation.

The Court concluded that an equal distribution would not be just and equitable. Due to her behavioural and dependency issues, the court characterized her contribution …"as a homemaker and a parent [as] minimal". Her contribution to the company was "non-existent". His savings and RRSP were not taken into account as they were already valued in the corporation's value (when measured at the date of separation). Finally, the court took into account the oral agreement to transfer one-third of the husband's interest – despite its lack of implementation.

After deciding the issue of "distribution", the court had to decide the issue of "implementation" of its award. The wife's estate argued that there should be a share transfer. The husband argued that it should be by way of a money-payment order. It was an important issue as the evidence indicated that the shares had risen in value post-separation.

The court held that a transfer order was not a practical solution. First, as the wife was deceased, the transfer would be to her estate. Thus, the "rollover" provisions of the *Income Tax Act* could not be applied. This would result in an immediate and substantial tax burden to the husband. Second, such a transfer would violate a Unanimous Shareholders' Agreement between the husband and a minority shareholder. Finally, it would vest voting control of the company in the hands of non-participating shareholders – the children (to whom he was estranged) and the minority shareholder.

The court chose to distribute the award by a money-payment. Considering that the parties had made an oral agreement in 2004 (albeit unimplemented), and that the wife had made no contributions post-separation, the court chose to value the company at separation and not at the trial date.

In so doing, the court looked at the income tax implications. There were 3 "notional" scenarios put before the court. If the husband took out income by way of bonus or employment income, the tax cost would be 39%. If the husband sold his shares, the cost would be much less [about 18%]. Finally, if he took the funds out as dividends, the tax rate would be 25%.

The court employed a median between the capital gains and dividend rate and discounted the value of the husband's shares 22% for tax. The ultimate value was, consequently, fixed at $3,200,000. The distribution, at 50%, was $1.6 million.

The distribution order required the husband to hold one-third of that amount in trust for the son. The balance was to be paid out to the two daughters of the wife on terms:

1. $100,000 to each forthwith;
2. the balance at $1,500 monthly to each;
3. if bonuses or dividends are declared, one-third of the after tax value to each daughter by way of accelerated payment;
4. post-judgment interest on any unpaid balances; and
5. an acceleration clause providing that if the husband defaulted, the entire unpaid balance would immediately fall due.

Thibodeau v. _Thibodeau_ (2009), 177 A.C.W.S. (3d) 166 (Ont. S.C.J.)

If property is jointly-owned, the trustee in bankruptcy ordinarily accrues the bankrupt's half interest despite claims being made under the *Family Law Act*.

If property of a bankrupt spouse is impressed by a trust, the trustee in bankruptcy takes subject to the trust.

The court can order a transfer of registered retirement savings funds to satisfy an obligation arising under Ontario's Family Law Act.

In arbitration proceedings the wife received lump sum support for spousal support arrears, an equalization payment and costs. Shortly thereafter, the husband went bankrupt. An issue arose as to whether the wife had priority over the husband's creditors to the husband's half share of the proceeds of sale of their jointly-owed matrimonial home. Secondly, an issue arose as to whether the court could now vest the husband's RRSP's in the wife to satisfy her judgments.

The arbitration award specifically directed that the matrimonial home be sold and that the wife was to receive the husband's half share to satisfy his equalization and lump sum support obligations.

With respect to the sale proceeds, the court noted the general law – namely, that if property is jointly-owned, the trustee in bankruptcy accrues the bankrupt's half-interest, despite the *Family Law Act* claims. However, the court also noted that if a spouse agrees or is ordered to transfer property to the other, prior to bankruptcy, the court will impose a trust on the property, enforceable against the bankruptcy trustee. The court held that the wife had priority on the principle of constructive trust. The arbitration award clearly divided the husband's share

of the sale proceeds. It represented a final and comprehensive division of same. Thus, the disposition of the husband's share was made prior to his bankruptcy.

Turning to the RRSP's, the court looked to recent amendments to Ontario's *Family Law Act* dealing with the court's jurisdiction to vary an arbitration award after its filing. It concluded that such jurisdiction existed.

Thereafter, the court noted the policies that underlay attempts by spouses to defeat family law claims through bankruptcy – and which existed prior to the amendments. Normally, bankruptcy proceedings should not be employed, nor were they intended, to defeat legitimate matrimonial claims. Dividing or equalizing pensions, between spouses, does not affect other creditors due to the exclusion from property of the bankrupt. The court is empowered to make RRSP transfers through the combined effect of s. 9 of the *Family Law Act* and s. 146(16) of the *Income Tax Act*.

The court transferred the RRSP funds of the husband by way of a spousal rollover.

Under Ontario's *Family Law Act*, assets and liabilities must be calculated as of the valuation date.
Contingent assets or liabilities must be valued according to the contingencies that exist on the valuation date. The court may not employ "hindsight" evidence.

***Greenglass* v. *Greenglass* (2009), 179 A.C.W.S. (3d) 658 (Ont. S.C.J.)**

The parties separated in 2001. Resolution of their marital differences were delayed because the husband was involved in bitter litigation with his former employer, B. J. Inc. B. J. Inc. had terminated his employment shortly before the separation, alleging serious wrongful conduct on his part and claiming $4.8 million against him. The husband counter-claimed, alleging wrongful dismissal, although the amount of his counterclaim was not identified in the judgment. By separation, he had incurred $82,000 in legal fees of which $6,000 was unpaid on the date of separation.

Following the separation, the acrimonious litigation between the husband and B. J. Inc. continued. The parties went to trial, argued fiercely in the Court of Appeal, and finally stopped litigating when the Supreme Court of Canada refused to grant leave to further appeal.

By the time the litigation concluded, the husband had spent $950,000 in legal fees, received a recovery of $310,000 and had spent $75,000 pre-separation. He claimed a deduction for the $565,000 spent in post-separation legal fees.

The court rejected his claim, other than for the $6,000 actually due and owing on the date of separation. In Ontario, assets and liabilities must be calculated at the date of separation where liabilities are "contingent". They must be addressed and valued according to the contingencies extant on the separation date. Therefore, actually valuing the costs of the litigation based on the outcome constituted an impermissible use of "hindsight" evidence.

Although the husband called his litigation lawyer to confirm all of his legal

expenses, and to confirm that there was little expectation of settlement, the lawyer admitted that she had not prepared any projections or opinions as to the likely or probable cost of the litigation. Indeed, at the date of separation, no one could have foreseen the dimensions of the litigation – a full trial, an appeal to the Court of Appeal, and a motion for leave to appeal to the Supreme Court of Canada.

Secondly, the Court noted that the husband never accounted for the present value of his own claims in preparing his net family property calculations.

Finally, the husband's corporation may have paid (and expensed) some of the costs of the litigation, thus tainting the legitimacy of the expense claim.

The court cannot employ "hindsight evidence". The value of an asset must be based on the knowledge available at the valuation date.

Jackson v. _Jackson_ (2009), 179 A.C.W.S. (3d) 875 (Ont. S.C.J.)

The parties had entered into a separation agreement. Under the terms of the agreement, the wife was required to purchase the husband's shares in a cash-strapped farming corporation "based on the corporation's year end financial statement for 2006". At the time, the corporation was being sued for $500,000 and this debt was reflected in the financial statements. The corporation had counterclaimed for $1.2 million. There was no mention of the counterclaim in the company's financial statements.

In 2008, the litigation was settled. No money changed hands.

The husband moved for judgment, arguing that as the litigation had been settled, the 2006 financial statement could be re-stated with precision. On a motion for judgment, the court must determine whether there is a genuine issue for trial.

The husband's motion failed. While the financial statements for 2006 could be re-calculated with precision, the 2008 settlement was inadmissible. The agreed upon valuation date was the corporation's year end for 2006. Therefore, the 2008 settlement was "hindsight evidence". Valuation must be based on the knowledge available at the valuation date. It cannot be used retrospectively to determine value. Such evidence may, however, be used for the limited purpose of testing the reasonableness of the valuation assumptions.

A party wishing to "discount" the value of an asset for underlying income taxes must prove the value of the "discount" claimed.

Businesses are normally valued on a capitalization of future earnings. The fact that the business-owning spouse must also pay support out of such earnings does not constitute double recovery.

Bozak v. _Bozak_ (2008), 173 A.C.W.S. (3d) 542 (B.C.S.C.)

The husband was a dentist. He incorporated his practice and separately incorporated the premises from which he practised. The British Columbia *Family Relations Act* is a "re-apportionment" statute. It provides each spouse with a presumptive one-half undivided interest in each "family asset" upon amongst other things, entry into a separation agreement. Both parties conceded that the only practical solution was that the husband keep the practice and the building and the wife keep the matrimonial home. A cash adjustment would be made.

The husband put forth two arguments. First, as his assets were corporately-owned, they should be discounted for income tax purposes. Second, the goodwill value of his practice was based on a capitalization of his future earnings. The goodwill was valued at $340,000. Therefore, he argued, that it must be taken into account in the quantification of spousal support. Otherwise, the wife would receive “double recovery”.

His argument for a tax discount was summarily dismissed as no evidence was tendered to establish the tax liability or when it would be paid.

The argument with respect to “double recovery” was also rejected. The court noted that the “double recovery” argument related primarily to pensions. In the case of a pension, the payment of income results in the capital being liquidated. Thus, the same capital that was equalized is converted into an income stream. By contrast, when a business is producing income, that income can be spent without affecting the asset itself. The value of the business can be equalized, and it is not depleted by producing income.

***Aelbers* v. *Aelbers* (2009), 62 R.F.L. (6th) 395 (B.C.S.C.)**

The calculation of income under the *Spousal Support Advisory Guidelines* is to be calculated in the same fashion as under the *Federal Child Support Guidelines*. Thus, the court may attribute all or a portion of a corporation’s pre-tax profits to the shareholding spouse.
It is prudent that a shareholding spouse call expert evidence relating to the retention of corporate profits. A court will be “cautious” in relying on the evidence of the spouse standing alone.

The husband and wife entered into a consent order in 2005 which required the husband to pay $2,100 monthly to the wife. The agreement contemplated that the support amount was properly calculated under the *Spousal Support Advisory Guidelines*. It provided for ongoing financial disclosure so that the support amounts could be carried, from time to time, depending on the income of the parties.

The *Spousal Support Advisory Guidelines* would, in this case (as there were no children), award the wife a percentage share of the difference in her husband’s income and her income based on the number of years of cohabitation.

Thus, the income determination of both parties was central to the calculation.

It appeared that the husband had disclosed his personal income as set out in his T-1 General tax return, but failed to include or disclose the income generated by a marine services company that he owned and controlled. His personal income was in the $100,000 level. Therefore, it appeared that the support award was about 25% of the income differential, as the wife had no income.

Ultimately, the husband was forced to make corporate disclosure. It was discovered that the corporation was exceedingly profitable. The retained earnings were:

2005	$102,000
2006	$244,000
2007	$521,000

The income determination under the *Spousal Support Advisory Guidelines* is to be conducted in the same fashion as the *federal Child Support Guidelines*. Thus, a court may add all or a portion of a corporation's pre-tax profits to the income of a shareholder. The wife argued that all of the pre-tax profits of the corporation for the years 2005 through 2007 be added to the husband's personal income and support be retroactively re-calculated.

Despite the legal mandate that attribution of corporate income be on a pre-tax basis, the judge focused on the increase in the retained earnings of the corporation. He stated that he had to decide:

> …what, if any, of the retained earnings of A-1 Marine Services should be attributed, notionally, to the defendant as his income. This amount, when combined with his annual salary, will provide his total income for determining support according to the *Spousal Support Advisory Guidelines*.

The husband failed to call any expert evidence relating to the retention of corporate profits. He testified that:

1. his business was cyclical. Thus, earnings had to be retained for downturns in the cycle;
2. his company was a new company in a highly competitive market. Therefore, it faced an uncertain future;
3. he had a prior company fail because it had not kept retained earnings in reserve;
4. he wished to acquire a building to house the business as he was subject to the vagaries of his landlord; and
5. strikes could disrupt his business as his employees would not cross picket lines.

The court, in noting that there was no expert evidence stated that it "would be cautious in relying on the defendant's evidence on these issues".

In the end, the court held it had to decide what amount of the retained earnings would be "objectively reasonable" to attribute to the husband. It concluded that the amount would be 50% of the retained earnings over the three year period. [Editor's note: the judge left the calculation up to counsel, but it would appear that the addition to the husband's earnings would be $260,000 and the retroactive support would leave him owing the wife $65,000 in support arrears. Moreover, there would be serious income tax implications as all of the arrears would be over a year old and outside of the deduction limitation period established by ss. 56.1(c) and 60.1(c).]

A payor of child support who does not increase his or her child support payments with his or her increasing income may face a retroactive child support claim.

Normally, a retroactive child support award should not pre-date the first "notice" given by the recipient.

"Notice" does not require formal notice. All that is required is that the topic of child support be "broached".

If the support payor has engaged in "blameworthy conduct", a court may look back beyond the date of notice in making a retroactive child support award.

There is "an emerging presumption" that all of the corporate income will be available for child support. Thus, the onus will fall upon the shareholder to prove corporate need.

The court can attribute the "pre-tax corporate income" to a shareholder in an appropriate case. Judges should not confuse "pre-tax income" with "retained earnings".

Hausmann v. _Klukas_ (2009), 64 R.F.L. (6th) 54 (B.C.C.A.)

This is a very important case dealing with the corporate income attribution under the *Child Support Guidelines*. As it interprets federal law, it will have persuasive effect throughout Canada, and is binding law on all trial courts in British Columbia.

In 2001, the parties agreed to a court order dividing their family assets and establishing the husband's child support obligation. The consent order required personal and corporate disclosure to be made on an annual basis.

The husband failed to make timely disclosure for a number of years, despite repeated requests by the wife. As the disclosure "trickled in", in the words of the judge, the wife's independent chartered accountant produced several expert reports. In turn, they were critiqued by the long time accountant of the husband's business. Although the husband voluntarily increased the support payments over the years, the wife alleged that the increases were inadequate under the *Child Support Guidelines*.

The wife asked that all of the corporate pre-tax profits be added to the husband's income for all the years going back to 2002 (when the first adjustment was to be made). She asked for lump sum support to make up for all of the years of deficient payment.

The court first ruled on the retroactive support claim and the date that the retroactive claim should commence. The agreement called for the first adjustment to be made in 2003. The wife, however, did not ask for disclosure until 2004. The Court of Appeal appeared to "split the difference" to 2003. The Court acknowledged that retroactive support should not pre-date the first "notice" given by the recipient that he or she wishes to "broach the topic" of support. While that was 2004, the husband was guilty of "blameworthy" conduct in failing to disclose on the timely basis prescribed by their consent order. "Blameworthy conduct" permits a court to look back beyond the date of notice. The husband should have disclosed in 2002 and did not.

The case presented a factual dilemma for the courts. The wife's expert stated that all of the corporate earnings were available to the husband. The husband's accountant testified that no corporate earnings were available.

In 2002, the husband owned two companies, a numbered company and a company called Pioneer. These two companies entered into a joint venture with an Alberta company to supply wood products to the construction industry. Under the joint venture agreement, Pioneer and the numbered company had to repay certain loan obligations of the Alberta company, share profits with the Alberta company and ultimately buy out the Alberta company.

In the years following, the husband drew out the profits of his companies, paid

tax on the personal income and loaned the balance back to the companies.

The trial judge held that his personal income was the line 150 income reported on his tax return. The loans back were not truly debt obligations but the creation of personal wealth or equity. The Court of Appeal agreed.

However, the trial judge then refused to attribute further corporate income to the husband noting that it already had brought a great deal of income into the husband's hands and further, that the corporation needed the funds to meet its obligations to reduce the Alberta Company's loan and eventually complete the buyouts.

It was clear that the trial judge had made certain factual errors in determining the profit-sharing obligations and whether the loan obligations had already been taken into account. More important, however, was the unresolved question of whether the buyout may have incorporated the cumulative obligations payable and paid over time. The appeal justice curtly added "I pause to note that this is not an exercise that a court should have to undertake".

Later, the appeal justice stated:

> The confusion created by the conflicting accounting evidence presents enormous challenges in a case such as this one. It is neither necessary nor desirable for litigants in family law disputes to have to adduce numerous expert reports to establish the legitimate calls or the corporate pre-tax income of a company solely owned and controlled by the payor spouse. It should be a relatively straightforward exercise for the payor spouse with the benefit of financial advice. The absence of clear evidence raises the question as to the onus to be met…[under s. 18].

The court went on to consider various other cases that interpreted s. 18. In so doing, it noted an "emerging presumption" that all of the corporate income would be available for child support. Thus, the onus would fall upon the shareholder to prove the corporate need. A court must not be left to "speculate" about need. It must be proven in the evidence. And the shareholding spouse, who controls that information, must lead clear evidence of corporate need.

As the husband left the Court of Appeal with "unclear and unsubstantiated" evidence of corporate need, all of the corporation's pre-tax income was attributed to him.

As a final note, the Court of Appeal noted that some judges had fallen into error by looking at changes in corporate "retained earnings" as opposed to pre-tax profits. This is in error as "retained earnings" are the result of subtracting from pre-tax income tax, dividends, and other changes to the capital accounts.

A professional services corporation is not a "business asset" within the meaning of New Brunswick's *Marital Property Act*.

Milton **v.** ***Milton*** **(2009), 62 R.F.L. (6th) 286 (N.B.Q.B.)**

The New Brunswick *Marital Property Act* requires that marital property be divided equally between the spouses at the end of their relationship. "Business assets" are not marital property and are not subject to automatic sharing (though they may be shared on other "equitable grounds"). The case before the New Brunswick Court of Appeal was whether a professional corporation (in this case the husband's medical practice) was a marital asset. Moreover, the husband argued that his income, for support purposes, should be limited to the amounts he received personally from the professional corporation. A third issue, whether the court can order the securing of support by way of life insurance, is not reported in this summary.

The court concluded that the professional practice was not a business asset. Business assets are assets that have as their primary purpose the generation of income in an entrepreneurial sense. This purpose may be ascertained by the intentions, as manifested in their actions and their statements concerning the asset. The claimant's purpose of the corporation was to defer tax, retain the professional's income and possibly plan for one's retirement or estate. Otherwise, the practice had little entrepreneurial value. The retained or paid out earnings of the corporation were used for family purposes – shelter, transportation, household, educational and recreational purposes. Thus, it was a family asset and marital property.

The court rejected the husband's argument that the corporate income should not be attributed to him. His corporation was merely his alter ego. Piercing the corporate veil may sometimes be an essential mechanism to ensure adequate support.

Section 18(1) of the Guidelines is limited to the attribution of corporate profits within the most recent or current taxation year.
Judges must distinguish between corporate pre-tax profits and retained earnings. A failure to do so may lead to an incorrect analysis which could undermine a corporation's operations.

Bembridge **v.** ***Bembridge*** **(2009), 177 A.C.W.S. (3d) 174**

In 2003, the parties negotiated a separation agreement which, amongst other things, obliged the father to pay child support. The mother sought increased child support in 2009, alleging the father's income had increased. In particular, she alleged that he should have income imputed to him for several different reasons, including attribution of corporate income under s. 18(1) of the Guidelines.

The judge took pains to analyze s. 18(1) of the Guidelines which permits the court to attribute the corporate pre-tax profit to a shareholding spouse.

First, it is limited to the most recent or current taxation year. That is because income from previous years may no longer be available to the shareholder.

Second, a distinction must be drawn between corporate pre-tax profit and retained earnings. Retained earnings represent the difference between assets and liabilities. They are the accumulation of net income less dividends since

the company's inception. They represent the equity in the company.

A corporation must have retained earnings to be solvent. Often, banks require a level of retained earnings to obtain or maintain financing. Consequently, retained earnings do not necessarily represent money that the shareholders can take out as "income". A failure to distinguish between "income" and retained earnings may lead to an incorrect analysis that can undermine the operation of the corporation. Therefore, judges must inform themselves of this distinction.

In the end, the court declined to impute or attribute income to the father. Although the father produced his accountant for cross examination, it appeared that the mother's counsel did not cross examine on any issues relating to corporate income. The company's retained earnings were modest, the business was cyclical, it often carried a bank overdraft, and it financed some of its own expenditures.