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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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The wife's entitlement to support was based on compensatory principles which included the long duration of their relationship and the division of labour with the marriage.

The court can look to publications by Canada Revenue Agency to define terms in the *Federal Child Support Guidelines* – in this case "not at arm's length". Persons committed to each other romantically and with a shared vision for the business do not deal at arm's length.

Payments made by a corporation to a person who does not deal at arm's length will be "added back" to the corporation's profits by section 18(2) of the *Federal Child Support Guidelines* unless and to the extent that the payments are reasonable.

A portion of the wages paid to the shareholding father's girlfriend were reduced as exceeding a reasonable amount.

Lease payments made by a corporation to the shareholding father's girlfriend were reduced by the court, in part, because the court felt that they were unnecessary.

Timing differences between a corporation's fiscal year end and a shareholder's T-4 may result in income attribution to the shareholder.

Certain expenses for donations, telephone, meal and entertainment were "added back" to the corporation's pre-tax profits due to their personal component.

The Court can adjust a corporation's capital cost allowance expense if that expense exceeds the actual depreciation rate of the capital asset.

In long marriages, the former spouses should have roughly equivalent standards of living.

The court concluded that funds used by the husband's company to pay down debt and acquire new equipment was income "available" to pay child support under section 18(1) of the *Federal Child Support Guidelines*.

***Royer* v. *Butler* (2010), 189 A.C.W.S. (3d) 173 (B.C.S.C.)**

At issue was a determination of the husband's 2008 income. As he owned a corporation, section 18 of the *Child Support Guidelines* was engaged. Section 18 allows the court to attribute the corporate pre-tax profits to the shareholding spouse's income.

The corporation's 2008 operating income was $350,666. It had "other" income from a joint venture (alleged to be non-recurring) of $471,918. It paid a management fee of $220,000 to an associated company. Finally, it paid $125,896 in wages to the husband. Thus, the court concluded that the corporate income available for distribution was $1,168,480.

In 2008, the company spent $318,854 for new equipment and paid down its bank lines by $237,000. Its cash resources increased by $226,000.

The husband alleged that his income should be akin to his wages. The wife alleged that he was using the company to accumulate savings to the detriment of the children. She also alleged that the equipment purchases were in the nature of investments.

The court concluded that there was merit to the wife's arguments – namely, that the husband was accumulating assets. Thus, the court, while recognizing that the company had a legitimate need to retain profits, attributed $584,240, being half of the available corporate income, as the husband's income.

"Income" for child support purposes is income to be earned in the current calendar year (as opposed to income earned in the past year).

The amount of a "taxable benefit" reported in the T-4 is not conclusive of the actual income benefit for determining income under the *Federal Child Support Guidelines*.

Canada Revenue Agency's Interpretation Bulletins are not authoritative statements to interpret the *Income Tax Act*.

"Taxable benefits" are measured by the net gain for the employee.

***E. (C.L.)* v. *R. (B.M.)* (2010), 190 A.C.W.S. (3d) 533 (Alta C.A.)**

The husband was an employee of a Canadian chartered bank. His duties required him to live in Fort McMurray, Alberta. The bank leased a home to him and charged less than market rents. It reported a figure for a "taxable benefit" on his T-4, and was, thereby, included in his line 150 income.

The wife alleged, however, that the amount of the benefit was inordinately low and sought to have a greater amount imputed to him.

In analyzing the case, the court considered the reporting of income, the calculation of "benefits" and the revised definition of "extraordinary" expenses found in the 2006 amendments to the *Child Support Guidelines*.

First, the court noted that, apart from using the sources of income set out in the T-1 General form, the term "annual income" was not defined in the Regulation. Section 2(3) mandates the use of "the most current information". The objectives, set out in section 1, refer to simplifying the calculation of support and creating efficiencies. Section 21 requires delivery of the tax returns and Notices of Assessment. Section 25 calls for annual disclosure.

By section 7(1.1)(b) an expense for extra-curricular activities may still be extraordinary notwithstanding that the payor can "cover" the expense.

The court opted for a calculation of the current calendar year (as opposed to the income earned in the past year), citing prior decisions that it had made.

Second, the court considered the nature of the "taxable benefit". It rejected the notion that matters should end with the T-4 (although one of the justices dissented on this point). The T-4 is merely an information return. The T-4's are often a deductible expense to the employer, so there can be a motive to a high value. On the other hand, an employee can be victimized by a T-4 from a former employer. Therefore, the T-4 cannot be conclusive of the benefit. It follows that if the T-4 is not conclusive, line 150 cannot be conclusive.

Although Canada Revenue Agency published an Information Bulletin IT-470 R on fringe benefits, such bulletins are not authoritative sources for the interpretation of taxing statutes. Only the courts can interpret the law.

The court noted that the concept of a taxable "benefit" implies some form of net gain for the employee. Therefore, the cost to the employer is not the test. Moreover, if the employee is forced to incur any expense for the employer's work which is reimbursed, this does not make the employee better off.

In the end, the court concluded that it could not perform the calculation. Rather, it directed a trial as to average rents in Canada for a house equivalent to that occupied by the husband (a bungalow 30 years old of 1,200 and 1,900 square feet).

Finally, the court had to consider the wife's claims for "special or extraordinary" expenses under section 7 of the Guidelines. That section was amended in 2006, to resolve conflicting interpretations between appeal courts in Canada. Basically, an expense for extracurricular activities will be "extraordinary" if the payor cannot "cover" the expense from his or her resources (his or her income plus the basic child support). However, an expense can be "extraordinary" if it is within the parent's means but disproportionate to those means having regard to economic and non-economic factors listed in section 7(1.1)(b) such as the nature and number of activities, special needs or talents of the child, the overall cost of the activities and any similar and relevant factors.

Again, the court did not resolve the issue but sent the matter back for a trial. The court did note, however, that school fees and supplies of $115 and $65 annually were not "extraordinary". The trial would be over whether the parties would share $784 for horse riding lessons, $330 for soccer and $832 for gymnastics on an annual basis. [Ed. note: a trial over how $1,946 over a year should be shared?]

Where a company provides its shareholder with a job and a steady income and liquidation is not anticipated, the liquidation approach to valuation is inappropriate.

Stelter **v.** ***Stelter*** **(2010), 191 A.C.W.S. (3d) 512 (Sask. Q.B)**

The court dealt with a number of issues concerning the breakdown of the marriage – custody, support, and property distribution under Saskatchewan's *Family Property Act*. Only the value of the husband's business interests is dealt with in this summary.

The company, known as CDMac sold non-exclusive product lines of industrial chemicals and equipment. It also owned and operated a small car wash. The husband was the sole shareholder. He paid himself a salary of between $60,000 - $90,000 annually and was provided with a company car which he used extensively in business.

The husband's valuator testified that the shares had no value. He pointed out that the salary drawn by the husband was a reasonable management wage. Beyond that, there was no real rate of return on its assets, and its liabilities exceeded its assets. He testified that the company would require an annual capital injection of $17,500 to sustain capital reinvestment, mainly in the form of replacing vehicles.

The wife's expert, a chartered accountant, testified that a "liquidation approach" was inappropriate. He noted that the company continued to operate, its sales volumes were increasing, it continued to employ staff, it produced enough income to finance its debt and it produced a reasonable salary for the husband. He suggested a "rule of thumb" of 2 years net income before management salary, noting that this would enable a purchaser to repay the purchase price in 7 years while providing a salary of $80,000. Because the company would have a positive cash flow after the management salary, he contended that it should be valued on a going concern basis.

In the end, the court concluded that the liquidation approach was inappropriate. The husband had carried on the business for 6 years and intended to do so. The court averaged the income before management salary, $82,836, doubled it, $165,672, and reduced it by the accumulated deficit of $88,134. The court's conclusion was that the shares were worth $77,538.

The nominal subscription for shares in a corporation was held to be a mere accounting formality that did not turn an inheritance into a purchase.

S. 14 of Ontario's *Family Law Act* creating a presumption of equal ownership if property is held in joint names can be rebutted by evidence of actual intention.

Paddock **v.** ***Paddock*** **(2010), 78 R.F.L. (6th) 54 (Ont. S.C.J.) aff'd 78 R.F.L. (6th) 69 (C.A.)**

The wife had three sisters. Her parents owned a company called C.S. Inc. When the parents died, the company was left to the 4 daughters. Two of the sisters wanted out. As a result, a new investor was taken into the company.

The company was valued, at the time, at $950,000. The new investor and his wife invested cash of $187,500. The company borrowed $462,500 from the bank; $475,000 was paid out to the departing sisters and $50,000 paid to

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Inherited funds do not lose their character where the intermingling with other funds is minor and the usage of the funds is limited.

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the wife and the remaining sister to reflect the fact that their interests would be $187,500 (the same amount as the investor). $75,000 remained in the company as working capital.

A numbered company was incorporated to effect the transaction. A bill of sale transferred the chattels of C.S. Inc. to the numbered company and the departing sisters transferred their shares to the numbered company.

For reasons that no one could account for, the shares in the numbered company were not issued to the investor and the two sisters alone. Instead, the shares were issued to the 3 parties and each of their spouses, namely, 6 shareholders in all. All shareholders personally guaranteed one third of the corporate debt.

The company books showed each shareholder subscribed for his and her one sixth holding by a note receivable for $100. At the end of a year, the note receivable was taken off the books and each shareholder's account was debited accordingly.

The six shareholders all signed a unanimous shareholders' agreement in which each represented that he or she was a registered and beneficial owner of 100 shares in the corporation.

When the spouses separated, the wife asserted that:

1. her 100 shares were "excluded" from her net family property;
2. the husband's 100 shares were held by him in trust for her and were also excluded;
3. a savings account was excluded as being the "traced" proceeds of the $50,000 payout that she received on the organization of the numbered company; and
4. the husband's shareholder's account was held in trust for her.

Under Ontario's *Family Law Act*, property inherited by a spouse after the date of marriage will not be included in the calculation of that spouse's net family property. Likewise, property extant on the date of separation, into which inherited property can be traced, will also not be included. Although the word "excluded" is not used in the statute, it has become the term of art rather than "not included".

Section 14 of the Act also creates a presumption of resulting trust respecting property transfers between spouses (ie. ownership remains with the transferor). The section goes on to deal with situations of joint ownership. In cases where property is held in the joint names of parties or in a joint account, a presumption of equal ownership exists, "in the absence of evidence to the contrary".

The wife's shares in the numbered company were excluded. When the company

books were set up, the wife was credited, in her shareholder's account for $187,500 being the value of her interest in the common shares of C.S. Inc. (after payment of the $50,000). Thus, her holding in the numbered company was traceable to the inheritance. The corporate subscription for $100 did not detract from the inheritance. It was a mere accounting entry made after the inheritance.

The court held that the husband was a trustee of his hundred shares for the wife under section 14. First, it was not caught by the exception as there was no evidence that there was "joint" ownership. Each party held shares in his or her respective name. There was no evidence of an intention to benefit the husband by putting the shares in the spouses' names. In fact, there was evidence that the wife intended to keep her inheritance separate. Although the husband guaranteed a portion of the corporate debt, the court held that there was no possibility he'd be called upon. Finally, the shareholders' agreement could not be relied upon. The parties represented that each owned his or her own shares. The representation was not an admission by the other shareholders.

The extent of her shareholding was not the full 200 shares (or 1/3 of the numbered company). Her inheritance was one quarter (so it was limited to 150 shares).

The savings account was also excluded, despite some intermingling with other funds and a transfer "in and out" of a joint account. The savings account was used by the family for special expenses such as taxes, sporting equipment …etc. It was funded by deposits by each party. The court noted that recent case law rejected old tracing concepts like "first in, first out", placing more reliance on common sense. As the only large deposit was the traced proceeds of the $50,000 withdrawal, the account could be excluded. The fact that the money was "parked" in a joint account for a brief 4 day period did not create a beneficial interest in the husband under the "joint account" exception of section 14(b).

The wife engaged a chartered business valuator whose uncontradicted evidence was that the shares had a value of about 1.1 million dollars. He testified that disposition costs could run as high as $284,000. Noting that the company's assets may have to be sold and the proceeds distributed by dividend, the court reduced the "nominal" disposition costs by 50%. The exclusion was also reduced by the nominal disposition costs.

After the numbered company was organized, the wife asked the accountant to adjust the shareholder accounts. The accountant set up the 3 accounts, in the names of each set of spouses. The court held that the husband held his interest in the account on a resulting trust for the wife.

Finally, the wife asked the court to vest the husband's shares in her (pursuant

to its powers in section 9 of the Act) on a "tax free" rollover basis. The court declined to do so holding it could not bind the hands of Canada Revenue Agency.

[Ed. note: In the writer's opinion such a transfer would, in essence, "roll over" as it would not be a "disposition". It would be a transfer from a trustee to a beneficial owner of the asset.]

An appeal to the Ontario Court of Appeal was dismissed and the husband was required to pay the wife $10,000 costs in respect of the loss on appeal. By and large, the Court of Appeal concluded that the trial judge's analysis of the facts and the conclusion drawn from them disclosed no error in law.

As "stepparents" are "parents" under provincial legislation, they may owe a duty to disclose in child support proceedings.

O. (J.) **v.** ***M. (M.M.)*** **(2010), 192 A.C.W.S. (3d) 567 (B.C.S.C.)**

The case dealt with disclosure by a stepparent. The child, K, was 20 years of age. Her natural father, Mr. O, had abandoned the family years earlier. Her mother, O, then married M. They separated after 6 years of marriage and M, as a stepparent, agreed to pay child support until K turned 18.

Following her separation from M, she began to live in a common law relationship with C. K was 12 when that relationship began. They were still in that relationship when the action started.

At the time of the action, K was a full-time student in Australia.

M. sought financial disclosure from C alleging that C also owed a liability to support K. C's defence that he was not a "spouse" under the *Divorce Act* was quickly disposed of. He was still a potential "parent" as a stepparent under the provincial *Family Relations Act*.

Because K was over the age of majority and living away from home, her support fell to be determined under section 3(2)(b) of the Guidelines. That section enables the court to look at the financial ability of "each" parent. Thus, it was broad enough to catch C.

The court went on to make the disclosure order. It required C to:

1. produce his last 3 years' personal income taxes;
2. if he had a controlling interest in a company in which he was an investor, produce the last 3 years' financial statements of the company. If not, to produce its most recent statement;
3. produce any documents relating to the payment of K's expenses; and
4. deposits into his bank accounts.

He was not required to produce a full blown financial disclosure statement

required of other litigants under the Court Rules nor was he required to disclose whether he had paid any portion of O's legal costs.

The Order against M. was different (as he had, at one time, admitted his obligation). He was required to:

1. file a "full-blown" financial statement in the form required by the rules;
2. produce financial statements for corporations in which he had an interest;
3. provide a list of bank accounts and RRSP's and the current statement showing the balance.

The wife's claim that she was a half owner of a company was rejected. She did not pay any business expenses and did not personally report any of its income.

The court, in accepting a "discounted cash flow" approach to valuation, revised the discount based on admissions made by the expert in cross-examination.

Evidence of actual (as opposed to anticipated) events occurring after the valuation date are inadmissible as hindsight evidence.

***Duan* v. *Li* (2010), 188 A.C.W.S. (3d) 1096 (Ont. S.C.J.)**

The parties separated after a brief 4 year childless marriage in 2003. Both parties were software engineers. The case history was as chequered as the factual disputes – over who paid for their matrimonial home, what debts were owed to their parents, the value and ownership of a small software company, whether the husband's vacation pay should be included as an asset, and whether the husband should pay damages for assaulting the wife. The original trial judge retired without giving judgment, so a new judge was assigned to the case to listen to the audio transcripts. By this time, both parties had fired their lawyers and were self-represented.

Only the issue relating to the value of the software company is reported here.

The wife alleged that she was a half owner. The husband said he was the sole owner. Her claim was rejected. The husband testified in detail about the nature of the software and the requirements for CRA certification. The wife did not. She did not pay any of the expenses of the business and did not personally report any of its income. Indeed, the chartered business valuator who valued the company for her qualified his report stating "…we understand that at the valuation date the software was beneficially owned by your husband".

The software was tax preparation software which the user would download. The husband developed it for the 2002 tax year. The process required certification by CRA a lengthy procedure. The 2002 version was capable of producing only a "one person" return. Thus it prevented the sharing of data of couples and precluded them from optimizing their refunds. This issue was corrected in the 2003 and subsequent editions. Annually, the software had to be revised to correspond with tax table changes and annual re-certification was required. It was only used in 3 provinces. It offered customer support.

The wife's valuator testified that the proper approach was to estimate the future cash flow of the software product into the future and to then discount it for a

money and risk factor. He determined that its 2003 cash flow was $24,500 and that it would be expected to grow by 50% annually – ie. $36,800 for 2004, $55,200 for 2005, and $82,800 for 2006. He applied a 30% discount.

On cross-examination, the expert admitted that he had not examined the extent of customer support and that he had never examined the original 2002 software (basing his report on the 2005 version). He was forced to admit that in so doing, he hadn't taken into account the enhancements made in 2003, 2004 and 2005 to the original 2002 version. There was disputed evidence over the time it took to annually revise and certify the software. By 2005, a competitor was offering similar software free of charge (which the expert dismissed as being "hindsight information").

The court ruled that the actual post-2002 changes were, in fact, hindsight evidence. However, the court concluded that the expert failed to fully discount the need for ongoing revision and ongoing customer support. The product viability was entirely dependent on these factors which, in the court's opinion, were not adequately addressed in the 30% discount.

The court valued the software, at the valuation date, at $50,000.

B. (T.L.) v. B. (R.) **(2010), 189 A.C.W.S. (3d) 170 (B.C.S.C.)**

The court may attribute corporate pre-tax profits to a shareholding spouse under section 18(1) of the *Federal Child Support Guidelines* even though that spouse does not "control" the corporation.

The onus is on a partner to demonstrate the capitalization needs of the partnership. Failure to do so is fatal to a claim for deduction under section 12, Sch. III of the *Federal Child Support Guidelines.*

The husband had his own business, but the lion's share of his income came from a family investment company. His shares appeared to be non-voting, his mother holding the voting shares. He had no active management in the company as it was run by a sibling. He had no control over the declaration of payments to shareholders or when or how they would be received. He only had a minority interest.

He also had a 9% interest, along with other family members in a limited partnership.

Annually, he would be "credited" with interest payments, dividends, and partnership income. However, he would receive, in cash, only a portion of such "credited" income. Taxes would be paid on the entire "credited" income and a portion of the remainder would be credited to his shareholder's account or partnership capital account. An accountant's letter stated that:

> "In order to recover the otherwise payable Part IV Corporate Income Tax, [the company] declares sufficient dividends annually on the [non voting] shares."

The letter noted that 9.5% of the net rental income of the partnership was reported by the husband.

Finally, the letter stated that:

> "To the extent that [income] is not distributed, it is required to fund the operations and meet the mortgage commitments and capital expenditures".

About 50% of the income "credited" was actually paid out – about $140,000.

No one testified, however, as to why the company needed to retain the other $140,000. Meanwhile, the court noted that the book value of his holdings was increasing due, of course, to the income that was not paid out in each year.

The failure of the husband to lead evidence as to the corporation's and the partnership's need to retain the income "credited" to him was fatal to his defence. Income of $280,000 was attributed to him. No evidence was led as to the unique capital features of the businesses, their cash reserves, or their ability to fund the enterprise through borrowing.

While the husband's lack of control over the corporate and partnership income was a factor to be considered, it was not the sole factor. It is not even a factor under section 12 of Sch. III to the Guidelines (which deals with the capitalization needs of partnerships). To hold otherwise would enable the husband to accumulate wealth while avoiding legitimate child support obligations.

The court will not "rubber stamp" the expert's opinion.

The court commented upon the proper role of an expert witness.

Ramlochan v. *Ramlochan* (2010), 191 A.C.W.S. (3d) 922 (Ont. S.C.J.)

The husband controlled two companies. Although he reported an income of $57,000 on his 2007 income tax return, the evidence showed that he withdrew large sums of money from the corporations - $234,000 in 2006, $626,000 in 2007, and $557,000 in 2008. Applying section 18, by attributing the corporate pre-tax profits to him, his income would be $222,000, $630,000 and $557,000 for each of those 3 years.

It was common ground that there were no corporate debts or lender requirements, and the business was not capital intensive.

Surprisingly, the husband's expert opined that his annual income should be $200,000.

Meanwhile, the wife argued that his income should be "grossed up" to reflect the fact that no tax was paid on it. The husband said he was going to make a voluntary disclosure to CRA.

Noting that it was an interim motion, and the husband's intention to voluntarily disclose, the court declined the gross up. It was a matter for the trial judge who would likely be in a better position to determine the impact of the disclosure, the retained earnings of the companies, and whether imputation should be made.

The court rejected the expert's opinion that the husband's income was

$200,000. His current income was $557,000 applying section 18(a) to his 2008 income.

The court made the following observations concerning expert testimony:

> "The court will not accept an expert's opinion solely on the basis of the expert's "authoritative claim". That is, it is not sufficient to show that (a) she is an expert; (b) she has looked into the matter; (c) she has reached a conclusion; and (d) therefore the court should accept her conclusion. Rather, the expert should explain her assumptions, describe the material evidence and observations upon which the expert relies, describe the analysis and reasoning the expert has used to reach her conclusion, set out her conclusion, including any limitations and qualifications to that conclusion. The opinion is not just the "bottom-line" conclusion but the entire intellectual exercise of assumptions, evidence, analysis, reasoning, conclusions and limitations of that conclusion. It is then possible for the court to understand and apply the expert's opinion on the basis of facts, as found by the court, and to weigh competing opinions on contested issues.

The court will not automatically attribute the pre-tax profits of a corporation to a shareholding spouse under section 18(1) of the *Federal Child Support Guidelines.*

The court treated the repayment of shareholder loans as income, "grossing up" the repayment to arrive at a notional pre-tax amount.

Pallot **v.** ***Pallot*** **(2010), 191 A.C.W.S. (3d) 1237 (B.C.S.C.)**

The primary issue of the wife's claim for interim child and spousal support was the husband's income. He and a partner were equal owners in a group of companies that operated drugstores and a Home Hardware outlet. The husband bought into the company after the founder died. Matters were settled with the founder's estate, the partner took back $1.3 million in redeemable preferred shares, leaving him and the husband with an equal amount of common shares.

They each drew $143,000 annually as salary. The company would declare bonuses or dividends for tax purposes and much of this would be lent back to the group of companies.

The wife's expert testified that if his share of the corporate profits were attributed to the husband, his average income over the past 3 years would be about $600,000. The Plaintiff's expert noted that over the 3 year period there had been a very large increase in the corporate retained earnings.

The evidence indicated that in 2010, the husband had accessed his shareholder's account to pay support, to pay 2009 taxes and 2010 instalments, and to fund his RRSP contribution. These amounted to $138,769.

The court rejected the allegation that it should attribute a $600,000 "average" income for the husband. It noted that:

1. the husband did not, alone, have dominion and control over the corporate profits;

2. the company was a retail operation, not a personal services-type of company. Thus, the income could be needed to maintain the company's viability;
3. the local economy was in a state of flux;
4. the company was subject to financial controls, especially by its franchisor, Home Hardware, and its bank;
5. it had embarked on recent expansion; and
6. the partner had a legitimate right to call for redemption of some of his preferred shares.

The court held that what the husband actually did with his salary and shareholder account drawings would be a better barometer of his income. The court found his income to be $341,151 being the $143,000 salary and a "gross up" of the shareholder loan withdrawals of $137,769 to arrive at a notional pre-tax amount.

The court has power to re-adjust the expenses claimed by a corporation – in this case, its capital cost allowance expense.

Certain farming expenses were imputed to the father as being personal and living expenses.

The court treated recaptured capital cost allowance as "income" for child support purposes.

The disposition of capital assets to meet an inter-spousal property obligation will not exempt the capital gain from being "income" for child support purposes.

Moore v. Sharygalo June 4, 2010. Ball J. (Sask. Q.B.)

The husband carried on 3 businesses. He farmed as a sole proprietor, he traded cattle under a corporation – Trading Co., and he hauled livestock and freight under a corporation – Trucking Co.

The wife alleged that income should be imputed to him for 4 reasons:

1. the capital cost allowance claimed by him personally and corporately was excessive, thereby artificially reducing his funds available for child support;
2. he deducted personal expenses as business expenses;
3. the profits of Trading Co. should be attributed to him under section 18 of the Guidelines; and
4. his standard of living indicated undeclared income.

The court held that it had the power to adjust a capital cost allowance expense claimed within a corporation. It would be a two step process – first, the disallowed capital cost allowance claim would be added to the corporation's income. Second, it could attribute all or part of the corporation's pre-tax profit to the shareholder under section 18 of the Guidelines. Simply put, the court concluded that the intervention of a corporate barrier could not defeat the court's right to impute "unreasonably" deducted expenses.

However, the court held that it could not arbitrarily disallow or add back capital cost allowance. Rather, there must be evidence that either (a) depreciable

assets are not being replaced as they wear out or (b) the capital cost allowance claimed exceeded the actual decrease in the value of the assets over time.

On the evidence, the cost of replacing equipment in Trucking Co. exceeded the capital cost allowance claim. Moreover, even without the capital cost allowance claim, the company would have lost money. In regard to Trading Co., it claimed a capital cost allowance expense of $4,000 and did not acquire any replacement property. However, a capital loss carried forward eliminated any taxable income (although it had pre-tax profits). The court concluded that "unreasonableness" did not require the imputation of the capital cost allowance claim as it was isolated.

The court imputed some of the farming expenses back to the husband, namely, 25% of amounts claimed for electricity, fuel, insurance, taxes, office expenses, and the capital cost allowance claimed on a computer. These amounts totalled $4,400. The court found no reason to impute any corporate expenses to the husband.

Turning back to the Trading Co., it had suffered losses in prior years due largely to the mad cow disease crisis. These losses, when carried forward, eliminated any profit for tax purposes. However, the court noted that section 18 required it to look at the corporation's pre-tax profit. Noting that the corporation was little more than a personal services corporation, the court attributed all of the $39,000 pre-tax profit to the husband. [Ed. note: in so doing, the court impliedly held that the husband could not deploy the profits to retire the shareholder's loan or bank debt incurred in earlier years when the company lost money.]

The "undeclared income and lifestyle" argument advanced by the wife was summarily dismissed. The husband testified that he had liquidated substantial assets to meet his matrimonial property obligations. He purchased a new truck, car, camper and ATV with funds left over.

Finally, the court had to deal with the tax implications of the husband's sale of farms to meet his matrimonial property obligations. The disposition resulted in $27,000 of recaptured capital cost allowance. Although a non-recurring item, the court held that it was, in part, money from the disposition of assets and thereby available for payment of child support. One half of the recaptured capital cost allowance was imputed to the husband.

Finally, even though the husband was required to dispose of assets (farmland and equipment) to meet his matrimonial property obligations, the capital gain was, for child support purposes, treated as income. Applying section 17 to the non-recurring income item, the court imputed 25% of the actual capital gain to the husband for child support purposes.

The wife's claim for interim disbursements was premature.

McIlvenna v. *Pinkowski* (2010), 192 A.C.W.S. (3d) 1102 (Ont. S.C.J.)

The mother sought an order for interim disbursements in an application for child support. The father's financial affairs were described to the judge as "not being complex". He disclosed assets of approximately $4.7 million and an annual income of $200,000. The mother was an unemployed student who had debts. The CBV proposed by the mother estimated that her fees would be between $25,000 to $35,000. The case was in its early stages and discoveries had not been conducted.

The court denied the application as being premature. The husband had not yet delivered any expert's report, so a rebuttal was not yet required, and discoveries had not been conducted. No requests for further disclosure had been made.

The court characterized the mother's request as one in which she was questioning the credibility of the father and his financial disclosure without having tested it by discovery or cross-examination.

Retained earnings, left in a business, are not a matrimonial asset.

The husband's contributions to the wife's business should, in this case, be valued on a dollar amount basis, and not by an award of an interest in the business.

The husband's evidence of the labour he contributed to the wife's business was characterized as being a "helpful gesture or good turn for which compensation was never expected".

Gosse v. *Sorensen-Gosse* (2009), 184 A.C.W.S. (3d) 158 (Nfld & Lab U.F.Ct.)

Section 21 of Newfoundland and Labrador's *Family Law Act* permits a spouse to apply for an equal division of the matrimonial assets. Section 18(1)(a) of that Act defines "business assets", which are expressly excluded from the definition of "matrimonial assets". However, by section 29 of the Act, a spouse may apply for entitlement to the business assets if he or she contributed "...work, money or money's worth in respect of…the business asset…". The award can be a dollar amount or a share in the asset value.

Prior to the marriage, in 1986, the wife began self-employment as a dance teacher. They married in 1990. Initially, the wife taught dance after school hours on school properties. In 1991, she leased premises for her dance studio. In 1997, she incorporated her business. The corporation purchased real estate for a permanent home for the dance studio.

Pursuant to section 29, the husband claimed a 35% interest in the business. He asserted that the retained earnings of the business were, in reality, matrimonial earnings, he contributed money as his wife used joint funds to invest in the business at the time of incorporation and he contributed money's worth as the bank relied on his credit-worthiness in granting the corporation loans.

The court was faced with two challenges. First, what was the value of the business? Second, what was the extent of the husband's contribution?

The valuation evidence was presented by a Chartered Accountant. His

evidence was that although there were various ways of valuing the business, the liquidation approach was the most appropriate. The liquidation approach would yield an after-tax value to the shareholder of $170,000 based on the premise that the real estate had a value of $322,000, its book value. He testified that for each $100 of market value, the net liquidation value of the company would increase by $76, leaving the court to determine the market value of the corporation's real estate.

The court declined to value the business, concluding that a money amount would be more appropriate. The wife planned and implemented a strategy to grow the business. She was the executive and operating mind of the business and the reason for its success. She contributed her skills and talents. She took personal financial risk investing her own funds in the business. Other persons other than her husband, such as her family, had contributed unpaid labour to the school.

Thus, the issue came down to placing a dollar value upon the husband's contribution.

The court rejected the husband's argument that the retained earnings of the corporation were disguised "matrimonial income". Money was left in the business as a matter of conservative and prudent business practice. The retained earnings were modest – equal to about three months' operating expenses. There was no evidence that the wife's drawings were less than the fair market value of her contribution. While the court acknowledged that corporate retained earnings can be a matrimonial asset, there was no evidence, in this case, to warrant such a finding. Simply put, the court stated "…retained corporate earnings are not automatically a matrimonial asset".

The court rejected the credit-worthiness argument of the husband. He provided income information to the bank. However, he never signed any loan applications, business documents, or guarantees of the business indebtedness. There was no evidence that the bank relied on his credit-worthiness.

The court rejected his argument that he contributed "work". Factually, the court noted that her parents contributed substantial unpaid labour to the business. The court noted that when pressed in cross-examination, the husband's evidence of the "work" was vague and uncertain. In the end, the court characterized his efforts as being "in the nature of helpful gestures or good turns for which compensation was never expected".

The court did award a monetary amount to the husband. At the time of the incorporation, the wife cashed out approximately $18,000 of jointly-owned Canada Savings Bonds. Thus, "matrimonial property" found its way into the business. It mattered not that the money contribution was more of a happenstance rather than a conscious and deliberate investment. Thus, the

court found that in 1997, he contributed $9,000. Arbitrarily, the court concluded that the "money contribution" could be worth about $18,000, having regard to the overall financial contributions of the wife, her own family and what the money may have otherwise earned.

Money drawn from a company to satisfy an inter-spousal matrimonial award is, nevertheless, "income" for child support purposes.

***Chapman* v. *Summer* (2010), 188 A.C.W.S. (3d) 759 (B.C.C.A.)**

The husband and his three brothers carried on a cattle-ranching and trucking business through their closely-held corporation. Each was paid a $48,000 salary, but their personal and living expenses were also paid out of the corporation, charged to their shareholders' accounts and dealt with at year's end by bonus or dividend. The husband had drawn $600,000 from the company in 2005 and $300,000 in each of 2006 and 2007. Slightly over half of the $300,000 drawn in each of 2006 and 2007 was paid to the wife on account of her property settlement.

The trial judge concluded that the husband's income was $125,000, concluding that the isolated bonus in 2005 and the extra draws to pay the wife should be excluded from the husband's income. The wife appealed.

The appeal was allowed, the Court of Appeal fixing his income at $300,000. The court characterized the issue as to the husband's "available income". What the husband did with the money i.e. paying the wife was not relevant. Thus, the judge below erred in deducting the payments to the wife from the husband's draws. In so doing, the Court of Appeal noted that the husband's counsel conceded that the money paid to the wife came from the company and had not been borrowed and that the money drawn was not required for corporate purposes.

Before the court can calculate spousal support under the *Spousal Support Advisory Guidelines*, the court must determine that the claimant is entitled to spousal support.

The wife's entitlement to support was based on compensatory principles which included the long duration of their relationship and the division of labour with the marriage.

***D. (B.M.) v. D. (C.M.)* December 13, 2010. Maisonville J. (B.C.S.C.)**

The parties had been high school sweethearts. They began to live together when they were 21 and their relationship – prior to and during the marriage – lasted 27 years. They separated in 2004.

They had 2 children. Their older child, 25, at the time of trial had worked for the husband's company for 4 years, but had recently been laid off. The younger child was 15. From 2004 until 2009, he lived primarily with the wife. In early 2009, as a result of mediation, he lived 50% of the time with each parent.

In 2005, the parties entered into a separation agreement which resolved their property issues. It specifically recited that the property settlement and support provisions took into account the wife having "…foregone economic opportunities as a result of the marriage and staying at home…" to raise their younger child. The agreement recited that the husband's income was $80,000

The court can look to publications by Canada Revenue Agency to define terms in the *Federal Child Support Guidelines* – in this case "not at arm's length". Persons committed to each other romantically and with a shared vision for the business do not deal at arm's length.

Payments made by a corporation to a person who does not deal at arm's length will be "added back" to the corporation's profits by section 18(2) of the *Federal Child Support Guidelines* unless and to the extent that the payments are reasonable.

A portion of the wages paid to the shareholding father's girlfriend were reduced as exceeding a reasonable amount.

Lease payments made by a corporation to the shareholding father's girlfriend were reduced by the court, in part, because the court felt that they were unnecessary.

Timing differences between a corporation's fiscal year end and a shareholder's T-4 may result in income attribution to the shareholder.

Certain expenses for donations, telephone, meal and entertainment were "added back" to the corporation's pre-tax profits due to their personal component.

The Court can adjust a corporation's capital cost allowance expense if that expense exceeds the actual depreciation rate of the capital asset.

In long marriages, the former spouses should have roughly equivalent standards of living.

annually and that the wife was capable of earning $28,000 if she worked full time (in fact, she only worked 2 days weekly).

Child support was set at $739 monthly and spousal support at $650 monthly. Child support was to be reviewed and adjusted every second year. Spousal support could be varied if "a material change in circumstances" occurred.

In August of 2008, the husband, believing that his income and his wife's income were identical, ceased paying both child support and spousal support. He alleged that his income had declined significantly from the $80,000 set out in the 2005 separation agreement. He commenced a divorce and asked the court to determine his support obligations (if any). The wife asked the court to determine the husband's child and spousal support obligations into the future, and asked for judgment for arrears of support under the agreement from the time that the husband stopped paying.

The court dealt with certain jurisdictional issues not reported in this summary. The court defined the issues as follows:

1. was the wife entitled to spousal support?;
2. what was the husband's income having regard to:
   a. his sole ownership and control over the corporation that employed him;
   b. lease payments and salary paid to his girlfriend;
   c. the deduction of capital cost allowance on the company's equipment;
   d. the legitimacy of certain corporate expenses such as charitable donations, meals, entertainment, interest, and shop expenses.

By way of background, the husband's company was a trucking and crane operating business. The husband bought his first truck and crane in 1996 for $27,000. The court defined his vehicle as unit 1. In 2004, he bought a second truck and crane, unit 2, for $91,000. His son came to work for him at that time. In 2007, his girlfriend bought unit 3, a truck, for $105,000 U.S. and leased it to the husband's company. At about the same time, the company acquired unit 4, for $107,000 U.S. and in 2008, the company acquired unit 5 for $105,000 U.S.

The husband incorporated in 2006. At the time of the incorporation, he transferred ownership of units 1 and 2 to the corporation. He did so at their then fair market value, not their undepreciated capital cost. At or about the time of incorporation, the husband re-mortgaged his home. He paid out his proprietor's equity of about $260,000. The corporation then began to expense the carrying costs of the loan.

The husband began a romantic relationship with his girlfriend, S.N., in or about 2006. In early 2007, as mentioned above, she purchased unit 3, and leased it to the husband's company. The cost, in Canadian dollars, was $126,000. She used $15,000 of savings and borrowed $116,000 from a bank on a 10 year loan. Her monthly payments were $1,300.

The lease between her and the husband's company was for 4 years. Basic rent was $2,800 plus $365 P.S.T. and G.S.T. The company was responsible for repairs and maintenance of the vehicle. It would pay a commission of 15% of crane usage.

There was no buyout option on the lease's expiry. The husband testified that a lease from a third party would have cost between $4,000 and $5,000 monthly. At trial, S.N. testified that the company was slightly behind in its lease payments.

At the same time as the leasing arrangements were made, in early 2007, S.N. was hired by the husband's company. She was paid a salary of $3,000 monthly. The expectation was that she would become a crane operator. She obtained a Class 1 licence which allowed her to operate all of the company's trucks. She took an airbrake course. However, after 3 months, it was apparent that she was not physically capable of lifting the heavy equipment involved. She switched to dispatching, bookkeeping, banking, sales and marketing. The husband testified that he'd been working 10-12 hour days performing his regular duties together with these administrative and clerical duties. S.N. testified that she worked long hours, including nights and weekends.

In early 2009, the husband borrowed $70,000 and a further $10,000. Much of this was to meet corporate obligations such as source deductions. As the year progressed, and to save expenses, the company ceased to insure the vehicles and at year's end, two employees, including the husband's son, were laid off. S.N. tried to sell unit 3, listing it for $118,000, but took it off the market when the best offer she received was $85,000. In March, 2010, she stopped working for the company. Bookkeeping services in 2010 were contracted out at a cost of approximately $21,000.

The court found that the wife was entitled to "compensatory support". A finding of entitlement to spousal support is a condition precedent to the calculation of spousal support under the *Spousal Support Advisory Guidelines*. "Compensatory support" provides redress to a recipient spouse for either *(a)* the economic disadvantage arising from the marriage and/or *(b)* the economic advantage conferred upon the other spouse. Generally, compensatory support recognizes the sacrifices made by the recipient spouse in child-rearing and household responsibilities and the attendant advantages of the payor spouse in his or her ability to pursue a career, gain seniority, obtain opportunities for promotion, etc.

The wife's entitlement was founded on the long duration of the relationship (27 years), the division of labour adopted by the parents, the absence from the labour force by the wife for periods of time and her sporadic part-time employment after the birth of their second child.

As the husband was the sole shareholder of his corporation, section 18 of the *Child Support Guidelines* was engaged. This had 2 significant results. By section 18(1), the court could attribute any or all of the corporation's pre-tax profits to the husband. Secondly, by section 18(2), any amounts paid to or for the benefit of persons, who do not deal with the corporation at arm's length will be "added back" to the corporation's pre-tax profits unless the shareholder-spouse establishes that the payments were reasonable.

The court had to determine whether the lease payments and the salary paid to S.N. were non-arm's length payments. Though referred to in section 18(2) of the Guidelines, the term "not ..at arm's length" is otherwise undefined. As a result, the court looked to Canada Revenue Agency's Interpretation Bulletin. IT-419R2 proposed the following guidelines:

a) was there a common mind which directed the bargaining for both parties?

b) were the parties acting in concert?

c) was there "de facto" control?

The court concluded that their romantic relationship, their plans to ultimately marry and the husband's desire to establish a warm relationship with S.N's children all supported a finding that they did not deal at arm's length.

As a result, the court concluded that a portion of the salary paid to S.N. was not reasonable. The accountants called by each party testified that a reasonable clerical wage would be $12 - $15 hourly. The court "added back" her wages to the extent that they exceeded $25,000 per annum.

The court also disallowed 70% of the lease payments paid to her. The court took pains to instruct itself that it should not interfere with the business decisions of management when applying section 18(1) of the Guidelines: *Kowalewich* v. *Kowalewich* (2001), 19 R.F.L. (5th) 330 (B.C.C.A.). However, the court noted the close relationship between S.N. and the husband in planning the growth and development of the business – further evidence of the non-arm's length relationship. The rapid expansion of the company in 2007 by the addition of two units resulted in a "dramatic under-utilization" of the units according to the wife's accountant. Hence, the partial disallowance by the court.

The court went on to determine whether certain corporate expenses should be disallowed or revenue added to the husband. The company had a fiscal year

end of February. The wife's accountant noted that timing differences between the T-4 issued to the husband on a calendar year basis tended to be less than the salary expensed by the corporation in February. This "timing difference" amounted to $41,000 in the last year examined – 2009.

The mortgage payments paid by the corporation were adjusted. The wife's accountant testified that the cash injection, made at the time of incorporation, "merely repaid the company for assuming the plaintiff's line of credit upon incorporation".

The court followed the suggestion of the wife's accountant that the actual interest paid by the company should be "added back" and replaced with a prescribed rate of 4%.

The court added back 20% of the telephone expense and all of the company's donations, meals, and entertainment expenses. In so doing, the court noted that the issue of "reasonableness", for family law purposes, is not solely governed by whether the deduction is permitted under the *Income Tax Act*, as section 18(1) talks about income "available to pay child support".

Finally, the court went on to determine if the capital cost allowance expense claimed by the company was "reasonable". Citing authority of other appellate courts, notably *Rudachyk* v. *Rudachyk* (1999), 47 R.F.L. (4th) 363 (Sask. C.A.) and *Andries* v. *Andries* (1998), 36 R.F.L. (4th) 175 (Man. C.A.), and the testimony of the wife's accountant, the court observed that there is a distinction between amortization as a general accounting expense from capital cost allowance – a defined matter under the *Income Tax Act*. Capital cost allowance may often exceed normal amortization methods due to tax incentives for policy purposes. The capital cost allowance rate on the vehicles was 30%. However, the value of the vehicles did not depreciate at that rate on the evidence. The accountant for the wife pointed out that on incorporation, the husband "rolled in" the vehicles to the corporation at their fair market value. S.N. advertised her truck for sale two years after its purchase for a price close to its original cost. The court did not advert, however, to the amortization rate that it actually employed.

After that the court determined the husband's income to be as follows:

2007 - $107,808

2008 - $154,942

2009 - $138,972

2010 - $ 93,782

Wife's income

It was also necessary for the court to determine the wife's income. There were two reasons for this. First, in early 2009, the parties changed to a "shared custody" regime. Thus, child support would be determined under section 9 of the *Child Support Guidelines* (making the income of each parent relevant). Second, the proposed recipient's income is always relevant where a calculation of spousal support under the *Spousal Support Advisory Guidelines* must be made. The wife accepted that she could earn $34,000 annually if she worked full time (though her actual earnings as a part-time employee were half that). She also received net rental income of $3,700. Thus, her income was determined to be $37,700.

As the original agreement based child support upon the husband's representation that his income was $80,000 per annum, the court was disposed to make a retroactive child support award. In so doing, the court noted that its hands could not be tied by the parties' separation agreement. Child support was the child's right. Thus, it could not be bargained away by the parents. However, as the wife sought only the arrears arising under the agreement, the court fixed those arrears for 18 months (from July, 2008 when he stopped paying until the husband started the litigation in January, 2009). From that date of litigation on, the husband was ordered to pay the proper amount under section 9 of the Guidelines – namely, $867 monthly for 2009 and $506 for 2010. [Ed. reminder: the reduction in child support reflected the change, in 2009, to a "shared custody" situation.]

Finally, the court dealt with spousal support. As there was a child support order, the calculation under the *Spousal Support Advisory Guidelines* followed the "With Child Support" formula. That formula requires a determination of the "net disposable incomes" of each parent. The formula also produces "ranges" of awards – between 40 to 46% of each spouse's individual net disposable income (after taking into account the payment of and the receipt of child support by the payor and recipient respectively). The court set the spousal support award at the high end of the range at $1,430 monthly noting that "in long marriages the result will likely be a rough equivalency of standards of living".

The spousal support award took effect as of the trial date. The wife was awarded arrears of support arising under the agreement.