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Marmer Penner Inc. Newsletter

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At a Loss

The *Federal Child Support Guidelines ("Guidelines")* lists its objectives as follows:

a) To establish a fair standard of support for children that ensures that they continue to benefit from the financial means of both spouses after separation;

b) To reduce conflict and tension between spouses by making the calculation of child support orders more objective;

c) To improve the efficiency of the legal process by giving courts and spouses guidance in setting the levels of child support orders and encouraging settlement; and

d) To ensure consistent treatment of spouses and children who are in similar circumstances.

The *Guidelines*' position, or lack thereof in some cases, on the treatment of losses along with its inconsistent treatment of payor spouses who hold their business interests through a corporation as opposed to an unincorporated entity may result in inequitable conclusions in the determination of income.

Pursuant to section 16 of the *Guidelines*, the starting point of any income calculation is the "total income" from the payor's personal income tax return, also referred to as Line 150 income, adjusted in accordance with Schedule III of the *Guidelines*. Total income is made up of a number of items including employment, pension and investment income, as well as business, professional, farming and rental income or losses, among other items.

As the *Guidelines* move on to appropriately recognize that further assessments are required for spouses that are shareholders of a corporation, certain inconsistencies begin to arise. Section 18 of the *Guidelines* indicates that where a spouse is a shareholder, director or officer of a corporation, all or part of the pre-tax income of the corporation that is deemed to be available may be added to that spouse's annual income. No specific mention is made about corporate losses, and many believe that the words "all or part of

the pre-tax income" exclude the consideration of a corporate loss. Yet, if an entity remains unincorporated and suffers losses, those losses are included in Line 150 income, as the financial results of an unincorporated entity are directly reported on a taxpayer's personal income tax return. Take, for instance, dentist A, who incorporated his practice which paid him $50,000 by way of a T4 and incurred an overall loss of $100,000 after deducting such salary. If the loss is excluded, dentist A's *Guidelines* income would be $50,000. Now, consider dentist B who did not incorporate his practice which had the same financial results as that of dentist A. Based on this, dentist B would report a $50,000 loss ($100,000 loss similar to the corporation plus the $50,000 salary expensed) as part of his Line 150 income. Based on this, a swing of $100,000 between dentist A and dentist B would result in the calculation of their respective *Guidelines* income. It may be inequitable to let the business structure impact *Guidelines* income.

Further inconsistencies with the treatment of losses are highlighted in Schedule III of the *Guidelines*, specifically in the following areas:

a) Paragraph 6 of Schedule III indicates that taxable capital gains realized in a year are to be replaced "by the actual amount of capital gains realized by the spouse in excess of the spouse's actual capital losses in that year." This suggests that capital losses in excess of capital gains are not considered in the determination of income. Firstly, Line 150 income gives credit to the payor spouse for losses arising from self-employment activities, yet, losses arising from investing activities are not considered. Furthermore, the timing of capital losses can lead to a different conclusion when determining *Guidelines* income. Assume that a payor spouse sells TD shares resulting in a $100,000 capital gain and also sells Blackberry shares at a loss of $100,000 during 2016. Based on this, there is a nil effect on the spouse's 2016 *Guidelines* income calculation. Now assume further that in an attempt to reduce the loss from Blackberry shares, the spouse decided to hold on to those shares and, after giving up on his efforts, actually disposed of them in 2017 still at a loss of $100,000, his/her *Guidelines* income for 2017 may not consider the loss as there are no capital gains that can offset the loss incurred. As a result of the timing of the latter scenario, *Guidelines* income of $100,000 would result in 2016 while in 2017, no income would be the result, for overall income of $100,000 over the two years compared to no income for the former investor who sold all of his interests in 2016. It may be inequitable to allow the timing of transactions impact the determination of *Guidelines* income;

b) Paragraph 7 indicates that business investment losses suffered by the spouse during the year are to be deducted when calculating *Guidelines* income. A taxpayer's business investment loss is a capital loss from a disposition of shares in, or a debt owing to the taxpayer by, a small business corporation. Unlike ordinary allowable capital losses, the allowable portion of a business investment loss for a tax year may be deducted from all sources of income for that year. Even though

every investment has a degree of risk no matter its form, the *Guidelines* seems to allow losses in investments that are in small business corporations, yet losses from investment vehicles such as marketable securities in large, public corporations are not. Assume the scenario where investor A contributes $100,000 in his own business venture which is deemed to be a small business corporation under the income tax rules and investor B who invests $100,000 in Blackberry shares. Now assume that the entity started by investor A along with Blackberry both file for bankruptcy an all amounts invested are lost. In calculating investor A's *Guidelines* income, the $100,000 loss is clearly deductible for *Guidelines* purposes, while investor B's loss is not. Each investor took a degree of risk, yet only one is provided a break for the adverse results of such risk; and

c) Paragraph 12 states that when a spouse earns income through a partnership or sole proprietorship, any income required by these entities for the purposes of capitalization can be deducted in the calculation of *Guidelines* income. The focus of this paragraph is on partnerships and sole proprietorships, and not corporations. The *Guidelines* specifically recognize the lack of access to income if a business entity requires the funds to capitalize its business. The *Guidelines* do not specifically mention this as it relates to corporations, though it remains one of our primary focus, as valuators, when determining income for *Guidelines* purposes.

Payors who are in similar situations such as the examples above all have the same sources of income out of which to pay support and yet the parties they support would not be treated consistently as a result of the different income determinations arising out of the literal interpretations of the *Guidelines*.

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***.