

Marmer Penner Inc. Newsletter

Written by Steve Z. Ranot, CA•IFA/CBV, CFE
Edited by James A. DeBresser CA•IFA/CBV

Deductibility of Legal Fees Pertaining to Support

During with the last week of the April tax filing season, we were hit with a flurry of questions regarding the deductibility of legal fees pertaining to support. However, a number of family law specialists expressed concern regarding the provisions of Canada Revenue Agency's ("CRA") interpretation bulletin IT-99R5, and what is commonly understood.

Let's start with a little bit of background on the evolution of the tax rules regarding the deductibility of legal and accounting fees. The *Income Tax Act* does not contain a provision which allows for legal fees pertaining to either spousal or child support to be deducted. CRA issues interpretation bulletins ("ITs"), which, according to CRA are issued "to provide technical interpretations and positions regarding certain provisions contained in income tax law. Due to the technical nature, ITs are used primarily by our staff, tax specialists, and other individuals who have an interest in tax matters."

“.... While the comments in a particular paragraph of an IT may relate to provisions in the law in force at the time they were made, these comments are not a substitute for the law.”

We are unsure what may have prompted a number of family law specialists to suddenly read and re-read IT-99R5 which includes the following:

“Paragraph 17...Legal costs of seeking to obtain an increase in spousal or child support or to make child support non-taxable under the *Federal Child Support Guidelines* are non-deductible.”

“Paragraph 20...A person who incurs legal expenses is not entitled to deduct them when they are incurred in connection with a receipt of a lump-sum payment which cannot be identified as being a payment in respect of a number of periodic payments of support amounts that were in arrears....”

Towards the end of IT-99R5, Paragraphs 17 and 18 have been revised to clarify that legal fees incurred in establishing the right to spousal support under the *Divorce Act* are not deductible. We can certainly see how the existence of such a document would cause concern for family law practitioners. However, practitioners should rest assured that IT-99R5 also indicates that it was most recently modified on September 6, 2002.

Shortly after release of this document, CRA issued its Income Tax Technical News No. 24. This technical news release stated the following: “Following the decision in the case of *Gallien v. the Queen* (2001) 2 CTC 2676, 2000 DTC 2514 (TCC – informal procedure), CRA has reconsidered the above positions. As a result, we now consider legal costs incurred to obtain spousal support under the *Divorce Act* or under the applicable provincial legislation in a separation agreement to have been incurred to enforce a pre-existing right to support. Consequently, these costs

are deductible pursuant to the comments in Paragraph 18 of interpretation bulletin IT-99R5. We also now accept that legal costs of seeking to obtain an increase in support or to make child support non-taxable under the *Guidelines* are also deductible.

Accordingly, the provisions in Paragraphs 17 and 20 of IT-99R5 which appeared to have denied the deductibility of legal costs incurred in establishing the right to support or in connection with the receipt of the lump sum support do not, in fact, deny the deductibility of these fees. Loyal readers of this newsletter never had reason to worry as they recall our October 2002 newsletter entitled "The Fallout from *Gallien v. the Queen*: the Deduction of Legal Fees".

In general, legal fees are deductible to a recipient spouse to obtain, enforce or vary an order for child or spousal support and are non-deductible to the payer spouse. There is an exception for the payer spouse when the payments going one way are actually a net amount of support being paid by each of the two spouses. In a reported case, the father was a custodial parent for one child and the mother was a custodial parent for the second child. As the husband was the higher income parent, child support from each parent to the other was netted, and the father paid a net monthly amount to the mother. In that case, the Tax Court accepted that there were actually child support payments going both ways. Accordingly, when the husband incurred legal and accounting fees to determine his former spouse's income, the amounts were deductible to him even though, in form, he was the payer spouse.

* * * * *

While this is the thirteenth year of the Marmer Penner Inc. newsletter, it is the first issue written from our new premises at 2 Bloor Street West, Suite 2603. We are very happy to announce that the move went smoothly and we hit the ground running on April 19, 2010. We invite our many clients to visit us at our new premises and, while we are no longer at the corner of Cumberland and Bellair, we are still just a short walk away from the nicest outdoor patios where we can have a business lunch or after hours drinks. We look forward to seeing all of you soon.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.