# GUIDELINE INCOME MANUAL FOR LEGAL AND ACCOUNTING PROFESSIONALS

Prepared for: **Business Issues in Family Law**

Legal Education Society of Alberta

Written by:

Ken Proudman

Miller Boileau Family Law Group

and

Agnes Leung, CPA, CA, CBV, RCP

Agnes Leung Professional Corporation

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By Ken Proudman of Miller Boileau Family Law Group and Agnes Leung, CPA, CA, CBV, RCP of Agnes Leung Professional Corporation

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## INTRODUCTION

This Manual was created to assist legal and accounting professionals in properly determining a person's guideline income. We hope to achieve consistency in guideline income calculation, and we hope that those who are following this Manual will achieve better credibility with the courts. Conversely, by recommending standards, we hope that it will be easier to dismiss reports created by those who have made no attempt to implement a proper guideline income analysis. If you have used this Manual to prepare your report, we welcome you to note in your report that you have implemented this Manual's recommendations.

That said, this Manual does not have the force of law, and should not constrain the independence of experts, as discussed below. It focuses primarily on the law, with a view to setting standards, however it does not address how to perform accounting calculations, nor conclude whether any business practices are reasonable or not. Only a properly-qualified expert may provide opinion evidence to the courts about the reasonableness of business practices such as the deduction of expenses and retention of profit.

Please also be aware that decisions of the Provincial Court, Court of Queen's Bench, or from outside of Alberta, are not necessarily binding and are subject to change. Decisions of the Court of Appeal and Supreme Court of Canada are binding. Court of Appeal decisions can usually be identified by the letters "ABCA" or "Alta CA" appearing in their citation, whereas the Supreme Court of Canada can usually be identified by a citation including "SCC" or "SCR".

# PRELIMINARY CONSIDERATIONS

## DEFINITIONS

Except for the words "child", "income", and "spouse", the terms used in sections 15 to 21 of the *Federal Child Support Guidelines* (the "*Guidelines*") have the meanings assigned to them under the *Income Tax Act* (Canada) ("*ITA*").[1]

The most significant result is that the *ITA*'s definitions apply to the list of section 21 mandatory financial disclosure (discussed in the topic "Required Documents/Evidence" below), although not necessarily to the additional documentation that might be required to be produced following a Notice to Disclose / Application.

[1] *Guidelines,* s 2(2).

The most notable definitions are:

a. "**Control**" of a corporation means "the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors"[2] (typically anyone who has more than 50% of the voting shares). Courts should look at the share register and any limitations contained in constating documents (e.g. articles and by-laws), unanimous shareholders' agreements (if the formal requirements are met), and applicable legislation, but generally not to any other documents.[3] The definition is satisfied where the control existed at any time in the year.[4] The control can be by a group of people where there is a common link or interest between them or evidence that they act together to exert control.[5]

b. Although not necessarily incorporated into the *Guidelines*, there is also a more expansive definition of "**controlled, directly or indirectly in any manner whatever**", which is where the controller has a direct or indirect influence that, if exercised, would result in control in fact of the corporation. This includes "the clear right and ability to effect a significant change in the board of directors or powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors."[6] Courts can look at economic dependence, operational control, and the family relationship between shareholders of the corporations.[7] The definition is satisfied where the control existed at any time in the year.[8] There are exceptions to that definition, such as:
    a. Where the corporation and the controller are dealing with each other at arm's length and the influence is derived solely from a franchise, license, lease, distribution, supply or management agreement, or other similar agreement or arrangement, the main purpose of which is to govern the relationship between the corporation and the controller regarding the manner in which a business carried on by the corporation is to be conducted;[9] or

[2] *Buckerfield's Ltd. v Minister of National Revenue*, [1964] CTC 504 at 507 (Ex Ct), as cited at *Duha Printers (Western) Ltd. v Canada,* [1998] 1 SCR 795 at paras 35, 85.
[3] *Duha Printers (Western) Ltd. v Canada,* [1998] 1 SCR 795 at paras 51, 55, 71, 85.
[4] *Taber Solids Control (1998) Ltd. v the Queen*, 2009 TCC 527 at para 31.
[5] *Silicon Graphics Ltd. v Canada,* 2002 FCA 260 at paras 55, 58.
[6] *Silicon Graphics Ltd. v Canada,* 2002 FCA 260 at para 67.
[7] *Transport MI Couture v the Queen,* [2003] 3 CTC 2882 (TCC) at para 33.
[8] *Taber Solids Control (1998) Ltd. v the Queen*, 2009 TCC 527 at para 31.
[9] *Income Tax Act*, s 256(5.1).

b. In some cases, arrangements for the safeguarding of debts, or shares to be redeemed or purchased.[10]

c. Those not dealing at **arm's length** means:[11]
    a. **Related persons**, which means:
        i. Individuals connected by blood relationship (including where one is the child, descendant, brother, or sister of the other), marriage or common-law partnership (including where one is married/partnered to a person who is connected by blood relationship to the other), or adoption (either legally or in fact, including if one has been adopted as the child of a person who is connected by blood relationship (other than as a brother or sister) to the other;
        ii. A corporation and:
            1. A person who controls the corporation, if it is controlled by one person;
            2. A person who is a member of a related group that controls the corporation; or
            3. Any person related to a person described in the preceding two items;
        iii. Any two corporations:
            1. If they are controlled by the same person or group of persons;
            2. If each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation;
            3. If one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation;
            4. If one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation;
            5. If any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation; or

[10] *Income Tax Act*, s 256(6).
[11] *Income Tax Act*, s 251.

6. If each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation;

iv. Where two corporations are related to the same corporation as set out above, they are deemed related to each other; or

v. Where there has been an amalgamation or merger, and the predecessors were related immediately prior to the amalgamation or merger, the new corporation and any such predecessor corporations are generally deemed related;

b. Generally a taxpayer and a personal trust; or

c. Where in "fact" persons are not dealing with each other at arm's length.

## WHO SHOULD PERFORM

Whenever practical, we recommend that guideline income reports be prepared by accountants who holds the designation of Chartered Business Valuator ("CBV"), and who are familiar with the *Federal Child Support Guidelines*. CBVs must adhere to the Canadian Institute of Chartered Business Valuators' Standard No. 310 "Expert Reports" which requires CBVs to list the scope of review, explain the rationale of the approach taken, and list the assumptions used and the procedures followed to determine the reasonableness and appropriateness of key assumptions. This can result in a higher quality report that is more likely to withstand judicial scrutiny. CBVs are also used to addressing issues such as fair market compensation and the reasonableness of expenses, as these adjustments are often made in valuation reports. Some CBVs have received additional training in litigation support and basic principles in dispute resolution.

In addition to a CBV designation, it can also be helpful if the accountant also holds a Chartered Professional Accountant ("CPA") designation, as not all CBVs are accountants. Accountants are usually familiar with the *Income Tax Act* rules governing the deduction of expenses. While those rules are not determinative with respect to the calculation of a person's guideline income, they can serve as an important starting point in order to spot irregular expenses.

In any event, it is absolutely critical that the author be familiar with the *Guidelines*. A report which merely adds corporation net income, dividends, and the shareholder's salary, is highly deficient.

We generally recommend against the use of financial planners and business consultants who do not hold the above designations, as they may not have familiarity with any of the above and may not qualify as an expert.

It is possible for a lawyer to perform guideline income calculations which can be helpful either for the purposes of achieving an early and cost effective settlement or where the parties do not have the resources to hire an accounting expert. However, it should be cautioned that courts may be reluctant to adopt a lawyer's calculations, and they will often defer to an expert's report, even where there are deficiencies. Furthermore, lawyers are generally prohibited from submitting their own evidence or opinions,[12] meaning that in most circumstances they cannot swear substantive affidavits, and cannot tender opinion evidence such as that pertaining to the reasonableness of expenses and retention of profits in relation to standard business practice.

If fraud, the diversion of funds, improper bookkeeping, or undeclared income are suspected, then a forensic accountant's report, audit, or private investigator's investigation should instead be considered. This is separate from the guideline income calculations set out in this Manual.

If a report is to be submitted to the court, the author will need to be properly qualified as an expert. This is because opinion evidence dependent on inferences is generally not admissible, unless tendered by a properly qualified expert.[13] A properly qualified expert must have special or particular knowledge in relation to the topic for which they are providing an opinion, which they acquired either through education or experience. Their opinion must be necessary to assist the judge with a matter which is outside of general common experience. They are qualified either by admission of the opposing party or by the judge. The onus rests on the proponent of the expert's evidence to qualify that expert. Their educational qualifications should be from a well-known institution. Their opinions should be generally accepted within their expert community. Courts can limit the topics for which the expert may testify.

It may be beneficial to retain an expert early so that they can assist with any discovery and valuation and before preferred experts are retained by the opposing party.

[12] *Law Society of Alberta Code of Conduct*, rule 5.2-1
[13] *R v Abbey*¸ [1982] 2 SCR 24 at 42.

## ROLE OF AN EXPERT AND DUTY TO THE COURTS

An expert's role is to provide an opinion. As stated throughout this Manual, in most cases only a properly qualified expert can tender opinion evidence to the courts. When it comes to guideline income calculations, that opinion will often pertain to business issues such as the reasonableness of expenses and retention of profits, which may be considered in light of that expert's experience with other businesses, although much of a report will simply be performing calculations.

Experts have a duty to the courts to give fair, objective, and non-partisan opinion evidence. At a certain point, expert evidence can be ruled inadmissible due to the expert's lack of impartiality, objectivity, or independence, which depends on the circumstances.[14] A prior relationship with a party does not necessarily make an expert not independent, so long as the expert is not unfairly favouring one side's position, such that their opinion would change depending on the party that retains them.[15] For example, an expert who always claims that their clients don't have expenses which personally benefit them, but also always conclude that opposing parties have expenses which personally benefit them, would be taking an improper partisan approach. Where the opposing party establishes that there is a realistic concern that the expert is unable or unwilling to comply with their duty, the onus again shifts to the proponent of the expert's evidence to establish admissibility. Exclusion for such a reason will typically only occur in very clear cases.

For good practice, where an accountant has assisted in year-end compliance work for a family business where both spouses are or were shareholders and/or directors, the incumbent accountant with knowledge of the day-to-day affairs of the business should obtain consent from both spouses before acting as an expert for only one spouse, whether that be for determining guideline income or business valuation.

On the other hand, the expert's role is not to make the final determination, except in rare circumstances such as arbitration. Courts cannot delegate their decision-making power to an expert.[16]

Unless the court orders otherwise, only one expert per party or affiliated parties can tender opinion evidence in court on a particular topic.[17] Where an expert is retained to determine guideline income,

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[14] *Mouvement laïque québécois v Saguenay (City)*, 2015 SCC 16 at para 106.
[15] *White Burgess Langille Inman v Abbott and Haliburton Co*, 2015 SCC 23.
[16] *Stewart v Stewart*, 1990 ABCA 355 at para 9; *Durocher v. Klementovich*, 2013 ABCA 115 at para 15.
[17] *Rules of Court*, Alta Reg 124/2010, r 8.16 ("*Rules of Court*").

this would not necessarily rule out another expert addressing another topic, such as the diversion of funds or valuation. Courts may also appoint a person to act as the court's expert.[18]

Once an expert's report is disclosed to the opposing party, the expert has a continuing obligation to immediately disclose, in writing to all parties, any change in their opinion.[19] Courts may also permit the withdrawal of reports.[20]

## DEADLINES

The deadlines for which a report must be completed differ depending on whether the court action is set for a trial or not. Sometimes judges set additional rules for a particular case.

If a matter is set for trial in the Court of Queen's Bench, the parties usually cannot obtain a trial date until they have certified that experts' reports have been completed and exchanged, or that such will be completed prior to the trial.

If a matter is instead being heard in Special Chambers, we recommend that the expert's report be contained within an affidavit (discussed further in the topic of "Format", below). In that case, the Affidavit filing deadlines set out in Family Law Practice Note 2 ("PN2") will apply. Unfortunately PN2 does not address experts' reports. The current PN2 (effective January 20, 2017) permits Supplementary Affidavits to be filed in addition to the parties' affidavits, but does not set any deadlines. A draft of a PN2 revised on October 12, 2017 has been circulated by the Court of Queen's Bench, although as of the time of writing it is not yet in effect. That draft does not refer to supplementary affidavits. Instead it refers to "Update Statements" or "Update Affidavits", using the same terminology as the *Family Law Act*. Update Statements, pursuant to the *Rules of Court*, must be served "within a reasonable time before the claim is scheduled to be heard or considered".[21] The draft PN2 purports to alter this by requiring Update Statements be filed at least two weeks before the hearing date.

That said, releasing the report shortly before the hearing or trial might lead to the adjournment of the hearing or trial so that there is proper time for the opposing party to review it, consult their expert, and potentially prepare a rebuttal report. Such an adjournment could severely frustrate the parties and significantly increase costs where updates to the reports and affidavits would be required.

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[18] *Rules of Court*, r 6.40-6.43.
[19] *Rules of Court*, r 5.38.
[20] See factors at *Campbell v Beekman*, 2011 ABQB 437.
[21] *Rules of Court*, r 12.22(3).

Because experts are required to immediately disclose any changes of their opinion in writing to parties to which their report has been disclosed,[22] reports providing an opinion about ongoing income may need to be revised if new Financial Statements are released following a new year end.

## FINANCIAL YEARS

It is the instructing lawyer's obligation to determine which years need to be calculated. The lawyer should keep in mind that because a corporate year end is not necessarily the same as a calendar year end, there may be overlapping years. The corporate year end will appear in the corporation's financial statements, typically next to "as at". For example, if a corporation's year end is June 30th, then half of its income might pertain to the preceding year and the other half might pertain to the current year. It that case, it may be necessarily to pro-rate many of the corporate adjustments set out in the Manual. On the other hand, experts may choose not to pro-rate year ends where pro-rating may not necessarily be more accurate, for example due to seasonality.

If the latest financial statements show a drastically different financial state than previous years, a separate opinion may need to be provided which addresses what guideline income would be if such a state were to continue. For example, if in the past two years a corporation earned profits of $100,000 and $80,000, but in the latest financial statement it suffered a loss of $60,000, it may not be fair to give the court the impression that average net income of $90,000 should be used, and the party controlling the corporation would likely never accept such as suggestion, which may obstruct settlement. However, lawyers and their client should be aware that such an ongoing analysis may be expensive and somewhat arbitrary, and some expenses might fluctuate along with revenues. For example, if a business has fewer clients, they may not be spending as much on fuel, although their shop lease might be the same, and their interest expenses might increase if their debt swells.

Technically ongoing child support is only set at a temporary amount. Once a year has concluded, parties can apply to retroactively adjust that year's child support payments to reflect actual income earned.[23] In that regard, guideline income reports should clearly state what financial years have been relied on, when overlapping years mean that the calculations for any given year are limited by unavailable documentation, and when an ongoing amount has been based on estimation or projection.

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[22] *Rules of Court*, r 5.38.
[23] *Lavergne v Lavergne*, 2007 ABCA 169 at paras 22, 26-28.

Most guideline income reports will address the three most recently concluded calendar years, for the following reasons:

1. Arrears are usually retroactive to the date that effective notice was given that the amount was inadequate, but generally not more than three years from the notice date.[24] This is subject to several exceptions. For example, if an agreement provides for annual disclosure of financial documentation and that disclosure does not occur, then courts can seek retroactivity to the date of that agreement.[25] That annual disclosure usually includes income tax returns and notices of assessment.

2. Where the traditional approach would not be the fairest determination of income, the *Guideline*s permit a court to look at a three year average of income to "determine an amount that is fair and reasonable in light of any pattern of income, fluctuation in income or receipt of a non-recurring amount during those years".[26] A three year average is by no means a default, but the availability of such a determination means that lawyers may want to provide this information to the court. See the topic of "Periodic Fluctuations and Material Changes" below. In some circumstances, a five year average for spousal/partner support purposes might even be appropriate.[27]

3. Because of overlapping fiscal years, two years may be required to be able to calculate guideline income in any given calendar year, where pro-rating is appropriate.

## REQUIRED DOCUMENTS/EVIDENCE

The exchange of financial disclosure is of central importance to the resolution of support matters. Especially in uniquely vulnerable circumstances, there is a duty to make full and honest disclosure of all relevant financial information.[28] Where clients refuse to obtain the other party's financial disclosure, lawyers ought to obtain written waivers.[29]

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[24] *DBS v SRG*, 2006 SCC 37 at paras 5, 123, 124.
[25] *Goulding v Keck*, 2014 ABCA 138 at para 62.
[26] S 17(1).
[27] *Shaw v Shaw,* 2015 ABCA 11. The Ontario Court of Appeal also recently concluded that a 3 year income average for a business operator was permissible, in *Halliwell v Halliwell,* 2017 ONCA 349.
[28] *Rick v Brandsema*, 2009 SCC 10 at para 47.
[29] *Webb v Birkett*, 2011 ABCA 13 at para 54.

Section 21 of the *Guidelines* generally requires that both the applicant and respondent to any child support application exchange:

a) a copy of every personal income tax return filed by the spouse for each of the three most recent taxation years;
b) a copy of every notice of assessment and reassessment issued to the spouse for each of the three most recent taxation years;
c) where the spouse is an employee, the most recent statement of earnings indicating the total earnings paid in the year to date, including overtime or, where such a statement is not provided by the employer, a letter from the spouse's employer setting out that information including the spouse's rate of annual salary or remuneration;
d) where the spouse is self-employed, for the three most recent taxation years
    i. the financial statements of the spouse's business or professional practice, other than a partnership, and
    ii. a statement showing a breakdown of all salaries, wages, management fees or other payments or benefits paid to, or on behalf of, persons or corporations with whom the spouse does not deal at arm's length;
e) where the spouse is a partner in a partnership, confirmation of the spouse's income and draw from, and capital in, the partnership for its three most recent taxation years;
f) where the spouse controls a corporation, for its three most recent taxation years
    i. the financial statements of the corporation and its subsidiaries, and
    ii. a statement showing a breakdown of all salaries, wages, management fees or other payments or benefits paid to, or on behalf of, persons or corporations with whom the corporation, and every related corporation, does not deal at arm's length;
g) where the spouse is a beneficiary under a trust, a copy of the trust settlement agreement and copies of the trust's three most recent financial statements; and
h) in addition to any income information that must be included under paragraphs (c) to (g), where the spouse receives income from employment insurance, social assistance, a pension, workers compensation, disability payments or any other source, the most recent statement of income indicating the total amount of income from the applicable source during the current year, or if such a statement is not provided, a letter from the appropriate authority stating the required information.

Financial disclosure exchanged through either a child support application or Notice to Disclose / Application in the Court of Queen's Bench must be contained in a Disclosure Statement, as directed

by the Court's Notice to the Profession and Public "Section 21 Disclosure Initiative Information Summary" dated May 19, 2016. As of the time of writing (November 12, 2017), the Court's website has not yet published an editable version of the Disclosure Statement, however an editable and more easy-to-use Disclosure Statement prepared by Ken Proudman of Miller Boileau Family Law Group can be found at http://familycounsel.ca/download.php?id=29. This precedent was distributed by the Legal Education Society of Alberta at the *Family Law: Chambers Advocacy and Practice Pointers Seminar* on April 21, 2017.

In addition to the above, where a person controls or has at least a 1% interest in a business, we recommend also obtaining:

1. If prepared, a **general ledger** for each year, or alternatively any other breakdown of received revenues and expenses;
2. Bank account and credit card statements for **business accounts throughout** the relevant years;
3. **Amortization schedules** (often referred to as Property, Plant, and Equipment Schedules);
4. Any breakdown of personal expenses provided to the business's accountants. Often this is contained in a separate **personal expense form** that the accountants send to their clients to be completed;
5. Financial Statements should include an **Income Statement** (summary of revenues and expenses) and a **Balance Sheet** (breakdown of assets and debts). Cash Flow Statements are optional, as many businesses will not have prepared one;
6. Where Financial Statements are not prepared, it would be useful to obtain Schedules 100 and 125 of the General Index of Financial Information (GIFI) contained in the corporation's Income Tax Return;
7. All schedules to each personal Income Tax Return should be obtained, especially Form **T2125 "Statement of Business or Professional Activities"** where a person is self-employed or receives partnership income. Form **T776 "Statement of Real Estate Rentals"** is also relevant where a person receives rental income; and
8. When available, **year-end journal entries** prepared by an external year-end accountant can be useful, as the general ledger may not reflect all transactions.

Where a party does not provide this voluntarily, same could be sought through a procedural application pursuant to Rule 1.4, Notice to Produce an Affidavit of Records pursuant to Rule 12.38(2), application to obtain documents from a third party pursuant to Rule 5.13, or through undertakings at Questioning. See the *Family Law Chambers Procedure Manual* by Ken Proudman of

Miller Boileau Family Law Group, published by the Legal Education Society of Alberta: https://www.lesaonline.org/product/family-law-chambers-procedure-manual/

### Expense Disclosure

Of particular significance to guideline income calculations is the **"statement with a breakdown of compensation and personal benefits"** where a person controls or has at least a 1% interest in a business. In the 2017 decision *Cunningham v Seveny*, the Alberta Court of Appeal turned this requirement into a significant and comprehensive obligation, which is not readily apparent at first glance.[30] In particular:

a) The statement must include a sufficient enough explanation to facilitate an assessment of the reasonableness of the compensation or benefits in the context of determining available income.[31] "The content of required disclosure must be sufficient to allow meaningful review by the recipient parent, and must be sufficiently complete and comprehensible that, if called upon, a court can readily discharge its duty to decide what amount of the disclosing parent's annual income fairly reflects income for child support purposes".[32]

b) Personal benefits must be disclosed. "Common examples include personal use of corporate vehicles, computers, cellphones, personal benefits associated with travel, entertainment and promotional expenses and other non-arm's length expenditures".[33] If the disclosing party is of the opinion that there was no personal benefit, they must explain why those expenses, or part of them, should not be attributed.

c) "The issue is whether full deduction of an expense results in a fair representation of the actual disposable income of the party, and the court must balance the business necessity of an expense against the alternative of using that money for child support".[34]

d) This disclosure obligation continues throughout the child support proceedings.[35]

e) If the party only has a partial interest, they could have a managing partner or similar entity provide a letter confirming that the expenses conferred no personal benefit.[36]

f) The level of scrutiny that is justified will be commensurate with the level of control the disclosing parent has over the business entity's overall financial decisions.[37] "Simply put,

[30] 2017 ABCA 4 ("*Cunningham*").
[31] *Cunningham* at para 23.
[32] *Cunningham* at para 27.
[33] *Cunningham* at para 25.
[34] *Cunningham* at para 27.
[35] *Cunningham* at para 26.
[36] *Cunningham* at para 34.

parties ought not to be put to time-wasting, money-draining line-by-line justifications of every dollar that has been spent. In keeping with the foundational rules, pre-trial disclosure must not become a process that wholly consumes the very parental resources that otherwise would be available for child support."[38]

*Cunningham* replaces the previous decisions which had held that the non-shareholding spouse must first establish that the expense is *prima facie* unreasonable at which point the burden shifts to the shareholding spouse to prove reasonableness.[39] Now that all expenses must be proven to be reasonably deducted, the question becomes how that onus is satisfied, particularly in light of affidavit and exhibit page limits.

As of the date of writing (November 12, 2017), the only reported decision to have interpreted *Cunningham* and to have determined what breakdown would be sufficient to satisfy the disclosure of personal benefits was *Zdyb v Zdyb*.[40] *Zdyb* adopted the form of disclosure set out in an earlier decision,[41] *Sweezey v Sweezey*.[42] At paragraph 48 of *Sweezey*, the Honourable Madam Justice D.A. Yungwirth stated that as a general rule, the shareholder should provide at least the following:

1. a brief explanation concerning each payment category, including:
    a. the nature of the payment/expense;
    b. how it was calculated;
    c. why it was a reasonable corporate expenditure;
    d. whether any amounts paid or owing in relation to that category provided or resulted in a personal benefit to the shareholder or other non-arm's length person (common examples of such expense categories in closely held corporations are vehicle, travel, promotion, phone, and insurance). This would include an explanation for:
        i. what portion of the total expense formed the personal or non-arm's length benefit;
        ii. how this was calculated;

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[37] *Cunningham* at para 34.
[38] *Cunningham* at para 35.
[39] For example, see *McCaffery v Dalla Longa*, 2008 ABQB 183 at paras 237-243; *Wildeman v Wildeman*, 2014 ABQB 732 at paras 33-34; *Goett v Goett*, 2013 ABCA 216 at para 21; *Homsi v. Zaya*, 2009 ONCA 322 at paras 27-28; *Berta v. Berta*, 2015 ONCA 918 at paras 62-64; *Lo v. Lo*, 2011 ONSC 7663 at paras 55-59; *Bekkers v Bekkers*, [2008] OJ no 140 (Sup Ct Just) at paras 19-20; *Halliwell v Halliwell*, 2016 ONSC 182 at para 78; *Joy v. Mullins*, 2010 ONSC 1742 at paras 34-35; *Rogers v. Rogers*, 2013 ONSC 1997 at para 46; *Sobiegraj v. Sobiegraj*, 2014 ONSC 2030 at paras 64-68; *Monney v Monney* (1999), 133 Man R (2d) 302 (QB) at para 6; *Rush v. Rush*, 2002 PESCTD 22 at paras 20-21; *Aten v. McKenna*, 2004 CarswellPEI 122 (TD) at para 13.
[40] 2017 ABQB 44 ("*Zdyb*").
[41] *Zdyb* at para 50.
[42] 2016 ABQB 131 ("*Sweezey*").

iii. a description of any services performed for the corporation by a non-arm's length person (such as a new partner/spouse of the shareholder), and information regarding whether the salary s/he was paid for the services was commensurate with the market value of the services; and

2. documentation to support all of the above explanations, such as invoices and receipts regarding non-arm's length payments.

Although a court form has not yet been published by the courts, a blank Business Expense Disclosure Statement based on *Sweezey* compiled by Ken Proudman of Miller Boileau Family Law Group can be found at http://familycounsel.ca/download.php?id=20. A version with instructions and examples can be found at http://familycounsel.ca/download.php?id=21 These documents have been distributed by both the Legal Education Society of Alberta and the Canadian Bar Association's Family Law Section (North).

*Sweezey* notes that the obligation also applies to the self-employed (and presumably to partners as well).[43] The decision also states that where there is no non-arm's length component to an expense category, the explanation can indicate that "all payments in a particular category were for corporate purposes and no personal benefit was derived from them."[44] *Zdyb* also states that this breakdown is required in any child support application, whether under the *Family Law Act* (Alberta) or *Divorce Act* (Canada), or whether required by a Notice to Disclose / Application.[45] However, the degree of disclosure was stated to be based on a number of factors, not listed, except that the most important would be the degree of control exercised by the person over the business.[46] In *Sweezey* it was also acknowledged that minority shareholders in large corporations may not have access to the same information.[47]

It has been stated that in light of *Cunningham*, a letter from an accountant that expenses have been treated in accordance with Canada Revenue Agency principles will not suffice.[48] That principle complies with section 19(2) of the *Guidelines* which states that "the reasonableness of an expense

[43] At para 49.
[44] *Sweezey* at para 36.
[45] At para 46.
[46] *Zdyb* at para 47.
[47] At para 45.
[48] *Zdyb* at para 48.

deduction is not solely governed by whether the deduction is permitted under the *Income Tax Act.*" It was stated in *Sweezey* that general ledgers and financial statements alone are also insufficient.[49]

It is not clear whether the second part of the *Sweezey* test will be adopted: the suggestion that supporting documentation be provided. In many cases this could involve clients paying their accountants to make thousands of pages of photocopies, with many of those pages painstakingly scanned in one-by-one, as receipts often cannot be fed into a photocopier in bulk. In *Zdyb*, the following example is provided:

> "The corporation expensed $9,939 relating to automotive expenses incurred relating to the shareholder's 2015 Ford F-150 truck. The expenses included costs for gas, oil, maintenance and repairs, insurance, licencing and depreciation. The expenses claimed represented a 50/50 split of the expenses between business and personal use which represents my best reasonable estimate. Personal use has been factored into the amount of expense charged to the corporation. **Receipts and invoices will be produced if requested.**" (emphasis added)[50]

Where supporting documentation is not overly voluminous, we suggest that lawyers could include general ledgers and receipts in their clients' Disclosure Statements, as *Sweezey* seems to suggest that it forms part of the expense/benefit breakdown Statement. However, where there is sensitive information, clients should be advised that despite the new Family Law Practice Note 10 limiting access to family court files, it could still be possible for a third party to apply to obtain this documentation. Judges may also balk at thick files, however these may be necessary to meet the significant onus placed by *Cunningham*. Where thousands of receipts make the provision of supporting documentation cost-prohibitive or impractical, it may be better to follow the *Zdyb* approach and state that receipts/invoices for any particular category can be produced if requested, or even to state that they can be made available for inspection by counsel at an accountant's office.

### Third Parties

Even where a party is not a majority shareholder, if they are in *de facto* control of the corporation, they might still be required to provide all of the disclosure required by section 21 of the *Guidelines*,

[49] At para 47.
[50] *Zdyb* at para 59.

especially if it appears that the share structure may have been designed in part to shelter, or has the effect of sheltering, the shareholder spouse from liability for child support.[51]

Rule 5.13 permits applications to obtain records in the possession of a third party (which would include a corporation, which is technically a third party). See the *Family Law Chambers Procedure Manual* by Ken Proudman of Miller Boileau Family Law Group, published by the Legal Education Society of Alberta: https://www.lesaonline.org/product/family-law-chambers-procedure-manual/

## FAILURE TO ADEQUATELY DISCLOSE

Failure to meet the disclosure requirements set out by the preceding chapter will affect how guideline income calculations are prepared. First, we'll discuss the available options in the courts.

Where the documents required in a child support application are not provided within 30 days of service (or 60 days if residing outside of Canada or the United States, or unless ordered otherwise), courts can either:

1. Order that the party provide the documentation, typically by a certain date;

2. Proceed to decide the matter in any event, in which case the court is permitted to "draw an adverse inference against the spouse who failed to comply and impute income to that spouse in such amount as it considers appropriate". This is more likely to occur where a clearly inadequate amount of support is being paid or there is no payment; or

3. Where a party fails to comply with an order to provide the documentation courts may:

    a. Strike out their pleadings (for example, their application to vary support could be dismissed);
    b. Declare the party in contempt (although this rarely occurs);
    c. Proceed to decide the matter in any event, again drawing an adverse inference as set out above; and/or
    d. "award costs in favour of the other spouse up to an amount that fully compensates the other spouse for all costs incurred in the proceedings".[52]

[51] *Sweezey* at para 44.
[52] *Federal Child Support Guidelines*, ss 22-24.

Where the documents required to be provided pursuant to a Notice to Disclosure / Application are not provided within one month of service, courts may:

a. Order that the party provide the requested documents by a specified date;
b. "Draw an adverse inference against and impute income to the respondent and order the respondent to pay support in an amount the Court considers appropriate";
c. "Order the respondent to pay costs to the applicant in an amount that fully compensates the applicant for all costs incurred in the proceeding"; or
d. "Grant any other remedy the Court considers appropriate."[53]

Where financial disclosure has been deficient, accounting professionals can perform their analysis under the assumption that an adverse inference can be drawn. Although not specifically defined in the family law context, the Supreme Court of Canada has defined an adverse inference to be a presumption that the evidence was not tendered because the resulting evidence would adversely affect their case.[54] In *Sweezey* this meant presuming that the expenses have a personal benefit component.[55] This doesn't necessarily mean adding the entire expense back in, but it may be reasonable to assume that the documentation was not provided because the party has a high number of expenses which benefit them personally. Although this may seem harsh particularly where the deficient party may be merely unsophisticated, our Court of Appeal has stated that family law litigants in general "are expected to keep reasonable records of their income and expenses, especially post-separation, and especially when they are involved in claims for support. A litigant with unexplained income or expenses cannot simply fall back on an honest inability to provide particulars."[56] *Sweezey* itself provides an interesting analysis of several expense categories.

However, before drawing an adverse inference, accounting professionals should consult the instructing lawyer to ensure that financial disclosure has in fact been deficient and that no further disclosure is anticipated, in case special circumstances apply. For example, the parties might have agreed that a certain document need not be provided.

However, not all courts may take such a strict approach. In one decision which referred to *Cunningham*, despite only handwritten lists of expenses, the Court accepted the business-owner's

[53] *Rules of Court*, r 12.41(7).
[54] *Levesque v Comeau,* [1970] SCR 1010 at para 6; *McDonald v McDonald,* 2011 MBQB 241 at para 38.
[55] At para 36.
[56] *Durfey v Durfey*, 2017 ABCA 166 at para 17.

suggestion that their personal expenses were between 15-20%, and attributed 20% of expenses, as he claimed to have changed accountants because his accountants did not keep proper records.[57]

In *Empson v Findlay*, the payor was found in contempt of Court for failing to provide court-ordered monthly financial information relating to his business.[58] Ordered invoices were also missing. However, the Court determined that imputing income was not an available remedy for contempt nor sufficient to determine that the payor was deliberately under-employed.[59] This may have been because the ordered information was not necessary to determine guideline income. However, double column 3 costs were awarded as a result of the breach.[60]

See *Sweezey v Sweezey*, 2016 ABQB 131 for examples of how various expense categories are treated where there has been a failure to adequately disclose. That decision can be found here: https://www.canlii.org/en/ab/abqb/doc/2016/2016abqb131/2016abqb131.html

## TREATMENT OF DOCUMENTATION/EVIDENCE

The Supreme Court of Canada has stated that "[b]efore any weight at all can be given to an expert's opinion, the facts upon which the opinion is based must be found to exist".[61]

However, that does not necessarily mean that accounting professionals can only base their statements on sworn Affidavits and filed Disclosure Statements. There are certain exceptions where the accounting professional can rely on other unsworn statements made by third parties:

1. So long as the source of the information is disclosed in the report or accompanying affidavit;[62]
    - Except this cannot be relied on where the application is for a final order (which may be the case where there is a variation of a final order, where the parties have agreed or court has declared that the application will be for a final order, or a trial, although presumably the same statements will be repeated at trial). The instructing lawyer should ideally advise the accounting professional if the application is for a final order. As this might be forgotten, an accounting professional in doubt should contact their instructing lawyer.

[57] *Hrynkow v Gosse,* 2017 ABQB 675 at paras 18-20, 23, 24.
[58] 2012 ABQB 757 at paras 17-19.
[59] At paras 20, 22.
[60] At paras 61-62.
[61] *R v J, LJ,* [2000] 2 SCR 600 at para 59.
[62] *Rules of Court*, r 13.18; *Klein v Wolbeck,* 2016 ABQB 28 at paras 12-14.

2. Where each side agrees, preferably in writing. This could occur where no litigation is intended and the report is required for settlement discussions or Collaborative law;
3. Where the opposing party has admitted the fact (for example if the accounting professional acts for the non-business-controlling spouse, but they have authority to speak to the business-controlling spouse, who admits to a fact during a conversation);
4. Where facts are "so notorious or generally accepted as not to be the subject of debate among reasonable persons; or… capable of immediate and accurate demonstration by resort to readily accessible sources of indisputable accuracy" (referred to as "judicial notice").[63] For example, one 2016 decision took judicial notice of the poor economy in the context of an application to reduce spousal support.[64] This is usually looking at facts for which reasonable people would not disagree, or authoritative documents such as encyclopedias, maps, or dictionaries;
5. Where the information is based on the accounting professional's personal knowledge;[65]
6. Where the information is law, for example the rules contained in the *Income Tax Act*;
7. Where the fact is the accounting professional's opinion, such as the reasonableness of expenses or retention of profit; or
8. Where there is an exception to the rule against hearsay (which can be determined by the instructing lawyer).[66]

Where evidence conflicts, courts determine whether it is more likely than not that the event occurred (known as the "balance of probabilities" standard).[67] In other words, what is probably true, or has a greater than 50% chance of being true. Evidence must be scrutinized with care. Evidence must always be sufficiently clear, convincing, and cogent.[68] Courts speak of "weighing" evidence using a variety of methods, such as considering the reliability of the source, or that some events are inherently improbable.[69] Where the probable truth of an event is clear to the accounting expert, they should be able to rely on that fact. However if there is significant doubt it may be beneficial to provide an additional calculation to address what guideline income would result were the alternative accepted by the court.

That said, a party should not be believed because they are more likeable nor disbelieved because of their poor conduct (unless it relates to an issue such as credibility, fraud or dishonesty). This is

[63] *R v Find,* 2001 SCC 32 at para 48.
[64] *Schmaus v. Schmaus*, 2016 ABQB 408 at para 5.
[65] *Rules of Court*, r 13.18(1)(a) & (2).
[66] *Murphy v Cahill,* 2012 ABQB 793 at paras 25-26; *Klein v Wolbeck,* 2016 ABQB 28 at para 15.
[67] *FH v McDougall,* 2008 SCC 53 at paras 44, 49.
[68] *FH v McDougall,* 2008 SCC 53 at paras 45, 46, 49.
[69] Inherent improbability: *FH v McDougall,* 2008 SCC 53 at para 48.

because the misconduct of spouses is generally considered to be irrelevant unless it relates to an issue to be determined.[70] However, the consequences of misconduct can still be taken into account.[71] For example, if following the separation one spouse damaged the business's property or impeded its ability to earn income.

In some cases, new evidence may be provided to the accounting professional. Once an expert's report is disclosed to the opposing party, the expert has a continuing obligation to immediately disclose, in writing to all parties, any change in their opinion.[72] Courts may also permit the withdrawal of reports.[73] On the other hand this does not necessarily mean that accounting professionals should drop their other obligations in order to make a last minute update. In one decision, it was stated that where substantial detail is provided in a late reply affidavit which cannot be responded to, and does not aid in the fact-finding process, courts may disregard that information.[74]

## FORMAT

Guideline income reports should:

1. Breakdown calculations for each year;
2. Clearly indicate what amount or proportion of net income was added into guideline income;
3. Clearly indicate what amounts or proportions of personal expenses were added into guideline income; and
4. Breakdown the aforementioned calculations by either calendar year or financial year;

It can be beneficial for reports to provide ranges as well, indicating what would be the case if different facts were accepted by the Court.

Calculations should only address guideline income and not perform child or spousal/partner support calculations. Those calculations can be affected by a number of determinations that are more properly made by the courts, such as adjustments for shared parenting, adult children, or the strength of a spousal/partner support claim.

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[70] *Divorce Act*, ss 15.2(5) & 17(6).
[71] *Leskun v Leskun,* 2006 SCC 25 at para 21.
[72] *Rules of Court*, r 5.38.
[73] See factors at *Campbell v Beekman*, 2011 ABQB 437.
[74] *McCarty v. McCarty*, 2016 ABQB 91 at paras 132, 134.

A report could set out a formula to calculate future support, but only if requested by the instructing lawyer. However, instructing lawyers should be cautious about requesting this because formulas are often easily exploited and, except in unforeseen circumstances, courts may be required to strictly interpret agreed-upon yearly recalculation provisions, even when they might have been in error.[75]

Unless indicated otherwise by the instructing lawyer or where required for trial, guideline income reports should be attached as exhibits to affidavits sworn by the accounting professional. The accounting professional's *curriculum vitae* (CV) or resume should also be attached to the affidavit as an exhibit, so that the professional can be properly qualified as an expert (see how to qualify an expert above under the topic "Who Should Perform" above). The CV or resume should list educational qualifications, professional accreditation, any awards or similar recognition, whether the accounting professional has published in their field, and whether they've been previously qualified as an expert.

Affidavits should be prepared by the instructing lawyer, unless the accounting professional volunteers to do so and the instructing lawyer agrees. See the chapter "Affidavits" in the *Family Law Chambers Procedure Manual* by Ken Proudman of Miller Boileau Family Law Group, published through the Legal Education Society of Alberta: https://www.lesaonline.org/product/family-law-chambers-procedure-manual/

### Reports for Trial

If the accounting professional will be called as a witness at trial their report must be set out in Form 25 along with their name, qualifications, the information and assumptions on which their opinion is based, and a summary of their opinion.[76] If using a Chartered Business Valuator, much of this information will likely already appear in their report.

Unless the parties agree otherwise or the court otherwise directs, the party with the initial onus of proof (here, the party controlling/owning the business) must serve their expert's report first, following which the opposing party can serve a rebuttal report, following which a surrebuttal report addressing any new issues raised may be served.[77]

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[75] *Goodkey v Goodkey*, 2015 ABCA 394 at paras 15-16.
[76] *Rules of Court*, r 5.34, "Form 25".
[77] *Rules of Court,* r 5.35(2).

A party seeking to challenge the admissibility of the expert's report (for example, alleging that the author is not an expert in their field) must notify the party serving the report of any objection to admissibility they intend to raise at trial as well as their reasons for the objection.[78] Objections to admissibility at trial cannot be made unless reasonable notice of the objection is given or the court otherwise permits.

A party may also serve notice of intention to use the report without calling the expert as a witness.[79] This would be much less costly, as the time to prepare for court and wait to be called can be significant. If the opposing party consents to the expert not being required to appear, that does not mean that they're admitting the truth or correctness of the report.[80] Unless within 2 months of service of the notice, a party serves a statement setting out their objection to entry of the report with reasons, or serves a request that the expert attend trial for cross-examination (which they can also do even if they agree to admissibility), the party cannot object to the admissibility of the report at trial.[81] If a party requests attendance for cross-examination, they must pay the costs of the expert's attendance pursuant to Schedule B of the *Rules of Court.*[82] However, as Schedule B tariffs are usually lower than the accountant's hourly rate, the excess would need to be paid at the outset by the party who hired the expert (although they can still seek contribution through advance costs or following the trial, see the topics on "Advance Costs" and "Funding" below). The party entering the report may also question their expert at trial in such a case.

### Rebuttal Reports

A rebuttal report responds to another accounting professional's guideline income report. It must follow the same formalities, such as being in Form 25 if used for trial, properly qualifying the expert, and maintaining independence.

Rebuttal reports are critiques or reviews, not second opinions.[83] If a competing guideline income report is sought, it should appear in a separate report.

The following recommendations may be helpful, although they are not necessarily binding:[84]

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[78] *Rules of Court*, r 5.36.
[79] *Rules of Court,* r 5.39.
[80] *Rules of Court,* r 5.39(3).
[81] *Rules of Court,* r 5.39(2), 5.40.
[82] R 5.40(3).
[83] *LAU v IBU,* 2016 ABQB 74 at paras 135, 136.
[84] *LAU v IBU,* 2016 ABQB 74 at paras 137, 138.

1. A critique should be factually and ethically grounded;
2. It should offer clear, cogent and current knowledge of the relevant literature;
3. It should contain a discussion of alternative, rival hypotheses;
4. It should be objective and bias-free;
5. The critique should offer a discussion of its own limitations as well as the limitations of the reviewed report; and
6. Its tone should be forceful, open and honest.

## FUNDING

The cost of the guideline income report will often be a central issue, especially given that the effect of the report will often have a limited duration as child support is usually recalculated annually and spousal support can in some cases be reviewed or recalculated.

We strongly recommend that accounting professionals provide a clear estimate of the cost and what circumstances could change the scope of the work. We also suggest that the lawyer describe the financial documentation to the accountant to give them a proper sense of the work required. A sample of the general ledger could even be provided which will often be very telling. Many clients need to seek external funding to pay for the report meaning that it may be difficult to recover amounts exceeding the quote. In many cases the client will also be funding costly litigation at the same time.

The Law Society of Alberta's *Code of Conduct* recommends that experts be retained through a written retainer agreement.[85]

Although some files take significantly longer than anticipated, there is some benefit in sticking closely to a quote. Unless clearly indicated otherwise in writing, lawyers are personally responsible for paying the expert's fees.[86] This means that if the cost of the report significantly exceeds the quote and the lawyer is forced to pay this amount personally but is unable to recover from their client, in the future they will likely opt out of this personal guarantee, or choose a different accounting professional. Although many lawyers may appear to be part of larger firms, they may actually be merely an association of independent practices/businesses. This is common with family law groups. In those cases, paying these amounts personally can be very difficult. That said, the

[85] Commentary to r 7.1-2.
[86] *Code of Conduct,* Law Society of Alberta, commentary to r 7.1-2.

lawyer may not necessarily be immediately obliged to pay the funds, they can attempt to assist the accounting professional to collect from the client first. The personal guarantee is very beneficial to the accounting professional as it means they will almost certainly be paid for their services. Having the law firm retain the expert directly is also beneficial to the client as it means that privilege can extend to the report, especially if there is a concern that the report will not be used if the result is not favourable. We recommend that accounting professionals provide a reasonable estimate of the total cost of the report to the instructing lawyer and that the instructing lawyer hold the funds in trust prior to the commencement of the report.

Following the ruling, the party paying for the report should specifically seek that the opposing party contribute to the cost of the report. This is because costs do not include the fees and other charges of the expert unless specifically ordered.[87] Courts will often award or apportion the cost of the expert where the expert's report is helpful to the determination of the issues. The party being requested to contribute should request a breakdown of the expert's time spent in case other services were also provided such as valuation or forensic work.

### Advance Costs

Quotes are important because lawyers may need to seek an advance litigation costs award to be able to fund the report. Advance costs are typically sought by a client with limited financial resources to be paid by a former spouse with substantial financial resources. They are governed by Rule 12.36.

The test in civil matters is as follows:[88]

1. The party seeking the order must be impecunious to the extent that, without such an order, the party would be deprived of the opportunity to proceed with the case;
2. The claimant must establish a *prima facie* case of sufficient merit; and
3. There must be special circumstances sufficient to satisfy the court that the case is within the narrow class of cases where this extraordinary exercise of its powers is appropriate.

Although some courts have stated that a strict application of the civil test should not be applied in the family law context, the Alberta Court of Appeal recently seemed to have endorsed the civil test in

[87] *Rules of Court,* r 10.31(2)(d).
[88] *British Columbia (Minister of Forests) v. Okanagan Indian Band*, 2003 SCC 71.

*Pecharsky v. Pecharsky*,[89] in which it was alleged that the lower court had implemented the wrong test. In any event, courts are usually required to find severe financial disadvantage which may prevent a case from being put forward.[90] There must also be an evidentiary basis to prove that without costs the party would be without the resources necessary to respond.[91]

There is nothing to prevent the Court of Appeal from also ordering advance costs.[92] However, a separate list of factors is to be considered in appeals.[93]

The payor is not entitled to know what the recipient's counsel is doing in service of the recipient and isn't entitled to challenge whether that work is reasonable.[94] In some cases it can be ordered that a Bill of Costs be provided periodically, but only to certify that fees and disbursements are charged in relation to the case, as the payor is not entitled to particulars of specific work performed, to know the purpose of disbursements, and is not entitled to a review based on simple doubt.[95]

After the matter is decided, the judge can account for advance costs in a matter deemed appropriate.[96]

## QUESTIONING

A Questioning (also known as an Examination for Discovery), is where a lawyer (or the party, where they don't have a lawyer) asks a person questions under oath, and both the questions and responses are typed up by a Court Reporter. It usually occurs in one of the lawyers' offices.

Parties may elect to question experts because they believe they may be able to get the expert to admit:

1. The limitations of their report (e.g. if general ledger statements were not reviewed or whether they relied on their client's unsworn oral statements);
2. That their opinion would be different if certain facts were different (e.g. if cash payments were not declared);
3. An error in the report;

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[89] 2016 ABCA 259 at para 4.
[90] *Lakhoo v. Lakhoo*, 2015 ABQB 357 [here one party had approximately 100 times the financial resources].
[91] *McDonald v McDonald*, 1998 ABCA 241 at para 539; *MacFarlane v. MacFarlane*, 2016 ABCA 183 at para 25.
[92] *Scott v. Glazebrook*, 2015 ABCA 235 at Note 1.
[93] *Scott v. Glazebrook*, 2015 ABCA 235.
[94] *Lakhoo v. Lakhoo*, 2016 ABCA 200 at para 20.
[95] *Lakhoo v. Lakhoo*, 2016 ABCA 200 at paras 22 and 23.
[96] *Gerlitz v. Gerlitz*, 2005 ABCA 424 at para 8.

4. Irregularities in bookkeeping or tax returns;
5. Facts that will otherwise assist in the litigation (e.g. dissipation of assets);
6. Why there are discrepancies between the reports of multiple experts; or
7. The inadequacy of their expertise (e.g. no familiarity with the *Guidelines*).

Choosing a Chartered Business Valuator (CBV) will improve the chances of the expert's testimony holding up in a Questioning because of the methodology that CBVs must adhere to. See the topic on "Who Should Perform", above.

Each party has the right to question any person who swears an affidavit in relation to a court application.[97] Such a transcript must be filed with the court.

Even if no affidavit is sworn, where the parties agree, or if the court considers there to be "exceptional circumstances", an expert may also be Questioned prior to trial.[98] Such a Questioning must be limited to the expert's report and courts can set limits on the length of the Questioning, how the expert's cost is to be paid, and any other matter relating to such a Questioning. The expert's evidence isn't evidence of their client unless their client adopts it. An expert may be questioned about the truth of the statements made in their report or affidavit and have questions put to them relevant to their credibility.[99] Courts can deny such a questioning where it appears to be a "harassing and delay tactic only".[100] If the party questions more than one expert, then the questioning party must pay the fees of all but the first expert, unless otherwise agreed or ordered.[101]

To question an expert, a party must serve a **Notice of Appointment** setting a reasonable date, time, and place for the Questioning, and setting out what records the expert is required to bring.[102] The expert can request "arrangements necessary to accommodate the person's reasonable needs which, to the extent reasonably possible, must be accommodated."[103] A **witness allowance** must also be paid along with the Notice of Appointment, calculated under Schedule B of the *Rules of Court*. The cost in excess of the witness allowance must be paid by the expert's client (or in some cases, the lawyer. See the topic on "Funding", above).

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[97] *Rules of Court,* r 3.13.
[98] *Rules of Court,* r 5.37.
[99] *Karaha Bodas Company, L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 2009 ABQB 482 at para 27.
[100] *Harrison v McDougall,* 2007 ABCA 176 at paras 7, 8.
[101] *Rules of Court,* r 5.17(2), 5.37(4).
[102] *Rules of Court,* r 6.16.
[103] *Rules of Court,* r 6.16(1)(c).

Lawyers can object to questions posed to experts if:[104]

1. The answer is privileged (e.g. if it relates to a conversation between the expert and the lawyer);
2. The question is not "relevant and material";
3. The question is unreasonable or unnecessary; or
4. Any other ground of objection recognized by the courts (e.g. hypothetical, speculation, conjecture, bad faith, badgering, statements known to be false, misstating facts, arguing, abuse, rhetoric, asking to draw a conclusion, asking to interpret a document which speaks for itself, commenting on other evidence, fishing expeditions, disclosing evidence rather than facts, matters of law, reputation for veracity).

Instead of attending a Questioning, a party can choose to serve "**written interrogatories**", which are written questions.[105] This may be much more cost-effective especially since a Court Reporter would not need to be hired.

During the Questioning, the questioning lawyer can ask for "**undertakings**", which is to agree to look up an answer or provide a document. Lawyers might decide to take the undertaking "under advisement" which means that they want to consider whether or not they should be required to provide the document (e.g. where they think that it might be privileged). Experts "cannot be required to undertake to provide documents that are not within their power or possession or to undertake to answer questions outside their personal knowledge."[106] Undertakings are usually provided through the lawyer acting on the expert's side, in the form of a letter. Experts can also be questioned on their answers to undertakings.

After the opposing party has finished their questioning, the lawyer acting on the expert's side will sometimes choose to do a "**redirect**", which is where they can ask open-ended questions to "explain, elaborate or provide context for an answer initially given", after which the opposing party can question again.[107]

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[104] *Rules of Court,* r 5.25.
[105] *Rules of Court,* r 5.22.
[106] *Karaha Bodas Company, L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 2009 ABQB 482 at para 27.
[107] *Rules of Court,* r 5.25(5) & (6).

## GUIDELINE INCOME

### PRINCIPLES OF CHILD SUPPORT AND SPOUSAL/PARTNER SUPPORT

Child support is calculated according to the *Federal Child Support Guidelines.* There are four "fundamental and pressing objectives" of the *Guidelines:*[108]

1. to establish a fair standard of support for children that ensures they benefit from the financial means of both parents;
2. to reduce conflict and tension between parents by employing an objective calculation for child support;
3. to improve efficiency of the legal process by giving courts and parents guidance in setting levels of child support and encouraging settlement; and
4. to ensure consistent treatment of parents and children who are in similar circumstances.

Spousal support (or "partner support", where the parties were not married) is calculated according to judge made law which looks at each party's "means". "Means" include "all pecuniary resources, capital assets, income from employment or earning capacity, and other sources from which the person receives gains or benefits".[109] For example, a reasonable rate of return on investments could be calculated.[110] Although not law, reference is generally had to the *Spousal Support Advisory Guidelines* ("*SSAG*") which provides recommendations to judges. It recommends that each party's income be calculated in the way prescribed by the *Federal Child Support Guidelines*.

### DEDUCTIONS AND INCLUSIONS

The starting point for determining income is typically **line 150** of that party's tax return.[111] This is subject to several adjustments.

Many of those adjustments are contained in Schedule III to the *Guidelines,* which states that the following **employee expenses** must be deducted from a person's income, as described in the *Income Tax Act*:

1. Expenses of **teachers exchange fund contribution** (s 8(1)(d));

[108] *Cunningham v Seveny,* 2017 ABCA 4 at para 36.
[109] *Strange v Strang,* [1992] SCR 112 at 119; *Leskun v Leskun,* [2006] 1 SCR 920 at para 32.
[110] For example, the Ontario Court of Appeal recently accepted that a 3% rate of return would be reasonable in *Halliwell v Halliwell,* 2017 ONCA 349.
[111] *Guidelines,* s 16.

- Not exceeding $250 in a year.

2. Expenses of **railway employees** (s 8(1)(e));
    - For meals and lodging in certain circumstances when away on work if not already reimbursed or entitled to be reimbursed.
3. **Sales** expenses (s 8(1)(f));
    - If employed in connection with the selling of property or negotiation of contracts and required to pay their own expenses pursuant to a contract; ordinarily required to carry on the duties of employment away from the employer's place of business; the employer is paid in whole or in part by commissions; and not paid a travel allowance.
    - Can't exceed the amount of commissions.
    - Can't be outlays, losses, or replacements of capital or payments on account of capital.
    - Can't be outlays or expenses for membership fees or dues in any dining, recreational, or sporting facility club, or for the use or maintenance of a yacht, camp, lodge, golf course or facility (unless it was part of the ordinary course of their business of providing that property for hire or reward).
4. **Transport employee's** expenses (s 8(1)(g));
    - Where the employer's principal business was passenger, goods, or passing and goods transportation.
    - Where the employee's duties regularly require travel away from their residence.
    - Can't deduct if already reimbursed or entitled to be reimbursed.
5. **Travel** expenses (s 8(1)(h));
    - If ordinarily required to carry on their duties away from the employer's place of business and required by contract to pay their own travel expenses.
    - Can't deduct if they received a travel allowance that wasn't included in their income.
6. **Motor vehicle travel** expenses (s 8(1)(h.1));
    - If ordinarily required to carry on their duties away from the employer's place of business and required by contract to pay their own motor vehicle expenses.
    - Can't deduct if they received a motor vehicle allowance that wasn't included in their income.
7. **Dues and other expenses of performing duties** (s 8(1)(i));
    - Professional membership dues necessary to maintain a professional status recognized by statute, contractually-required office, contractually-required rent, contractually-required salary to an assistant or substitute, contractually-required

supplies consumed directly in the performance of duties, union dues, certain public servants' association memberships, statutorily-required dues to a parity or advisory committee or similar body, or statutorily-required professions board dues.

- Can't deduct if already reimbursed or entitled to be reimbursed.

8. **Motor vehicle and aircraft** costs (s 8(1)(j));
    - Interest and Capital Cost Allowance (i.e. prescribed amortization) on loans to acquire motor vehicle used in the performance of duties, or an aircraft required to be used in the performance of duties.
9. **CPP contributions and EI premiums paid in respect of another employee who acts as an assistant or substitute for the spouse** (s 8(1)(l.1));
    - Unlikely to come up, usually the employer would be hiring the assistant or replacement.
    - There are some restrictions.
10. **Salary reimbursement** (s 8(1)(n));
    - Where the person is required to reimburse any amounts paid to them for a period throughout which they didn't perform their duties, if the amount paid was included in their income.
    - Amount reimbursed can't exceed the amount received.
11. **Forfeited amounts** (s 8(1)(o));
    - In relation to salary deferral arrangements.
    - There are some restrictions, see section 8(1)(o) of the *Income Tax Act*.
12. **Musical instrument** costs (s 8(1)(p)); and
    - For maintenance, rental, or insurance of an instrument.
    - Can claim Capital Cost Allowance (i.e. prescribed amortization).
    - If employed as a musician and required as a term of employment to provide their own musical instrument.
    - Can't exceed their income from that employment for that year.
13. **Artists' employment** expenses (s 8(1)(q)).
    - If their income includes income from an artistic activity, that was either:
        i. Their creation of paintings, prints, etchings, drawings, sculptures, or similar works of art (but not their reproduction);
        ii. Their composition of a dramatic, musical, or literary work;
        iii. Their performance of a dramatic or musical work as an actor, dancer, signer, or musician; or

iv. Where they were a member of a professional artists' association that is certified by the Minister of Communications.

- Expenses incurred for the purpose of earning income from that activity.
- Can't exceed the amount by which the lesser of $1,000 and 20% of their artistic activity income before deducting the expense, exceeds their deducted musical instrument costs and motor vehicle and aircraft costs.

The above deductions can't be double-counted (e.g. can't claim the same expenses as both a sales expense and travel expense). Note that the above is a specific list. Not every deduction allowed by section 8 of the *Income Tax Act* is to be deducted from a person's guideline income. This means that although normally deductible for tax purposes, the following can't be deducted when calculating guideline income: legal expenses of an employee, clergy's residence, Quebec parental insurance plan, employee's registered pension plan contributions, employee retirement compensation arrangement (RCA) contributions, reimbursement of disability payments, employee profit sharing plan forfeited amounts, excess employee profit sharing plan amounts, apprentice mechanics' tool costs, or tradesperson's tools.

This is only a starting point. These expenses can be added back to a person's guideline income where they were **unreasonably deducted** and the reasonableness of an expense isn't governed solely based on whether the *Income Tax Act* permits the deduction.[112]

**Schedule III** also requires the following adjustments:

a. Child support included in income must be deducted (although child support shouldn't be included in income anyways);
b. **Spousal support** received from the other spouse must be deducted;
c. Any Universal Child Care Benefit (**UCCB**) must be deducted;
    - This has been replaced by the Canada Child Benefit (CCB), so UCCB would only be deducted if looking at past years.
    - CCB isn't deducted (except in relation to section 7 expenses) because it's not taxable income.
d. For the purpose of calculating **section 7 expenses only**:
    1. Deduct **spousal support paid** to the other spouse.
    2. Deduct any **UCCB** reported as taxable income in relation to any child for whom section 7 expense is not being requested. Include any UCCB which isn't reported as

[112] *Guidelines*, ss 19(1)(g) & 19(2).

income if received in relation to a child for whom section 7 expenses are being requested. See above as well.

- The instructing lawyer should make this adjustment, not the accounting professional, because otherwise child support calculation software (ChildView or DivorceMate) might double-count the adjustment and spousal support arrangements might not have been finalized.

e. Deduct any **social assistance not attributable to them** (i.e. paid in relation to a dependent);

f. The **dividend gross-up** must be deducted (see the topic on "Dividends", below);

g. The taxable capital gain must be replaced with the **actual capital gain** (i.e. 100% instead of the 50% inclusion rate, at least for recent years. See topic on "Capital Gains, Capital Losses, and Recapture" below);

h. **Business investment losses** must be deducted (see topic on "Business Losses" below);

i. **Carrying charges and interest expenses** permitted to be deducted under the *Income Tax Act* must be deducted;

- Reported on line 221.
- Relates to some investment administration fees such as brokerage and interest on loans to purchase shares.
- But see topic on "Capital Gains, Capital Losses, and Recapture" below, because if a capital or business investment loss is non-recurring, the courts might also ignore the related carrying charges and interest expenses.

j. Salaries, benefits, wages, management fees, or other payments, paid to or on behalf of **non-arm's length persons by a self-employed spouse;**

- See topic on "Payments or Benefits to Non-arm's Length Parties" below.

k. **Additional amounts earned by a self-employed spouse in prior periods**, net of reserves, must be deducted;

- Pursuant to sections 34.1 and 34.2 of the *Income Tax Act*.
- This is where the business's fiscal year doesn't match the calendar year (December 31).
- Contained in Form T1139 "Reconciliation of [past year] Business Income for Tax Purposes".
- Most unincorporated businesses are required to have a calendar year end so this won't come up often. It might apply to some partnerships though.
- Pro-rating this income in the same way that corporate income would be pro-rated should be sufficient. It would be difficult to imagine courts requiring accountants to

spend enormous amounts of time breaking down every receipt and expense to determine in which calendar year it was incurred.

l. **Capital Cost Allowance (CCA) in relation to real property (land)** must be added-back into income;
    - See the topic of "Amortization/Depreciation/CCA" below.

m. **Amounts properly required for capitalization by a partnership or sole proprietorship** must be deducted;
    - See the topic on "Profit", below.

n. **Employee stock options;**
    - If the option is to purchase shares in a Canadian-controlled Private Corporation ("CCPC") or a publicly traded corporation if subject to the same tax treatment in relation to stock options as a CCPC would be.
    - Where received as an employee benefit.
    - The amount is the difference between the value of the shares at the time the options are exercised and the amount paid for the shares, and any amount paid to acquire the option to purchase the shares.
    - Add the amount if the options are exercised that year or deduct the amount if the shares are disposed of that year.

o. **Split pension amounts** received pursuant to section 60.03(2)(b) of the *Income Tax Act* must be deducted.
    - If included in taxable income.

The *Guidelines* also require the following further adjustments:

1. **Non-recurring capital or business investment losses** (see the topics on "Capital Gains, Capital Losses, and Recapture", and "Business Losses", below);
2. Part or all of the **pre-tax net income** of a corporation can be included (see the topic on "Profit" below);
3. Where a spouse is a shareholder, director, or officer of a corporation and their income doesn't fairly reflect all of the money available to them, the court can set their income to "an **amount commensurate** with the services that the spouse provides to the corporation, provided that the amount does not exceed the corporation's pre-tax income" (see the topic on "Profit" below);

4. **Compensation and personal benefits to non-arm's length persons**, unless reasonable in the circumstances, must be included (see the topic on "Payments or Benefits to Non-arm's Length Parties" below).
5. Where the spouse is a **non-resident of Canada** their income should be calculated as if they were a resident of Canada, although courts can consider what income would be appropriate if that country has higher effective income tax rates.[113]
6. Courts can **"impute"** income for various reasons (see the topic on "Imputing Income", below).

Where a person's tax return has not been completed in accordance with the *Income Tax Act* (which often occurs when a person completes their own tax returns), their income should also be adjusted to reflect a proper calculation.

## IMPUTING INCOME

Imputing income means to set a different income for a person than would otherwise have been calculated according to the *Guidelines*. If income is to be imputed, courts can impute such an amount as the court "considers appropriate in the circumstances, taking into account the following list. This might mean either using the other spouse's calculation or choosing an amount based on the best available information, even where that information is incomplete.[114]

Income can be imputed where:[115]

a. The spouse is **intentionally under-employed or unemployed** other than where the under-employment or unemployment is required by the needs of a child of the marriage or any child under the age of majority or by the reasonable educational or health needs of the spouse;
    - Requires evidence of a specific intention to undermine or avoid support obligations, or circumstances that permit courts to infer that the intention is to undermine or avoid support obligations.[116]
    - It's an error to only look at a person's capacity to earn an income, and an error for courts to ask if a person could have earned more, even if they're volunteering and pursuing an education which wouldn't improve their earning capacity.[117]

[113] *Guidelines,* s 20.
[114] *Sweezey v Sweezey,* 2016 ABQB 131 at para 55.
[115] *Guidelines,* s 19.
[116] *Hunt v Smolis-Hunt,* 2001 ABCA 229 at para 42; also cited in *DBF v BF,* 2017 ABCA 272 at para 77.
[117] *DBF v BF,* 2017 ABCA 272 at paras 77-79.

- A spouse can be found to be under-employed where they receive a large property settlement, numerous steps have been taken to help them upgrade, and they can't show any evidence that they've taken reasonable steps to find employment or pursue retraining with the objective of becoming self-sufficient.[118]
- A spouse might not be under-employed if they're seeking a Master's degree.[119]
- Withdrawing from business activities upon retirement might not be under-employed.[120]
- If a spouse is unable to be employed due to medical conditions, then they should at least obtain a letter from their doctor confirming same. If the other party wishes to challenge such a letter, they should obtain an Independent Medical Examination.

b. The spouse is **exempt from paying federal or provincial income tax**;
c. The spouse lives in a country that has effective **rates of income tax that are significantly lower than those in Canada**;
d. It appears that **income has been diverted** which would affect the level of child support to be determined under these Guidelines;
e. The spouse's **property is not reasonably utilized to generate income**;
    - For example, where a residence is vacant and could be rented out or where significant funds are sitting in a chequing account rather than being invested.
    - Courts must look at what a "reasonably prudent" businessperson would do with the property, taking into account any need for funds to be used for legitimate business objectives.[121]
    - It may be possible to argue that funds are a reasonable reserve against market changes, especially if the market does in fact decline.[122]
    - Where funds are not invested, courts can impute an income "based on what those assets could reasonably produce if invested", which should be based on professional actuarial advice.[123] Several recent Court of Appeal decisions outside of Alberta have imputed income at various rates between 1% to 6% of funds.[124]
f. The spouse has **failed to provide income information** when under a legal obligation to do so;

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[118] *Daschuk v. Mrdenovich*, 2015 ABQB 822 at paras 27-29.
[119] *Pattison v Shwaykosky*, 2017 ABQB 362.
[120] *Daschuk v. Mrdenovich*, 2015 ABQB 822 at paras 22,23.
[121] *Mollot v Mollot*, 2006 ABQB 249 at para 63.
[122] *McCarty v. McCarty*, 2016 ABQB 91 at para 254.
[123] *Boston v Boston,* 2001 SCC 43 at para 66.
[124] *Berta v Berta,* 2017 ONCA 874 at para 45 [6%]; *Mason v Mason,* 2016 ONCA 725 [4.5%], *Parrett v Parrett,* 2016 BCCA 151, leave to appeal to SCC dismissed [4%]; *Halliwell v Halliwell,* 2017 ONCA 349 at para 139 [3%]; *Berger v Berger,* 2016 ONCA 884 at para 105 [1%].

- See the topic on "Failure to Adequately Disclose" above.

g. The spouse **unreasonably deducts expenses** from income;
    - This isn't limited to corporations. It can apply to employees who deduct expenses, sole proprietorships, partnerships, trusts, and corporations.
    - See the topic on "Reasonableness of Expenses" below.
h. The spouse derives a significant portion of income from **dividends, capital gains or other sources** that are **taxed at a lower rate** than employment or business income or that are exempt from tax; and
    - This provision was used to both impute income for section 7 purposes and gross it up for tax where a spouse received the Canada Child Tax Benefit (CCTB, which has now been replaced with the CCB) and the National Child Benefit Supplement (NCBC).[125]
    - Has been applied to gross-up income where an exercise of stock options was exempt.[126]
i. The spouse is a beneficiary under a trust and is or will be in receipt of income or other benefits from the trust.

The list is not exhaustive. Courts can consider other circumstances.

## INCOMES OVER $150,000

Courts can choose a different amount of child support where guideline income is above $150,000, and shouldn't necessarily apply the *SSAG* calculation where income is over $350,000. However, this should not affect the calculation of a party's guideline income. In that regard, accounting professionals should not make any such adjustments for high incomes in their reports.

## PERIODIC FLUCTUATIONS AND MATERIAL CHANGES

Where the traditional approach would not be the fairest determination of income, the *Federal Child Support Guidelines* permit a court to look at a three year average of income to "determine an amount that is fair and reasonable in light of any pattern of income, fluctuation in income or receipt of a non-recurring amount during those years".[127] Although a three year average is relatively rare in

[125] *Mullins v Mullins,* 2016 ABQB 226 at paras 17-18.
[126] *Kowalski v Kowalski,* 2008 ABQB 163 at para 21.
[127] S 17(1).

relation to child support, the possibility of such a determination means that lawyers may want to provide this information to the court.

Although spousal support calculations often take their cue from the *Federal Child Support Guidelines*, the Court of Appeal recently endorsed a judge's use of a five-year averaging of incomes in relation to spousal support calculations.[128] That does not mean that a five-year average is appropriate in all circumstances though, merely that it was not an error in that particular matter. A recent Ontario Court of Appeal decision considered a 3 year average permissible for spousal support purposes where the spouse operated a business.[129]

We often base ongoing income based on the previous year, however that is not an appropriate approach to determining ongoing income where there is reliable information available about the current year or a significant change in circumstances.[130] Basing a recommendation as to ongoing income on past years is not appropriate where there is uncontradicted evidence of a significant decline in income due to economic downturn.[131] Conversely, it is not necessarily an error to increase guideline income on the basis that lower income in a separation year was due to the separation and that revenues will likely go back up.[132] As this is an opinion, a properly qualified expert may come to this conclusion. However, if a report comes to that conclusion, it should be clearly stated that such an adjustment has been made, along with the basis for such a determination.

Whether or not to average is not within an accounting expert's particular expertise. This determination must be left to the court. However it is permissible for the accounting expert to set out what an averaging might look like if the court decides that averaging is appropriate.

## UNDUE HARDSHIP

An undue hardship claim is where a person states that because of a special circumstance, they are unable to pay the calculated amount of child support. Although such a claim is rarely successful, and for that reason rarely sought, it may be necessary to perform a separate guideline income calculation that shows the result if an undue hardship claim were successful.

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[128] *Shaw v Shaw*, 2015 ABCA 11.
[129] *Halliwell v Halliwell,* 2017 ONCA 349.
[130] *Lavergne v Lavergne*, 2007 ABCA 169 at para 17, 18, 22.
[131] *Martens v. Martens*, 2016 ABCA 107 at paras 8-10.
[132] *Sparrow v. Sparrow*, 2006 ABCA 155 at paras 11-12.

Circumstances which could result in undue hardship include:

a. the spouse has responsibility for an unusually high level of debts reasonably incurred to support the spouses and their children prior to the separation or to earn a living;
b. the spouse has unusually high expenses in relation to exercising access to a child;
c. the spouse has a legal duty under a judgment, order or written separation agreement to support any person;
d. the spouse has a legal duty to support a child, other than a child of the marriage, who is
    i. under the age of majority, or
    ii. the age of majority or over but is unable, by reason of illness, disability or other cause, to obtain the necessaries of life; and
e. the spouse has a legal duty to support any person who is unable to obtain the necessaries of life due to an illness or disability.

Undue hardship claims must also be accompanied by a comparative Household Standards of Living calculation, as set out at Schedule II to the *Federal Child Support Guidelines*. It is typically the lawyer's responsibility to perform this calculation as they have access to software which can more easily calculate it, such as ChildView or DivorceMate. However, the financial professional could provide an alternative calculation showing what guideline income would look like were it not for the special circumstance. It is the lawyer's obligation to decide whether to instruct an accounting professional to perform such a calculation. Any such alternate calculation must only be made as a calculation aid. The accounting professional should not lend any opinion as to whether or not an undue hardship claim should be allowed.

## EMPLOYEE EXPENSES

See the topic on "Deductions and Inclusions" above which discusses the categories of employee expenses which can be deducted from income.

Although many of the factors in this Manual relate to businesses, an employee's expenses may also be added back into income if unreasonably deducted.[133] Whether an expense is reasonably deducted isn't governed solely by whether the deduction is permissible under the *Income Tax Act*.[134]

[133] *Guidelines*, s 19(1)(g).
[134] *Guidelines*, s 19(2).

In an Alberta Court of Appeal decision, the lower court was criticized for too readily adding an employee allowance back into income, not relying on uncontradicted sworn statements, and second-guessing transportation choices, even though the documentation was not great.[135] One recent decision stated that "[e]xpenses for travel, meals, and accommodation are typically not included in a salaried parent's income when the funds are used for business, as opposed to personal, purposes."[136] That also included expenses in relation to charitable events, professional fees, parking, and office supplies. However half of an $800 per month vehicle allowance, fuel, and vehicle maintenance amounts were added back, because of "incomplete disclosure and lack of information about whether it's a reimbursement for travel between sites or to and from home (which would not be a business expense)".[137]

An employee's RRSP contributions can't be deducted from income even if the employer matches.[138]

## OTHER INCOME

The following factors should be considered when determining whether **gifts** should be included in income:[139]

a. regularity of the gifts;
b. duration of their receipt;
c. whether the gifts were part of the family's income during cohabitation that entrenched a particular lifestyle;
d. the circumstances of the gifts that earmark them as exceptional;
e. whether the gifts do more than provide a basic standard of living;
f. the income generated by the gifts in proportion to the payor's entire income;
g. whether they are paid to support an adult child through a crisis or period of disability;
h. whether the gifts are likely to continue; and
i. the true purpose and nature of the gifts.

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[135] *Calver v Calver,* 2014 ABCA 63 at paras 16-24.
[136] *DBF v BF,* 2016 ABQB 484 at paras 286, 288, appeal allowed in part on other unrelated grounds in *DBF v BF,* 2017 ABCA 272.
[137] *DBF v BF,* 2016 ABQB 484 at paras 290-291, appeal allowed in part on other unrelated grounds in *DBF v BF,* 2017 ABCA 272.
[138] *CWT v KAT,* 2014 ABQB 719 at para 41.
[139] *Bak v. Dobell*, 2007 ONCA 304 cited in *Hartley v. Del Pero*, 2010 ABCA 182; *Simpson v. Bettenson*, 2014 ABCA 21at para 12; *Hartley v. Del Pero*, 2017 ABQB 1 at para 121.

**Loans** should not be included in income where there isn't any evidence of the loans being anything other than a one-time loan.[140]

**RRSP/RSP withdrawals** should presumptively be included in income for child support purposes and won't necessarily be deducted even if already equalized as matrimonial property.[141] It shouldn't be considered income if used to pay child support arrears and it was already equalized though.[142]

Decisions out of the Ontario Court of Appeal state that the portion of a **personal injury award** relating to lost earnings should be included in income, grossed-up for taxes if not taxable income (e.g. where it's a "structured settlement") and if the amounts are actually for pain and suffering then the person who received the personal injury award should provide documentation.[143]

**Veterans Affairs Canada (VAC) benefits** are income for support purposes.[144]

**Stock Options** are typically considered income for child support purposes, but may not be if the money received is a non-recurring amount that varied widely during various years and is used to fund retirement, not lifestyle.[145]

**Non-recurring share bonuses and dividends** (e.g. from sale of business) should be considered divisible matrimonial property, not income for spousal support.[146]

**Loyalty points or rewards, or travel points**, such as Air Miles, can be included in income.[147]

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[140] *D.B.F. v. B.F.*, 2016 ABQB 484 at para 280 [litigation loan], appeal allowed in part on other unrelated grounds in *DBF v BF,* 2017 ABCA 272.
[141] *Haig v Whitmore,* 2015 ABQB 267 at paras 39-40.
[142] *Haig v Whitmore,* 2015 ABQB 267 at paras 42, 44.
[143] *Hunks v Hunks*, 2017 ONCA 247 at para 33; *Fraser v Fraser,* 2013 ONCA 715 at paras 109-111.
[144] *Rooker v Rooker*, 2017 ABCA 87.
[145] *Warren v Baird,* 2015 ABQB 479 at paras 18, 19, 23.
[146] *Martin v. Martin*, 2016 ABQB 425; *Devlin v Devlin*, 2014 ABQB 616; *Johnson v Johnson*, 2005 ABQB 320.
[147] *McCarty v. McCarty*, 2016 ABQB 91 at para 134.

## BUSINESSES

### PROFIT

If the spouse is a shareholder, director, or officer of a corporation, and the court is of the opinion that their income as would otherwise be calculated doesn't fairly reflect all the money available for support purposes, courts can:[148]

1. Add all or part of the corporation's pre-tax income into the person's guideline income as well as that of any related corporation (see the definition of "related" under the topic of "Required Documents/Evidence" above); or
2. Add an "amount commensurate with the services that the spouse provides to the corporation, provided that the amount does not exceed the corporation's pre-tax income".
    - i.e. the amount of income added-back should at least result in their total compensation reflecting a proper salary.

This analysis is made in conjunction with a consideration of the last three years of income and whether there are any non-recurring capital or business investment losses (the factors in section 17).

The onus is on the shareholding spouse to satisfy the court that there are valid business reasons to leave all or part of the pre-tax income in the corporation.[149] Courts can't speculate about business needs in the absence of evidence.[150]

When considering whether to include pre-tax net income courts should consider the "*Kowalewich*" factors, which are:[151]

1. Nature of the company's business;
2. Any evidence of legitimate business;
3. The fact that funds needed to maintain the value of the business as a viable going concern are not available for support purposes;
4. The expansion of the business;
5. Depreciation;
6. Possible economic downturns; and

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[148] *Guidelines*, s 18.
[149] *Nesbitt v Nesbitt*, 2001 MBCA 113 cited in *Miller v Joynt,* 2007 ABCA 214 at para 22, and *Roseberry v Roseberry*, 2015 ABQB 75 at paras 70, 96; *Henderson-Jorgensen v Henderson-Jorgensen*, 2013 ABCA 328 at paras 12, 13.
[150] *Miller v. Joynt*, 2007 ABCA 214 at para 37.
[151] *Chekowski v Howland*, 2013 ABCA 299 at para 12.

7. Return on invested capital.

The following factors can also be considered:[152]

8. The nature of the corporation's business;
9. The historical spending patterns of the corporation;
10. The role the shareholder spouse plays in the corporation;
11. Whether the shareholder spouse is the sole shareholder;
12. The degree of control the shareholder spouse exercises, including his/her relationship with the controlling shareholder;
13. The benefits received by non-arm's length persons as a result of payment of corporate expenses;
14. Whether payments to non-arm's length persons were for services for which the corporation would otherwise have had to obtain from a third party; and
15. Whether the company's pre-tax income is required to manage the business and ensure its ongoing financial viability.

Including some or all pre-tax income doesn't require any element of bad faith nor an intention to avoid child support obligations.[153]

On the other hand, courts aren't required to "place the largest available shovel in the company store" but can consider "what an objective well-informed parent would make available for child support in the circumstances of a particular business over which the parent exercised control, having regard to the objectives of the Guidelines, the underlying parental obligation to support children in accordance with one's means, and any applicable situation in s. 17".[154]

Although interest appears in Financial Statements, the **principal portion of loan payments** does not, as it is not an allowable expense under the *Income Tax Act*. Minimum mandatory loan payments should be considered when determining whether profits are actually available, although be careful not to double-count loan payments by also allowing amortization based on these payments, especially where allowable amortization exceeds the loan payments.

We recommend that if it's possible that a court might include pre-tax net income, then separate calculations for whether the pre-tax income is included or not should be provided.

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[152] *Sweezey v Sweezey*, 2016 ABQB 131 at para 56.
[153] *Kowalewich v Kowalewich*, 2001 BCCA 450 at para 40 cited in *McCarty v. McCarty*, 2016 ABQB 91 at para 79.
[154] *Kowalewich v Kowalewich*, 2001 BCCA 450 at paras 44-45 cited in *McCarty v. McCarty*, 2016 ABQB 91 at para 79.

In relation to **child support** (and possibly also spousal support):

a) It is <u>not</u> appropriate to deduct **child support arrears payments** from pre-tax income;[155]
b) It is <u>not</u> appropriate to deduct **retirement savings** from pre-tax income, as "retirement planning does not take precedence over… ongoing child support obligations";[156]

In relation to **spousal support**, courts have cautioned against double-counting income where it is derived from a share of divided property (e.g. where a business has already been divided).[157]

In a similar fashion, amounts properly required for capitalization by a **partnership or sole proprietorship** must be deducted.[158]

- This essentially means funds required as a float, required to fund day-to-date expenses, or planned to be used for a specific business expense (i.e. saving up for a large piece of equipment, especially if the purchase did in fact occur after the year-end).
- In a way, this is the reverse of section 18(1)(a) of the *Guidelines* which can add back all or some corporate profit.
- There is sparse judicial treatment in relation to this section.
- One Supreme Court of Nova Scotia decision states that "[c]apitalization refers to the cash needed to operate on a day to day basis."[159]
- The Ontario Superior Court of Justice recently analyzed this section and made several observations. This section applies where there is a direct relationship between the spouse and the partnership, not where the spouse's corporation earns income from the partnership.[160] It doesn't apply where the payment is just paying down the principal portion of a loan or to purchase a capital asset such as a partnership or shares, even if required by a partnership agreement.[161] However, other courts have allowed part of the principal portion of mortgages used to acquire rental properties to be deducted.[162]
- That decision also endorsed a Supreme Court of British Columbia decision which stated that the analysis of this section is "essentially the same" analysis as relates to whether to include corporate pre-tax income found in *Kowalewich* (above).[163] That decision also states that the

[155] *Kondics v Kondics,* 2017 ABQB 493 at para 30.
[156] *Kondics v Kondics,* 2017 ABQB 493 at para 30.
[157] *Boston v Boston*, [2001] 2 SCR 413; *Alpugan v Baykan*, 2014 ABCA 152 at para 32.
[158] *Guidelines*, Schedule III, s 12.
[159] *Ghosn v Ghosn,* 2006 NSSC 2 at para 24.
[160] *Abelman v Abelman,* 2017 ONSC 1810 at para 55.
[161] *Ibid* at paras 57, 65, 68; *Boniface v Boniface,* 2007 BCSC 1543 at para 15.
[162] *Ghosn v Ghosn,* 2006 NSSC 2 at para 32 [50%]; *de Goede v de Goede*, 2000 BCSC 38 [unspecified "part"].
[163] *Ibid* at para 65, citing *TLB v RB,* 2010 BCSC 710 at paras 31-32.

"onus is on the payor to clearly establish the need for a retention of funds", and states that the spouse's control over the business can be a factor but isn't the sole factor.[164]

## CAPITAL GAINS, CAPITAL LOSSES, AND RECAPTURE

The *Guidelines* state that a net taxable capital gain must be replaced with the actual amount of the capital gain (i.e. 100% instead of 50%, in recent years).[165] However this approach does not necessarily need to be taken where a spouse has incurred a **non-recurring capital loss** or business investment loss and the rules wouldn't be the fairest determination of their income, in which case courts can use the amount they consider appropriate.[166] In that case not only can the loss be adjusted, but related expenses, carrying charges, and interest expenses can also be adjusted.

Our Court of Appeal has also stated that a **non-recurring gain** can be considered, especially if the sale of an asset will affect future income, or if it might be the basis of a retirement fund, rather than to fuel current lifestyle.[167] The Court however cautioned that "[f]requently, the fairest method of income [sic] may be to exclude the gain. On the other hand, where a non-recurring gain is in the nature of an employment bonus, in the sense that it is truly income for work done, its inclusion in section 16 income may not make that method of calculation unfair. The sale of stock options as part of annual compensation may be such an example… Thus, when determining a fair and reasonable income, the day-to-day standard of living the family would have enjoyed, had it remained intact, is relevant. A court might want to consider whether a specific non-recurring gain would have resulted in a change in lifestyle of a particular family, had it remained intact. For instance, if the family's standard of living is high to begin with, the unusual gain may not affect the family's standard of living at all but may simply be seen as a means of providing security for future years. Thus, notwithstanding a large gain, a section 16 calculation which includes the gain might not be the fairest method of calculation."[168]

The Court of Appeal also provided the following factors which can be considered in relation to non-recurring gains:[169]

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[164] *TLB v RB,* 2010 BCSC 710 at paras 33-37.
[165] *Guidelines,* Schedule III, s 6.
[166] *Guidelines,* s 17(2).
[167] *Ewing v Ewing,* 2009 ABCA 227 at para 32.
[168] *Ewing v Ewing,* 2009 ABCA 227 at paras 33, 34.
[169] *Ewing v Ewing,* 2009 ABCA 227 at para 35.

a. Is the non-recurring gain or fluctuation actually in the nature of a bonus or other incentive payment akin to income for work done for that year?
b. Is the non-recurring gain a sale of assets that formed the basis of the payor's income?
c. Will the capital generated from a sale provide a source of income for the future?
d. Are the non-recurring gains received at an age when they constitute the payor's retirement fund, or partial retirement fund, such that it may not be fair to consider the whole amount, or any of it, as income for child support purposes?
e. Is the payor in the business of buying and selling capital assets year after year such that those amounts, while the sale of capital, are in actuality more in the nature of income?
f. Is inclusion of the amount necessary to provide proper child support in all the circumstances?
g. Is the increase in income due to the sale of assets which have already been divided between the spouses, so that including them as income might be akin to redistributing what has already been shared?
h. Did the non-recurring gain even generate cash, or was it merely the result of a restructuring of capital for tax or other legitimate business reasons?
i. Does the inclusion of the amount result in wealth distribution as opposed to proper support for the children?

The same analysis should apply even if a return of capital is structured as a **capital dividend**.[170]

Unless it is entirely clear whether a capital gain or capital loss should be included, we recommend providing alternate calculations showing what guideline income would be if it were included or excluded from guideline income.

**Recapture** is an adjustment due to a capital cost allowance (CCA) class becoming negative following the disposal of an asset. It is only an accounting entry and does not result in any additional income available for support. Recapture should not form part of guideline income.[171]

[170] *Brown v Brown,* 2014 BCCA 152 at para 35, cited at *Emslie v Emslie*, 2015 ABQB 581 at paras 64, 181, 197, 198 [one-third of actual cash received added to guideline income, no forward-averaging]; *Vincent v Vincent,* 2012 BCCA 186 at para 59.
[171] *Schmidt v Beug*, 2009 SKCA 130 at para 2, cited in *McCarty v McCarty,* 2016 ABQB 91 at para 96.

## BUSINESS LOSSES

The *Guidelines* require that the **"actual" amount of business investment losses** "suffered by the spouse" be deducted from guideline income.[172] However this approach does not necessarily need to be taken where a spouse has incurred a **non-recurring** capital or **business investment loss** and the rules wouldn't be the fairest determination of their income, in which case courts can use the amount they consider appropriate.[173] In that case not only can the loss be adjusted, but related expanse, carrying charges, and interest expenses can also be adjusted. The following factors can be taken into account when determining whether to make such an adjustment:[174]

a. Was the investment made in good faith in the expectation of profit?
b. Was there a reasonable likelihood of profit being made from the business in which the loss was incurred at the time the investment was made?
c. Documentary proof of the portion of the loan advanced by a family member, the interest rate paid on the loan and proof of actual repayment.
d. Whether the entire loan had been repaid during the years over which retroactive child support is claimed and if not, what portion was repaid in each relevant year.
e. Whether any portion of the loan remains unpaid and, if so, when it is required to be paid by the underlying loan documentation.
f. The size of the loan in comparison to the payor's income from all other sources.

Our Court of Appeal has stated that the best interests of children do not automatically trump business losses, otherwise these provisions of the *Guidelines* would never apply, which couldn't have been intended.[175] The Court added that if the investment had turned a profit, that profit would have been shared.

The *Income Tax Act*'s definition of business investment loss is incorporated by virtue of section 2(2) of the *Guidelines*. The *Income Tax Act* only permits half of an allowable business investment loss to be claimed, meaning that by referring to the "actual" business investment loss, the *Guidelines* permit courts to choose to include 100% of the loss.[176] The *Income Tax Act*'s definition only relates to losses that are the result of dispositions of property which are:[177]

a. Shares of the capital stock of a small business corporation; or

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[172] *Guidelines,* Schedule III, s 7.
[173] *Guidelines,* s 17(2).
[174] *Kohlman v. Bergeron*, 2015 ABCA 410 at para 18.
[175] *Kohlman v. Bergeron*, 2015 ABCA 410 at paras 17, 19.
[176] *Income Tax Act,* s 248(1) "allowable business investment loss", s 38(c).
[177] *Income Tax Act,* s 39(1)(c).

b. Debts owing to the spouse by a Canadian-controlled Private Corporation (CCPC) that is a small business corporation (or one before going bankrupt or winding-up).

This means that this provision does not generally relate to **ordinary business losses** even if a shareholder's corporation has incurred a significant loss.

Because the starting point to calculate guideline income is essentially line 150, which takes into account losses sustained by **unincorporated businesses and partnerships**, the language of the *Guidelines* is more apt to permitting unincorporated business losses. As a result, courts have in some cases deducted ordinary business losses arising from self-employment except where there is a pattern of losses suggesting that the losses are the result of a hobby, leisure choice, or entertainment.[178] Given that corporations are technically distinct entities and shareholders are not necessarily responsible for losses there is some justification for this approach. The issue becomes murkier where the shareholder has personally guaranteed loans or loans funds to the corporation to sustain a loss because then corporate losses are in a way funded through that shareholder's savings.

Although this provision does not relate to ordinary business losses, when courts address **arrears** it may also be relevant that past profits were used to sustain a business which is now experiencing losses. There may be a double-counting issue if both past profits and draws from the profits of previous years are taken into account.[179]

We recommend that guideline income reports show separate calculations based on whether losses are included or excluded.

## CASH

Courts shouldn't focus on how much cash is available. The test is in relation to pre-tax income, and cash at any given time can be arbitrary given that cash could have been used to pay expenses immediately after the fiscal year.[180] Cash, or the lack thereof, may be relevant when considering whether net income should be included though, because the purpose of a guideline income analysis

[178] Review of several decisions in *LAK v AAW,* 2005 ABQB 657 at paras 31, 32; *Hargrove v Holliday,* 2010 ABQB 70 at paras 35, 36.
[179] *McCarty v. McCarty*, 2016 ABQB 91 at paras 255-260 [arrears stayed and addressed at review once actual financials are known].
[180] *McCarty v. McCarty*, 2016 ABQB 91 at paras 109, 110, 112, 113.

is to ensure that money is "actually available" for child support purposes.[181] Cash should not be considered "available" if it is needed for legitimate business purposes.[182] We recommend that guideline income reports not make any adjustment solely due to available cash.

## RETAINED EARNINGS

It can be an error to determine guideline income based on the annual change in retained earnings.[183] The analysis should only be in relation to pre-tax income. In that regard, we recommend that guideline income reports not make any adjustment solely due to fluctuations in retained earnings.

## DIVIDENDS

Due to the "principle of integration", dividends are "grossed-up" or reported as a higher amount than was actually paid to the shareholder. This is to account for lower taxes at the corporate level, especially in relation to eligible dividends issued by Canadian-controlled Private Corporations (CCPCs). The **dividend gross-up** must be deducted from guideline income, so as to reflect the actual dividend paid.[184]

The amount of the dividend gross-up can be determined by looking at the shareholder's T5 slip, which will show both the actual amount and the grossed-up amount. The dividend gross-up that must be deducted is the difference between those two amounts. Where the T5 slip is not available, in some cases, especially where the corporation's fiscal year matches the calendar year (December 31), it may be possible to determine the grossed-up amount by comparing the spouse's Income Tax Return to the Financial Statements. We recommend that guideline income reports deduct the actual dividend gross-up contained on the T5 slip, rather than trying to recreate their own gross-up calculations, since not all information required to perform the gross-up calculation is contained within the Income Tax Return.

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[181] *Goett v Goett*, 2013 ABCA 216 at para 15.
[182] *McCarty v. McCarty*, 2016 ABQB 91 at paras 103-104 [losses occurred and cash used to cover losses, so full balance not "available"]; *Kowalewich v Kowalewich*, 2001 BCCA 450 at para 58.
[183] *Miller v. Joynt*, 2007 ABCA 214 at paras 27-30.
[184] *Guidelines,* Schedule III, s 5.

In one decision, as there was no expert evidence, the grossed-up amount of the dividend was kept in place as the dividend may have been taxed at a lower rate.[185] Given the principle of integration, this may have been an error. Contrary to that decision, our Court of Appeal and other courts have approved of deducting the dividend gross-up.[186] In any event, it may be beneficial for accounting professionals to state in their report whether the effective rate on the dividends (including corporate tax) was lower than if the amount had been paid as a salary.

## PAYMENTS OR BENEFITS TO NON-ARM'S LENGTH PARTIES

The salaries, wages, management fees, and other payments or benefits paid to, or on behalf of, people who the corporation does not deal with at arm's length must be added to pre-tax income, unless the spouse can establish that the compensation was "reasonable in the circumstances."[187]

The evidential and persuasive onus to prove the reasonableness of expenses rests with the self-employed or corporate parent.[188] As business owners often fail to provide a breakdown of non-arm's length expenses, this topic should be considered in conjunction with the topic of "Failure to Adequately Disclose" above.

If the shareholder fails to establish that the compensation was reasonable, the entire amount must be added into their guideline income.[189] To prove that compensation is reasonable, spouses could provide time sheets, evidence of projects assigned, or a delineation of responsibilities.[190]

The same analysis applies in relation to children employed by the corporation, although it has been noted that the test is about reasonableness, not solely about whether or not the child is qualified.[191] It could be argued that payments to children should be grossed-down though if they're taxed at the highest marginal rate due to the "kiddie tax".

A benefit could include a reduced rate on a product offered by the corporation.[192]

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[185] *Shaw v Przybylski,* 2014 ABQB 667 at paras 36, 46.
[186] *Bohn v Bohn,* 2016 ABCA 406 at para 27; *Buchner v Long,* 2016 ABQB 523 at para 173.
[187] *Guidelines,* s 18(2).
[188] *Cunningham v. Seveny*, 2017 ABCA 4 at para 28; *Goett v Goett*, 2013 ABCA 216; *Nesbitt v Nesbitt*, 2001 MBCA 113; *Kowalewich v Kowalewich*, 2001 BCCA 450.
[189] *Wildeman v Wildeman*, 2014 ABQB 732 at para 41; *Sweezey v Sweezey*, 2016 ABQB 131 at para 38.
[190] *McCarty v. McCarty*, 2016 ABQB 91 at paras 156, 157.
[191] *McCarty v. McCarty*, 2016 ABQB 91 at paras 155, 157.
[192] *DBF v BF,* 2017 ABCA 272 at paras 66-70 [new partner receiving discount on new home, even though spouse was only an 8.2% shareholder, but only 8.2% of the discount was attributed].

Unless it is very clear as to whether or not the payments were reasonable (which you might only be able to determine if you've seen each side's affidavits as well as any Questioning transcripts and undertakings), we recommend providing alternate calculations stating what guideline income would look like if the compensation was or was not included.

## REASONABLENESS OF EXPENSES

Expenses which are unreasonably deducted can be added back into income.[193] Whether or not it was reasonable to deduct an expense isn't determined solely by whether or not the expense was deductible under the *Income Tax Act*.[194] However, in general, if income is included from a business or investments, reasonable expenses must also be deducted.[195]

The evidential and persuasive onus to prove the reasonableness of expenses rests with the self-employed or corporate parent.[196] As parties often fail to provide a breakdown of personal expenses, this topic should be considered in conjunction with the topic of "Failure to Adequately Disclose" above. See *Sweezey v Sweezey*, 2016 ABQB 131 for examples of how various expense categories are treated where there has been a failure to adequately disclose. That decision can be found here: https://www.canlii.org/en/ab/abqb/doc/2016/2016abqb131/2016abqb131.html

In determining reasonability courts can consider:[197]

a. The role the spouse plays in the corporation;
b. Whether the spouse is the sole shareholder;
c. The degree of control the spouse exercises;
d. Evidence as to the availability of retained earnings to pay child support; and
e. Whether those earnings are required to manage the business and ensure its ongoing financial viability.

Expert evidence about reasonability can help although it isn't necessarily required. Courts can make a common sense analysis and look at the supporting documentation or deduct a percentage based on what is deemed an appropriate estimate.[198]

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[193] *Guidelines*, s 19(1)(g).
[194] *Guidelines*, s 19(2).
[195] *Linke v Linke*, 2015 ABCA 367 at para 7 [in relation to spousal support].
[196] *Cunningham v. Seveny*, 2017 ABCA 4 at para 28; *Henderson-Jorgensen v Henderson-Jorgensen*, 2013 ABCA 328 at para 8.
[197] *Goett v Goett*, 2013 ABCA 216 at para 16.

When discussing reasonableness, we generally aren't looking to second-guess legitimate business decisions. Instead, reasonableness typically refers to whether the spouse earned a personal benefit. Common improper personal benefit deductions might include vehicles, cell phones, expense accounts, home office deductions, life insurance, travel, meals, entertainment, promotion, insurance, or alcohol. A vehicle used for personal expenses might appear in several expense categories, such as fuel, maintenance, repairs, interest on the loan, registration, and insurance. Similarly expenses relating to a home office might appear under utilities, property taxes, interest on the mortgage, and phones. It is relatively rare that businesses won't have any personal expenses because it would be bad tax planning to not reimburse yourself for the business' use of your cell phone or vehicle. There are exceptions though. For example businesses that only make up a tiny fraction of a spouse's annual income may not justify the additional record-keeping, and owners of larger businesses might not operate the business, may be able to afford separate work and personal phones/vehicles, or the existence of other owners might discourage these types of personal benefits.

Sometimes the non-shareholding spouse will make wild allegations about improper expenses being deducted. Courts might ignore this information if it's not based on personal observations, the source of a statement isn't identified, it's speculative, or conflicting evidence can't be resolved on the record.[199] If it's alleged that personal assets are owned by the corporation, there must be evidence of that.[200] Where the non-shareholding spouse swears that expenses are unreasonable, courts might ignore their information if there is no basis provided, no evidentiary foundation, no evidence of their qualifications, or it's a mere assertion.[201] In such cases a non-shareholding spouse is a directly interested party with a financial interest in the outcome. As such they can't provide a fair, objective, or non-partisan assessment.

A qualified expert's estimate of personal benefits can be adopted where there is reliance upon the shareholder's affidavit and discussions with the shareholder regarding "corporate operations, cash flow requirements, etc."[202] However in light of the Court of Appeal's decision in *Cunningham v Seveny* in 2017, it may instead be necessary for the expert to rely on the spouse's Statement containing a breakdown of personal expenses. The expert's opinion should not simply state that the expense is reasonable or unreasonable just because it complies with or does not comply with the *Income Tax Act*. We recommend stating whether the expenses are reasonable in light of the typical

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[198] *Sweezey v Sweezey*, 2016 ABQB 131 at para 51; *Sparrow v. Sparrow*, 2006 ABCA 155 at paras 11-12.
[199] *McCarty v. McCarty*, 2016 ABQB 91 at paras 135, 158.
[200] *McCarty v. McCarty*, 2016 ABQB 91 at paras 136, 137.
[201] *McCarty v. McCarty*, 2016 ABQB 91 at para 146.
[202] *McCarty v. McCarty*, 2016 ABQB 91 at paras 128, 146-151.

commercial practices of other businesses based on the expert's experience, especially in relation to businesses where the parents have not separated. We also recommend that guideline income reports state separate calculations based on whether the suspected expenses are included or excluded from guideline income, or based on a range or percentages of unreasonable expenses.

In one recent decision, where the payor claimed both a home office and a commercial office, only 50% of their **home office expenses** were added back, because presumably the space was not available for personal uses and expenses such as electricity would have increased due to the home office.[203]

## AMORTIZATION/DEPRECIATION/CCA/LOAN PAYMENTS

Depreciation is the decline in value of an asset. Amortization is spreading out the initial purchase price of an asset over several years. Capital Cost Allowance (CCA) is the amount of amortization that the *Income Tax Act* allows, although in financial statements this deduction will generally appear under the label "Amortization".

For **corporations** see Schedule 8 "Capital Cost Allowance (CCA) (2006 and later tax years)". For **partnerships** see Form T5013 "Capital Cost Allowance (CCA)". For **unincorporated farms** see Form T1175 "FARMING – Calculation of Capital Cost Allowance (CCA) and Business-use-of-home Expenses". For all **other unincorporated businesses** see Line 9936 of Form T2125 "Statement of Business or Professional Activities".

The analysis of whether an expense is reasonably deducted also applies to amortization, contained in the previous topic "Reasonableness of Expenses" above, but with some modification. Courts have in some cases disallowed the deduction of amortization where there is no intent to replace the asset being depreciated, money is not being set aside to acquire a new asset, or the asset is not required for the business.[204] The shareholder should provide actual evidence of the likelihood of replacement and continued need for the equipment.[205] However, because child support is an immediate need, it may outweigh the eventual need to replace equipment.[206] In that regard, if some of the children will

[203] *Kondics v Kondics,* 2017 ABQB 493 at paras 48,49.
[204] *Trueman v. Trueman*, 2000 ABQB 780 at paras 16 to 32.
[205] *Jaasma v. Jaasma* (1999), 1999 ABQB 764 at para 34.
[206] *Henderson v. Henderson*, 1999 ABQB 545 at para 16.

soon cease to be children of the marriage, then that might be a factor in disallowing part of the CCA.[207]

Several Alberta decisions have cited the following factors compiled by the Manitoba Court of Appeal:[208]

1. Was the CCA deduction an actual expense in the year?
2. Was the CCA deduction greater than or less than the cost of acquisitions during the same time period?
3. Was the CCA deduction greater than or less than the **repayments of principal** with respect to the chattels in question?
4. Was the CCA deduction the maximum allowable CCA deduction?
5. Was it necessary to take the CCA deduction in that year?
6. How much of a loss in a business year resulted in that year?
7. Are the chattels for which the CCA was claimed truly needed for business purposes?
8. Do the chattels for which the CCA was claimed truly depreciated?
9. Is it foreseeable that future chattel purchases will not be required?
10. Is there a pattern of spending which establishes a greater real income than income tax returns indicate?
11. If the children were living with the spouse, would they benefit from the actual income earned by the spouse?
12. Is there a dire need for child support?

It should be kept in mind that the **principal portion of any loan repayments** will not appear as an expense in Financial Statements, only interest and bank charges will (presumably so that the government can tax increases in equity without regard to depreciation, or so that businesses which do not require financing do not pay higher taxes than those which do require financing). In that regard, it is critical that lawyers provide information about mandatory minimum loan repayments to the accounting professional, as they may entirely justify amortization expenses. Also, it should be noted that because CCA is typically claimed at a higher rate than the loan repayments, loan repayments may be made long after the business has ceased claiming CCA, and may be a factor in determining whether pre-tax net income should be included, as the existence of loan repayments, without any corresponding amortization deduction, might mean that profits are not actually available for support purposes.

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[207] *Henderson v. Henderson*, 1999 ABQB 545 [18, 16, and 13 year old children, 2/3 of CCA disallowed].
[208] *Cornelius v Andres*, [1999] MJ No 103 (Man CA) at para 29 (cited in *Jaasma v Jaasma*, 1999 ABQB 764 at paras 35-36, *L(CG) v L(DK)*, 2016 ABQB 71 at para 34, *Trueman v Trueman*, 2000 ABQB 780 at para 25).

Appendix "A" to this Paper, "***Alberta Child Support Decisions re: Amortization/Depreciation/Capital Cost Allowance***" reviews over a hundred Alberta decisions addressing CCA, amortization, or depreciation. All Court of Appeal decisions upheld the lower courts' determinations in relation to CCA. Where courts specifically noted that full disclosure was provided, only one decision cited CCA as a factor in adding back some personal expenses, all other decisions declined to include any amount. Where courts specifically cited a lack of adequate disclosure in relation to expenses, two decisions appear to have added back 100% of CCA, two added 50% back, and one 30%. However, most of these decisions were prior to the onus established by *Cunningham*. Of the remaining decisions, 50% to 100% was typically added back where the amortized asset was also the business operator's personal vehicle. Many decisions state that the analysis should turn on the specific facts at hand. However, to give a sense of what these decisions have concluded, of the 27 decisions which state percentages and don't specifically relate to personal vehicles, 10 did not add any CCA back (0%), 4 added back 100%, 8 added back 50%, and on average 35.8% was added back.

Amortization deducted in relation to **real property (land)** must be added back into guideline income.[209] This is because the *Income Tax Act* doesn't permit CCA to be deducted in relation to land, since land doesn't depreciate and isn't subject to wear and tear. That said, the *Income Tax Act* does permit CCA to be deducted in relation to buildings, which isn't caught by this provision, however CCA on buildings might need to be added-back in any event, for example if there is a personal benefit or it would not be reasonable to deduct the expense.

## SHAREHOLDER LOANS

Shareholder loans are a loan by the corporation to one of its shareholders, or a partner/beneficiary/shareholder of a shareholder, or to a non-arm's length party. The *Income Tax Act* requires that the loan be included in calculating taxable income in the year that the loan is made, except in some circumstances. The major exception is where the entire loan is repaid within one year of the end of the lender's tax year, in which case the loan won't be taxed, so long as such repayment was not part of a series of loans and repayments. Interest of at least 1% must also be paid within 30 days of the year end, otherwise the failure to charge interest can be considered a deemed taxable benefit. A forgiven shareholder loan is also included in taxable income.

Courts of Appeal outside of Alberta have held that there shouldn't be any additional adjustments to guideline income in relation to shareholder loans, unless the shareholder foregoes income and

[209] *Guidelines,* Schedule III, s 11.

instead relies on the repayment of the loan as their source of income, although interest at least equivalent to the Canada Savings Bond rate can be imputed if interest is not otherwise payable.[210]

## FARMING ADJUSTMENTS

These adjustments only apply where the cash basis accounting method is elected, not accrual accounting. Cash basis accounting only applies where income is received from farming, fishing, or commissions.

One Saskatchewan decision notes it's "uncontroverted that the accrual method of accounting is the preferred method for preparing financial statements in accordance with generally accepted accounting principles because it reflects a more accurate picture of a corporation's or individual's financial position", and it's "undisputed that the cash method of accounting may be subject to manipulation in that income can be deferred, inventory stockpiled and expenses postponed or prepaid."[211] However, in that decision, it was determined that even though the cash basis accounting method was elected, there was no actual deferment.

Another often-cited Saskatchewan decision suggested that "the courts would be greatly assisted in the discharge of their function" by an expert's report converting cash basis farm income to an accrual basis which "would provide a more realistic picture of true farm income."[212]

One decision noted that particularly when an application is only on an interim basis, it is difficult to decide whether there should be an adjustment for inventory adjustments, Capital Cost Allowance (CCA), deferred crop payments, prepaid expenses, incentive programs, or other farming expenses.[213]

Inventory adjustments essentially permit farmers to average their income by claiming reserves for unsold inventory.

- See Form T2042 "Statement of Farming Activities". This sets out net income both before and after inventory adjustments.
- Where farmers incur losses, purchased inventory (such as livestock, their feed, fertilizer, and other chemicals) left over at the end of the year must be valued at the lower of fair market value (FMV) or purchase price, and then must be added to taxable income to the extent that

[210] *Rudachyk v Rudachyk* (1990), 180 Sask R 73 at paras 11-13, 25-27, 30; *Motyka v Motyka,* 2001 BCCA 18.
[211] *Labrecque v Labrecque,* 2011 SKQB 260 at paras 62, 79.
[212] *Poff v Fenell* (1998), 173 Sask R 275, [1998] SJ No 608 at para 10.
[213] *Kapteyn v Kapteyn,* 1999 ABQB 80 at para 13.

it reduces the loss (the "Mandatory Inventory Adjustment" or "MIA") listed at Line 9942 and the previous year's adjustment listed at Line 9937).[214] However, it can be deducted from taxable income the following year. Taxpayers can also elect to make an Optional Inventory Adjustment to increase taxable income by as much as the FMV of unsold inventory not part of an MIA, which is then deducted when the inventory is sold (listed at Line 9941 and the previous year's adjustment listed at Line 9938).[215] This is often done to take advantage of non-refundable tax credits or lower tax brackets, or to increase shareholder's RRSP limit.

- The Court of Appeal has noted that inventory elections "have in many cases been considered unreasonable deductions" in relation to guideline income.[216] There, the Court upheld an imputation of income as the payor was pursuing a rodeo hobby and offsetting that revenue against farm losses. However, as the trial judge imputed income to a round number rather than making a detailed calculation, it's not clear what portion of inventory adjustments were added back, if any.
- There are not many reported Alberta decisions relating to inventory adjustments. One reversed inventory adjustments.[217] Another decision declined to impute income due to Optional Inventory Adjustments as the payor had always elected to use Optional Inventory Adjustments, even during the marriage.[218] Another declined to make an adjustment due to an absence of evidence as to how the adjustments may affect the true income available (suggesting expert evidence may be required).[219]
- It has been noted that because inventory adjustments are averaged over a number of years, when looking at guideline income over a number of years, inventory adjustments might be a neutral factor and might not make any difference to the amount of child support arrears.[220]

At the time of writing (November 26, 2017), it did not appear that there were any reported Canadian decisions addressing **deferred crop payments**, **prepaid expenses**, or **incentive programs** in relation to guideline income, except the above decisions relating to the difficulty of making such adjustments at the interim stage and suggesting that accrual accounting would provide a more realistic picture. No reported decisions appear to address **AgriStability** or **AgriInvest** in relation to farming income.

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[214] *Income Tax Act,* s 28(1)(c).
[215] *Income Tax Act,* s 28(1)(b).
[216] *C(M) v Z(V),* 1998 ABCA 410 at paras 17-19 [which did apply the *Guidelines*].
[217] *Kuyten v Kuyten,* 1999 ABQB 646 at para 58.
[218] *H(KS) v H(WE),* 2002 ABQB 492 at para 22.
[219] *Lovich v Lovich,* 2006 ABQB 736 at para 73.
[220] *L(CG) v L(DK),* 2016 ABQB 71 at para 50.

## RELATED COMPANIES AND TRUSTS

As noted under the above topic "Profit", income of a related corporation can also be added to guideline income. The definition of "related" is set out in the above topic "Definitions".

The revenues of **family trusts** can be excluded if they were set up for the children during the relationship.[221]

## TAX GROSS-UP

This topic refers to "grossing-up" expenses to account for the fact that they were not taxed or were taxed at a lower tax rate. It does not refer to the dividend gross-up, which is discussed in the above topic "Dividends".

The concept behind grossing-up is that if the business owner had to pay for the expense personally rather than being able to deduct it as a business expense, they would have had to use after-tax dollars to pay for that expense. That means that adding the expense back wouldn't be a sufficient comparison, because they also received the advantage of using untaxed funds to acquire that benefit.

It's not clear whether the unreasonable component of **deducted expenses** should also be grossed-up. A majority of Alberta Court of Queen's Bench decisions and an Ontario Court of Appeal decision have permitted the expenses to be grossed-up.[222] However, in many of these decisions the amounts appear to have been grossed-up by the accounting professionals, without challenge by the parties, rather than the issue being thoroughly considered by the courts. At least one court refused to gross-up expenses.[223] Utilizing a gross-up could inherently lead to some unfairness. For example, if a corporation has revenue of $100, and it deducts $100 for a personal expense, should the $100 personal expense be grossed-up so that they would be paying support based on a grossed-up income that was higher than their revenues? What if they were reassessed by the CRA and had to pay taxes on that amount in a later year? Until the issue is decided by our Court of Appeal,

[221] *Daschuk v. Mrdenovich*, 2015 ABQB 822 at paras 19,20.
[222] *CMK v GSK,* 2017 ABQB 319 at paras 75-77; *Hall v Hall,* 2006 ABQB 329 at para 50; *Lavoie v Wills,* 2000 ABQB 1014 at paras 75, 80, 82; *Riel v Holland* (2003), 67 OR (3d) 417 (ON CA) at paras 36-37.
[223] *Kinasewich v Kinasewich,* 2001 ABQB 759 at paras 22, 23.

accounting professionals should not be faulted for using either approach. Our Court of Appeal has permitted untaxed salary to be grossed-up.[224]

Income may need to be grossed-up if **taxed at a lower rate**.[225] See the above topics on "Capital Gains, Capital Losses, and Recapture" and "Dividends".

For the purpose of calculating **section 7** expenses, receipts of the Canada Child Tax Benefit (CCTB, which has now been replaced with the **CCB**) and the National Child Benefit Supplement (**NCBC**) might need to be grossed-up.[226]

A tax-exempt exercise of **stock options** might need to be grossed-up.[227]

Decisions out of the Ontario Court of Appeal state that the portion of a **personal injury award** relating to lost earnings should be included in income, and grossed-up for taxes if not taxable income (e.g. where it's a "structured settlement"). [228] If the amounts are actually for pain and suffering then the person who received the personal injury award should provide documentation.

Where **payments to children** through a business are unreasonably deducted, it could be argued that those payments should be grossed-down, if they're taxed at the highest marginal rate due to the "kiddie tax".

**Non-taxable disability payments** should be grossed-up.[229]

To gross-up income on the basis that it was taxed at **another country's lower tax rate** there should be expert evidence.[230]

**Spousal support** received that wasn't claimed as taxable income should be grossed-up.[231]

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[224] *Kretschmer v Terrigno,* 2012 ABCA 345 at para 14.
[225] *Guidelines,* s 19(1)(h).
[226] *Mullins v Mullins,* 2016 ABQB 226 at paras 17-18.
[227] *Kowalski v Kowalski,* 2008 ABQB 163 at para 21.
[228] *Hunks v Hunks*, 2017 ONCA 247 at para 33; *Fraser v Fraser,* 2013 ONCA 715 at paras 109-111.
[229] *Mills v Mills,* 2000 ABQB 414 at para 16, cited in *Chalifoux v Chalifoux,* 2008 ABCA 70 at para 22; *Battershill v Battershill,* 2007 ABQB 53 at para 21.
[230] *Chalifoux v Chalifoux,* 2008 ABCA 70 at paras 6, 7, 23.
[231] *Low v Robinson,* 2000 ABQB 60 at para 12 of Supplementary Reasons.