

Marmer Penner Inc. Newsletter

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Legal Fees Incurred to Collect Child Support Non-Deductible in One Case

Nicholas Mills is a teacher who married in 1993 and separated in 2007. He had three children with his former spouse, who is also a teacher earning the same salary as Nicholas. In a 2008 settlement, Nicholas' ex-wife was granted full custody of the children and Nicholas was granted specified unsupervised access. The agreement, which was incorporated into a final order, provided that Nicholas was to pay his former spouse child support for the three children pursuant to the *Guidelines* with an annual adjustment based upon changes to Nicholas' income. A further provision added that Nicholas' child support obligation shall continue notwithstanding that his parenting time may exceed 40%.

It was this latter provision that Nicholas found to be most unfair since he was precluded from varying the child support even if he and his ex-spouse shared custody equally and earned the same income before support. Accordingly, in 2011, when the children were with each parent about one-half of the time, Nicholas brought an application to vary the order so as to oblige his ex-wife to pay him child support such that the two amounts would be set off.

The family court heard this case in September 2011 and released its decision in July 2012, denying Nicholas' claim and requiring him to continue paying full child support. This newsletter will not comment on the family law decision and limit any comments to the income tax issue.

Nicholas' efforts to vary the support order cost him about \$42,000 in legal fees. He sought to claim these legal fees as a deduction but was denied by CRA. Nicholas argued that he incurred these fees in an effort to enforce his pre-existing right to child support from his ex-wife who had an income. He hoped to convince the court that the two amounts should effectively offset one another or at least greatly reduce his net payment. The key issue to Nicholas was that he was not seeking a reduction of his own child support payments but an increase from zero from what he was receiving from his ex-spouse. To CRA, the key issue was that Nicholas did not incur these fees in order to gain or produce income. The outcome of this tax decision needs to be considered with CRA's stated administrative policy in mind. In its Technical News issue number 24 dated October 10, 2002, CRA released the following pronouncement:

“Following the decision in the case of *Gallien v. The Queen*, [2001] 2 CTC 2676, 2000 DTC 2514 (T.C.C. – Informal Procedure), Canada Customs and Revenue Agency...now consider(s) 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...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.”

CRA has already accepted that seeking taxable spousal support or non-taxable child support both meet the definition of “gaining or producing income”. Surprisingly, with that as the background, the decision of the Tax Court of Canada in *Mills 2014 DTC 1138* ruled in favour of CRA on the basis that the ex-wife could deduct her legal fees because they were incurred to receive child support but Nicholas was barred from doing so because he was attempting to reduce child support. The judge sympathized with Nicholas writing “I agree with him that it is not right that a parent who incurs legal expenses in order to obtain child support is entitled to deduct the legal expenses from income whereas the parent who incurs legal expenses in order to prevent child support from being

established or increased or to decrease or terminate child support cannot deduct these legal expenses from income”.

We hope Nicholas appeals this decision because even the judge referred to the *Rabb* case (which we highlighted back in our March/April 2008 newsletter). In that case, the tax court allowed Mr. Rabb to deduct the legal fees incurred to determine his wife's income because each parent had full custody of one child so it was clear that each had to pay child support to the other based on their respective incomes and, since Mr. Rabb earned more, he simply paid the net amount to his ex-wife. In that case, the court recognized that each had a child support right and Mr. Rabb's costs were deductible. The *Mills* decision indicates that *Rabb* is distinguishable from Nicholas' case because it dealt with the situation of split custody where each parent has full custody of at least one child as opposed to Nicholas' situation of shared custody of all of the children. In the eyes of a bean-counter, these are far too similar for there to be a different tax treatment.

This newsletter is not intended to substitute for proper professional planning. It is intended to highlight areas where professional assistance may be required or enough to discuss at the next hoedown. 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.