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Family Law Newsletters
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— Franks & Zalev - This Week in Family Law

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It Would be Nice if We Could all Get on the Same Corporate Attribution of Income Page

M.T. v. J.S. (2023), 86 R.F.L. (8th) 281 (B.C. C.A.) — Harris, Fenlon, and Abrioux JJ.A.

The parties were married for 19 years and had two children together, who were both still dependants at the time of trial (the wife also had two adult children from a prior relationship). Both parties were in their 50s at the time of the trial.

The husband was a successful real estate agent and operated his business through a number of companies, which for the purposes of our discussion we will refer to collectively as the "Company". The wife also had her real estate licence but had not worked outside the husband's Company for many years by the time the parties separated.

The parties had an 11-day trial that dealt with a number of issues — but the two that are of primary interest for our purposes are: (a) adding back personal expenses for the calculation of income for support purposes; and (b) the proper use of review Orders.

Section 18 of the *Child Support Guidelines* is the starting point for dealing with support payors who, like the husband in this case, earn income through a company that s/he controls. It provides as follows:

> **Shareholder, director or officer**
>
> 18 (1) Where a spouse is a shareholder, director or officer of a corporation and the court is of the opinion that the amount of the spouse's annual income as determined under section 16 does not fairly reflect all the money available to the spouse for the payment of child support, **the court may consider the situations described in section 17 and determine the spouse's annual income to include**
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> (a) **all or part of the pre-tax income of the corporation**, and of any corporation that is related to that corporation, for the most recent taxation year; or
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> (b) **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.
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> **Adjustment to corporation's pre-tax income**
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> 18(2) In determining the pre-tax income of a corporation for the purposes of subsection (1), **all amounts paid by the corporation as salaries, wages or management fees, or other payments or benefits, to or on behalf of persons with whom the corporation does not deal at arm's length must be added to the pre-tax income**, unless the spouse establishes that the payments were reasonable in the circumstances. [emphasis added]

After applying s. 18, but *before* considering whether the Company was paying any of the husband's personal expenses (that would be added back to the husband's income for support purposes), the trial judge determined that the husband was earning a total of $580,000 a year through the Company, and that all pre-tax corporate income left in the company should be attributed to the husband for support purposes.

However, the parties could not agree on whether any of the Company's expenses should be added to the husband's income. The wife argued that it was unreasonable for the husband to be deducting a total of $83,000 a year based on 90% of his cell phone, 90% of his vehicle expenses, 50% of his memberships at two country clubs, and significant amounts for meals and entertainment. She argued that these deductions were largely personal in nature, and that the majority of them should be added back to the husband's income for support purposes and grossed up.

To decide this issue, the trial judge considered s. 19(1)(g) of the *Child Support Guidelines*, which provides that income can be imputed if a "spouse unreasonably deducts expenses from income", and s. 19(2), which confirms that "the reasonableness of an expense deduction is not solely governed by whether the deduction is permitted under the *Income Tax Act*".

While we would have thought that at least some of the significant expenses the husband was deducting were personal in nature, for reasons that are discussed further below, the trial judge ultimately decided not to add ***any*** of those expenses back to the husband's income for support purposes.

After determining the husband's support obligations should be calculated based on an income of $580,000 a year, the trial judge ordered the husband to pay the wife $12,500 a month in spousal support (in addition to child support) based on the low range of the *Spousal Support Advisory Guidelines*. And, in a very brief portion of the reasons, the trial judge also ordered that the spousal support arrangements could be ***reviewed*** (i.e. without the need to establish a material change) if the husband's income for support fell below $350,000 a year or increased above $1,000,000 a year, when either child ceased to be entitled to child support, or when either party turned 65.

The wife appealed.

In her appeal, the wife argued, among other things, that the trial judge had erred by dealing with the personal expenses issue under s. 19(1)(g) (as opposed to s. 18(2)) of the *Guidelines* and by applying the wrong test in deciding whether some or all of the expenses in question should be added back to the husband's income for support purposes. She also challenged the trial judge's decision to allow spousal support to be reviewed in certain circumstances.

The Court of Appeal rejected the wife's argument that the trial judge had erred in relying on s. 19(1)(g) of the *Guidelines* (as opposed to s. 18(2)) to deal with the Company's expenses, and confirmed that both provisions can be used when dealing with expenses paid by a company:

> [8] First, where business expense deductions are in issue, the spouse claiming the deductions will bear the burden of establishing they are reasonable business deductions under either section. The spouse asserting that expenses should be added back to income must put that in issue in their pleadings by identifying the specific expenses being challenged, but **it will then be for the other spouse to assume the burden of proving the reasonableness of deductions from business income, whether in the context of self-employment or within a wholly-owned corporation:** *Wiebe v. Treissman*, 2017 BCSC 1523 at para. 94. See also *Cunningham v. Seveny*, 2017 ABCA 4 at para. 28.
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> [9] Second, **there is a long line of cases in this province recognizing that business expenses can be addressed under either s. 18(2) or s. 19(1)(g) where a corporation is involved:** *Dornik v. Dornik*, 1999 BCCA 627 at paras. 14 and 20-25; *Hausmann v. Klukas*, 2009 BCCA 32; *Ursel v. Ursel*, 2014 BCSC 1219.
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> [10] Section 19 will be the only option available where a sole proprietorship or partnership is in issue, but **there is no error in a judge using s. 19(1)(g) even when the payor meets the prerequisites in s. 18 of being a shareholder, director or officer of a corporation. Whether income is being imputed under s. 19(1)(g) or added back as an expense under s.**

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> **18(2), the same result obtains.** In both cases, the concern of the court is to ensure that the spouse's *Guidelines* income reflects all of the money reasonably available for child support: *Kowalewich v. Kowalewich*, 2001 BCCA 450 at para. 43. [emphasis added]

While we *generally* agree with the reasoning of the B.C. Court of Appeal here, there are two important caveats and there is a fair bit of confusion.

First, depending on where you are in Canada, it is not necessarily correct that ss. 18(2) and 19(1)(g) will invariably lead to the same result. For example, some provinces (we're talkin' about you, Saskatchewan) follow what has come to be known as the "Limited Rule" of corporate pre-tax income attribution. That is, the court can only attribute corporate pre-tax income from the *most recent year* — and if there is no corporate pre-tax income, there is nothing to attribute: *Bear v. Thompson* (2014), 52 R.F.L. (7th) 257 (Sask. C.A.); *Dungey v. Dungey* (2020), 48 R.F.L. (8th) 255 (Sask. C.A.); *Potzus v. Potzus* (2017), 91 R.F.L. (7th) 290 (Sask. C.A.); *Merrifield v. Merrifield* (2021), 58 R.F.L. (8th) 31 (Sask. C.A.).

Accordingly, in "Limited Rule" jurisdictions, if the company in question only has losses, or if there is a legitimate business reason why income should not be attributed (e.g. the payor does not have control of the business), it may not always be possible to adequately capture the personal benefits the payor is receiving under s. 18, and resort to s. 19(1)(g) will be necessary.

Other provinces, such as Ontario and Manitoba follow the "Unlimited Rule" of corporate pre-tax income attribution. Under the "Unlimited Rule", the court is not limited to attributing only the corporate pre-tax income of the previous year. Rather, the court can combine ss. 17 and 18 so as to consider a "pattern", or average, of corporate pre-tax income: *Mason v. Mason* (2014), 47 R.F.L. (7th) 173 (Ont. S.C.J.), rev'd, (2016), 83 R.F.L. (7th) 1 (Ont. C.A.); *Nesbitt v. Nesbitt* (2001), 19 R.F.L. (5th) 359 (Man. C.A.).

Second, in *Ward v. Murphy* (2022), 72 R.F.L. (8th) 255 (N.S. C.A.), which we discussed in the 2022-40 (October 31, 2022) edition of *TWFL,* the Nova Scotia Court of Appeal charted a somewhat different course from the one described by the B.C. Court of Appeal. In *Ward*, the majority determined that the trial judge had erred by first relying on s. 19(1)(g) instead of s. 18 to deal with personal expenses paid by a company. According to the majority in *Ward*, the court cannot just add back improper corporate expenses to personal income and gross up; the court must first add the expenses in issue back to pre-tax corporate income as the company may have had losses. That is, the court must first look to s. 18 and only then to s. 19(1)(g). While we indicated in our comment that we do not entirely agree with the majority's reasoning, it is obviously still good law in Nova Scotia, and something of which Nova Scotians must be aware when dealing with corporate-context attribution cases.

But we digress; back to our case. Although the B.C. Court of Appeal rejected the wife's first argument about the personal expenses issue, it agreed with her second argument — that the trial judge had applied the wrong test when assessing whether some or all of the husband's expenses should be added back for support purposes. As the Court of Appeal explained in its decision, the trial judge had placed far too much weight on the fact that the Company's expenses were permissible under the *Income Tax Act*, but had not considered whether they provided the husband with a personal benefit that a salaried employee would have to pay out of pocket:

> [15] Respectfully, I conclude that the judge erred in principle by not asking the right question. **The legitimacy of an expense deduction under the *Income Tax Act* is a relevant consideration** in the sense that a deduction that is not recognized as a valid business expense under the *Income Tax Act* is unlikely to be a reasonable business expense under the *Guidelines*. **However, that is not the end of the inquiry. The question under the *Guidelines* is whether the business deductions include expenses which provide a personal benefit or constitute an ordinary living expense that would normally be paid from a party's employment income — expenses which would not be deducted from a salaried party's income and should equally not be deducted when income flows through a corporation**: *Ursel [v. Ursel*, 2014 BCSC 1219] at para. 27; *Reis v. Bucholz*, 2008 BCSC 1156 aff'd 2010 BCCA 115. Typical examples include meals, entertainment, telephones, Internet and vehicle expenses. [emphasis added]

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Accordingly, even if the husband had really needed to incur all of the substantial entertainment, vehicle, and cell phone expenses for business purposes, the trial judge should not have ignored the fact that by doing so, he had still "used the golf and country club memberships, enjoyed meals, and used his cell phone and vehicle for personal matters as well as business ones."

The record before the Court of Appeal was insufficient to allow it to decide exactly which of the expenses in issue should be added back to the husband's income for support purposes with any degree of certainty. However, since the parties had already been through an 11-day trial, and in a bit of a "rough justice" moment, the Court of Appeal decided to just add back 50% of the $86,000 the husband had deducted for his vehicle, cell phone, country club memberships, meals, and entertainment. Adding $43,000 to the husband's income for support purposes brought it up to a total of $623,000. However, it appears that the Court of Appeal forgot that the $43,000 in personal expenses also had to be grossed up to account for the fact that the husband had received the benefit of $43,000 in after tax dollars, which is equivalent to approximately $85,000 in pre-tax dollars.

The other part of the Court of Appeal's decision that warrants brief comment is its discussion of the trial judge's decision to include a review clause.

In *Leskun v. Leskun* (2006), 34 R.F.L. (6th) 1 (S.C.C.), which is still the leading case on review Orders, the Supreme Court of Canada determined that while courts can make review orders in certain circumstances, they should usually refrain from doing so. As the Court explained in its decision:

> [39] *Willick [v. Willick*, 1994 CarswellSask 48 (S.C.C.)] and *Choquette [v. Choquette*, 1998 CarswellOnt 2939 (C.A.)] establish that a trial court should resist making temporary orders (or orders subject to "review") under s. 15.2. See also: *Keller v. Black*, [2000] O.J. No. 79 (Ont. S.C.J.). **Insofar as possible, courts should resolve the controversies before them and make an order which is permanent subject only to change under s. 17 on proof of a change of circumstances. If the s. 15.2 court considers it essential (as here) to identify an issue for future review, the issue should be tightly delimited in the s. 15.2 order.** This is because on a "review" nobody bears an onus to show changed circumstances. **Failure to tightly circumscribe the issue will inevitably be seen by one or other of the parties as an invitation simply to reargue their case. That is what happened here.** The more precise condition stated in the reasons of the trial judge was excessively broadened in the formal order. This resulted in a measure of avoidable confusion in the subsequent proceedings. [emphasis added]

While the wife agreed with the trial judge that spousal support should be reviewed when the children were no longer entitled to child support, she argued that changes in the husband's income and their eventual retirement should be dealt with by way of a variation proceeding. She also argued that the review should be limited to quantum, as entitlement had already been established.

The Court of Appeal agreed with the wife that either party turning 65 should not trigger a review, as there was no basis to assume that 65 was a "valid proxy for retirement for these parties." It also agreed that the review should be limited to quantum. However, it disagreed with her that significant changes in the husband's income should not trigger a review:

> [44] Because the [husband's] income had fluctuated widely in the past, it could be argued on an application to vary that those fluctuations were in the contemplation of the parties at the time the order was made. That could work to the disadvantage of either party — the low end of the *SSAG* range could well be inappropriate if the [husband's] income fell below $350,000, leaving the [wife] with too little, and could be too high, arguably, if the [husband's] income greatly exceeded $1 million. In these circumstances, it does not seem to me that the review provisions were unreasonable.

Respectfully, we would suggest that none of the circumstances raised by the wife or referred to by the trial judge or the Court of Appeal were sufficient to warrant or require a review Order. The better result would have been to set aside the review Order in its entirety, as a review Order was not needed to deal with the end of child support or significant changes to the husband's income.

In all but very high-income cases, the end of entitlement to child support is almost invariably a material change in circumstances as a result of s. 15.3(3) of the *Divorce Act*, which provides as follows:

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> 15.3(3) Where, as a result of giving priority to child support, a spousal support order was not made, or the amount of a spousal support order is less than it otherwise would have been, any subsequent reduction or termination of that child support constitutes a change of circumstances for the purposes of applying for a spousal support order, or a variation order in respect of the spousal support order, as the case may be.

Furthermore, support is based on income, not on ranges of incomes that could fluctuate. Respectfully, it should be impossible to argue that a significant increase or drop in income is not a material change because the payor had suffered historic large swings in income. It is difficult to conceive of a situation where a change in income from $580,000 a year to more than $1,000,000 or less than $350,000 would *not* constitute the type of change that "if known at the time [of the original Order], would likely have resulted in different terms": *L.M.P. v. L.S.*, [2011] 3 SCR 775 at para. 32. Given the Supreme Court's severe restriction on the use of review Orders (a restriction with which we do not agree in general), it was not necessary to cast future significant changes in income as the basis for a review.

A Claim for Costs in the Dark

Casey v. Casey, 2023 CarswellOnt 6021 (S.C.J.) — Pazaratz J.

Costs after litigation is relatively straight forward. With some provincial variation, all Canadian provinces and territories have some form of "loser pays" system.

But how does one determine the "winner" and "loser" after a settlement? After a settlement, sometimes there is a clear "winner" and "loser"; but, sometimes — not so much.

In *Casey*, Justice Pazaratz found himself tasked with determining costs for two motions in which he was wholly uninvolved. Both motions were brought by the father. One was a "travel motion" which the parties were ultimately able to resolve on their own. The second was a motion about parenting time exchanges, which the parties were also able to resolve.

Of course, both sides claimed costs.

The mother claimed costs of $2,431 for the "travel" motion and $2,373 for the "exchanges" motion — both amounts being less than full indemnity which would have totalled something in the range of $7,000. The father claimed costs of $2,500 for each motion.

As noted by Justice Pazaratz, he had absolutely nothing to do with the resolution of these particular motions.

His Honour first noted that, where parties reach their own settlement, leaving only the issue of costs to be determined by the court, costs can be awarded to a party even on settlement, but the analysis regarding costs calls for a cautious approach in such circumstances.

Then, his Honour suggested that, in the case of costs after settlements, "there should generally be a compelling reason to justify costs." For example, see: *Davis v. Fell*, 2016 CarswellOnt 2115 (C.J.); *Muncan v. Muncan*, 2021 CarswellOnt 2843 (S.C.J.); *Krueger v. Krueger*, 2017 CarswellOnt 3169 (S.C.J.); *Frape v. Mastrokalos* (2017), 6 R.F.L. (8th) 486 (Ont. C.J.); *Witherspoon v. Witherspoon*, 2015 CarswellOnt 15823 (S.C.J.); *Cummings v. Cummings* (2022), 81 R.F.L. (8th) 214 (Ont. S.C.J.).

Obviously, the main concern here is the sufficiency (or insufficiency) of evidence to support any necessary findings regarding costs. Settlements usually involve a global resolution of multiple issues based on compromises and concessions. In turn, this makes it a challenge for the court to apply the factors relevant to a determination of costs. One party may have made a large compromise where the other made several smaller compromises. As there has been no final determination by the court, the usual cost rules about "beating" one's own offer are not really applicable. One party may have capitulated a reasonable position simply to avoid further litigation costs. Where there has been no adjudication, it becomes difficult — if not impossible — to apply the "touchstone" considerations of reasonableness and proportionality: *Beaver v. Hill* (2018), 17 R.F.L. (8th) 147 (Ont.

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C.A.); *Ball v. Ball* (2014), 52 R.F.L. (7th) 244 (Ont. S.C.J.); *DeSantis v. Hood*, 2021 CarswellOnt 11528 (S.C.J.); *Goetschel v. Goetschel*, 2022 CarswellOnt 15607 (S.C.J.). You get the idea . . .

In fact, it can be such a challenge, that some courts have opined that to award costs after settlement is so fundamentally misconceived and inappropriate, it should not be done — even where Minutes of Settlement provide for it: *Talbot v. Talbot* (2016), 76 R.F.L. (7th) 370 (Ont. S.C.J.). However, in our opinion, this overstates the case. While it can be challenging, sometimes costs after settlement are warranted, especially where the unreasonableness or intransigence of one party has run up costs. An unreasonable party should not be able to avoid responsibility for costs simply because they "have seen the light." If a party claims "everything" and ultimately agrees to receive "nothing", the determination of success should not be difficult.

That said, if parties place the issue of costs before the court after settlement, the parties must put sufficient evidence before the court about the case: *Gibeau v. Parker*, 2017 CarswellOnt 830 (S.C.J.); *Parkinson v. Parkinson*, 2019 CarswellOnt 19938 (S.C.J.).

As Justice Pazaratz noted, costs usually go to the successful party. But only knowing how a case ended, without knowing how the case was litigated, may make it hard for the court to get a clear sense of which party "won" and the extent to which the settlement represents divided success, capitulation or an end to unreasonable behaviour: *Hmoudou v. Semlali*, 2020 CarswellOnt 2980 (S.C.J.); *Moreno v. Tuey* (2019), 25 R.F.L. (8th) 424 (Ont. C.J.).

And once a matter has settled, the court should be reluctant to spend too much time investigating the background to the settlement in an effort to determine which party's position on each issue was most likely to have been accepted at trial; having a mini trial about who would have won a given issue had there been an actual trial? Ridiculous. [See, for example: *O'Brien v. O'Brien*, 2009 CarswellOnt 7194 (S.C.J.); *Upton v. Harris*, 2016 CarswellOnt 6721 (S.C.J.); and *Moreno v. Tuey* (2019), 25 R.F.L. (8th) 424 (Ont. C.J.).] That said, sometimes, as noted above, it is not hard to determine the (un)successful or (un)reasonable party.

Ultimately, Justice Pazaratz agreed that, while caution is required, a blanket refusal to award costs in settled matters is not appropriate and could, in fact, have unintended — and undesirable — consequences for both the parties and the administration of justice. To quote Justice Pazaratz:

> [8] . . . a. Our family court system consistently encourages parties to settle their cases, to avoid costs. So we must be careful not to undermine our messaging in case management, by imposing post-settlement costs orders which may inadvertently eliminate an incentive to settle: *Moreno v. Tuey*, 2019 ONCJ 418 (OCJ). If litigants do what we urge them to do — reach their own negotiated settlement — the court should carefully assess whether compelling reasons remain to award costs: *Shute v. Shute*, 2017 ONCJ 533 (OCJ).
>
> b. But equally, costs should not be a barrier to settlement. Sometimes after protracted litigation the parties can agree on everything except costs. It is in neither the parties' nor the court's interest to waste an opportunity to resolve substantive issues. Litigants should not be forced to go to trial and achieve success in order to recover disputed costs. Parties should have confidence that if they settle all other issues, any residual costs claim will be given fair consideration by the court, on the merits: *Wunsch v. Wunsch*, 2013 ONSC 5208 (SCJ); *Hassan v. Hassan*, 2019 ONSC 1199 (SCJ).
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> c. A successful party who has behaved reasonably should not be precluded from pursuing their costs, simply because their opponent waited until the last moment to abandon a meritless or unreasonable position: *Atkinson v. Houpt*, 2017 ONCJ 316; *Moreno v. Tuey*, 2019 ONCJ 418 (OCJ).
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> d. If a party eventually makes a good litigation choice by signing Minutes, that epiphany doesn't automatically wipe out any history of *bad litigation choices* which would otherwise justify costs. Settling in the face of the inevitable may be little more than damage control. *Scipione v. Del Sordo*, 2015 ONSC 5982 (SCJ).
>
> e. While there may be public policy reasons against costs orders in the face of negotiated resolutions, there are also public policy reasons to hold parties liable for needless expense they created during whatever period they maintained an unreasonable position: *Horowitz v. Duthie* 2021 ONSC 7902 (SCJ).

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Here, Justice Pazaratz was concerned that he did not have sufficient evidence before him to apply the general rules and principles regarding costs. When counsel ultimately suggested that they might return at a later date to argue costs, the court was — understandably — not happy. Having booked a long motion (to deal with relatively small cost claims), the Court was of the view that the booked court time was to be used. This was their opportunity to argue their case for costs, knowing that judges dealing with costs claims in settled matters require an evidentiary foundation for their decision. And if they did not marshal the necessary evidence for the motion they booked, they should not be allowed to use still more court time later or at another court event.

Justice Pazaratz ultimately ordered the mother to pay the father costs of $1,500.

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