

THE WONDERFUL WORLD OF FARMERS, TRUCK DRIVERS AND SMALL BUSINESS OWNERS: Assessing Income under the Federal Child Support Guidelines.

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I. Introduction

Child support guidelines were first used in the United States in the 1980's and gradually expanded to England, Australia, the United Kingdom and lastly, Canada. It should be noted that our Guidelines, although a new concept to us, are rather old hat in the English speaking world.

The Federal Government's project on Child Support Guidelines started in about 1990 and stretched over seven and one-half years.

A great deal of thought and a certain amount of experience went into the establishment of the Guidelines. The Federal Government's policy (also adopted by the Provincial Government) was to create a system that relied heavily upon the income tax system to determine incomes in assessing child support. As well, the Guidelines are lengthy and intended to be quite specific so as to radically diminish the court's flexibility and discretion. This was quite directly intended to limit the scope and jurisdiction of the courts and the arguments that could be made.

The most obvious issue to determine in order to apply the Child Support Guidelines is income. The Federal Government already had a system in place for determining income called *The Income Tax Act*.

It should also be noted that the policy behind *The Income Tax Act* (yes there is one) is to assess income fairly and realistically and to ensure that taxpayers are treated equitably throughout this tax system. As a consequence, it seems logical and reasonable to rely upon the tax system in assessing income. Under the Act, taxable income is arrived at by applying various deductions allowed by the Act. For example, the Act gives a taxpayer the ability to deduct expenses like home, office, utility and vehicle expenses. These deductions are supposed to be made in a reasonable manner. Taxpayers are also allowed a deduction for the depreciation in assets used to earn income. Capital Cost Allowance rates are supposed to reflect loss of value that takes place over time on land and equipment.

The Income Tax Act is designed quite specifically to fairly assess income between people. It made sense for the Child Support Guidelines to piggy-back on the tax system.

The way writers have always viewed the Child Support Guidelines is that the taxable income of a party from the year prior to the date of assessment should be the basis for the support order. For example, 1998 awards should be based on the taxable income in 1997. You spend a great deal of time debating changes from year to year but overall the presumption has been to use last year's income. If the income is increasing over three consecutive years, the most recent year is to be used. If it is decreasing over the last three years, the most recent year is to be

used. If it has gone up and down over the last three years, then the court has a number of options to assess income.

The Guidelines specifically contemplate using taxable income as calculated under *The Income Tax Act*, subject only to Schedule 3.

Departure from taxable income was limited to the specific adjustments outlined in Schedule 3; adjustments where the tax return showed some nonrecurring loss [Section 17(2)], adjustments to income where a spouse is a shareholder of a company (Section 18), and in situations where the court would impute income or rule the expenses were not reasonable. [Section 19(2)]

Four objectives were to be achieved with the implementation of the Federal Child Support Guidelines. Those four objectives are set out in section 1 of the Guidelines. It was hoped that the Guidelines would establish fair standards of support for children, minimize conflict, improve the efficiency of the judicial system dealing with the issue of child support and to promote consistency of treatment of spouses and children in similar circumstances.

The Guidelines have been with us less than two years and its difficult to assess whether they have even come close to accomplishing any of the objectives. For certain the objective of minimizing conflict has not been achieved as numerous cases have been argued dealing with the application and/or interpretation of the Guidelines.

The Guidelines were intended to be easy to use. First determine the payor's income, second look at the table on child support, find the income and determine the appropriate amount of child support. The Child Support Guidelines are a wonderful middle class device. They are effective in dealing with situations where both husband and wife are employees and earn reasonable levels of income. The Guidelines are much more difficult to use when the parties are either at low incomes, high incomes or where they derive their income from self-employment or from business. In those cases assessment of income becomes much more difficult.

In Saskatchewan, many of us have been faced with the often difficult task of determining the income of a farmer for the purpose of applying the Guidelines. There are also a number of other payors in business whose incomes need to be reviewed before applying the tables. There is a wide disparate in which matters have been adjusted.

II. The Starting Point – Taxable Income and the Deductions in Schedule III

Sections 15 to 20 of the Guidelines, are the sections to use to determine the income of a spouse for the purposes of applying the Guidelines. Section 16 requires that the annual income for a spouse be determined using the sources of income set out under “Total Income” (Line 150) on the T1 General Tax Return. The sources of income included in Total Income include employment income, pension income, employment insurance benefits, taxable amount of dividends from Canadian corporations, interest and other investment income, net partnership income, rental income, taxable capital gains, support payments received, RRSP income, self-employment income (including farming, fishing, professional and business income), worker's compensation benefits, social assistance payments and net federal supplements.

Line 150 of the T1 General is just the starting point; anyone assessing income must look beyond Line 150 to see what has been included and deducted from the various sources of income to arrive at the total income reported. Section 16 of the Guidelines requires that

the Total Income be adjusted in accordance with Schedule III in order to determine the annual income of the spouse for the purposes of determining the appropriate level of support.

The adjustments required in Schedule III can result in either increased or decreased income depending on the particular adjustment. The Schedule III adjustments are applied in an attempt to determine the actual income a person receives from which they can pay support. Typically when dealing with a spouse who is self-employed, the income reported on the T1 General does not accurately reflect all the income available for the payment of child support.

In determining income under the Guidelines, the objective is to find the most reliable and fairest indicator of what the individual's current annual income is (*MacDonald v. Rasmussen* [1997] S.J. No. 667). That can, in many situations, be determined by applying s. 16 and Schedule III of the Guidelines, however that does not always achieve the fairest and most reliable result. In some circumstances, resort must be had to sections 17 to 19 to achieve the fairest result.

These sections are particularly important when assessing the income of farmers and the self-employed. Out of the numerous adjustments found in Schedule III, only seven have particular relevance to farmers, truck drivers and the self-employed:

1. **Dividends from Taxable Canadian Corporations (s. 5).** The dividends from taxable Canadian corporations as reported on the T1 are overstated at 125% of the actual dividend received. Dividends are taxed differently than other sources of income and are grossed up as part of the tax treatment they receive. In determining the income available for child support the taxable amount of the dividend must be replaced with the actual amount of the dividend. If this is not done, the spouse's Total Income would reflect more income than what was actually received and available for the payment of child support.

Simply multiplying the taxable dividends as reported on the T1 by four-fifths will reveal the amount of the dividend received. A number of Saskatchewan cases have applied this adjustment including; *Depeel v. Abramyk*, [1997] S.J. No. 749 (QL) *Wright, J.* and *Kelly v. Kelly* (1997), 33 R.F.L. (4th) 16 (Q.B.). *Depeel v. Abramyk* involved a substantial adjustment as a large portion of the spouse's income was dividend income.
2. **Capital Gains and Capital Losses (s. 6)** Capital Gains as reported on the T1 are understated at 75% of the actual gain realized. Capital gains are taxed differently than other sources of income, and to accomplish the favourable tax treatment for capital gains only 75% of the gain is reported as income. The taxable capital gain is replaced by the actual gain. Multiplying taxable gains as reported on the T1 by four-thirds will yield the actual capital gain, provided all of the capital gain realized in the year is reported in the year and any capital losses deducted from the capital gain were incurred in the same year. Care must be taken to ensure that all of the gains in a year are included not just those reported and that any capital losses were incurred in the same year they are deducted against the capital gains.
3. **Business Investment Losses (s. 7)** Business Investment losses are deducted from Total Income after Line 150 on the T1 form. Business investment losses are deductible against any kind of income, although the deductible loss is only 75% of the actual loss. Given that a business loss is factored in after Line 150, the income of an individual who

suffers a business investment loss is not accurately reflected on Line 150. Schedule III allows a spouse who does suffer a loss to deduct the full amount of the loss from income for that year.

4. **Net Self-Employment Income (s. 9)** Any non-arm's length payments for salaries, benefits, wages, management fees or other payments are to be added back into total income, unless the spouse establishes that "the payments were necessary to earn the self-employment income and were reasonable in the circumstances." Once it has been established that such a payment has been made, the onus is on the spouse to provide evidence of necessity and reasonableness. There is no indication of what evidence would be required, however, in *Poff v. Fenell* [September 14, 1998] Wilkinson, J. noted that the payor had not discharged the onus upon her as she failed to provide an explanation of the number of hours worked, the hourly rate paid or whether the rate paid was comparable to the standard rates for farm labour. It would appear that at a minimum evidence on these three issues must be provided to justify the deduction.
5. **Additional Amounts - Transition Reserve (s. 10)** Prior to 1995 many self-employed individuals used an off-calendar year-end to report their income. This effectively deferred the income earned (and more importantly the tax payable on that income) in one year to the next. With the 1994 Federal Budget all this changed and these individuals had to start reporting their income on a calendar year basis. In 1995 the previous fiscal year's income along with the income from the end of the last fiscal period to December 31, 1995 had to be reported as income. In many cases almost two full years of income had to be reported in 1995, in order to minimize the heavy tax burden that would have befallen many individuals the government allowed them to defer the reporting of that income over a ten year period. That income was placed into what has been referred to as a transition reserve, and a portion of the reserve must be included in the individual's income for each year until 2004 (5% in 1995, 10% in each of 1996 to 2003, and 15% in 2004). As a result the business income reported in a given year may include income earned prior to 1996. This is not income available for paying child support and thus must be deducted when determining the amount of income for the purposes of applying the guidelines.
6. **Capital Cost Allowance for Real Property (s. 11)** The deduction for CCA on real property must be added back into income as it is a noncash expenditure that will likely be recovered when the property is sold as real property does not tend to depreciate.
7. **Partnership or Sole Proprietorship Income (s. 12)** This deduction recognizes that the income reported on the T1 may not be the actual income received by the partner or sole proprietor as the business may have retained income to finance capital expenditures. It will be up to the spouse to establish what has been "properly required by the partnership or sole proprietorship for the purposes of capitalization."

III. Farmers

The assessment of the income of farmers is the most hotly contested aspect of the assessment of income of self employed people in Saskatchewan. This undoubtedly stems from the belief that farmers receive unwarranted "tax breaks" and that farmers earn the real income from the appreciation in their capital assets over the course of a lifetime. Perhaps this arises from the prejudices of non-farmers, or from the inadequacies of the guidelines. The inconsistency that

seems to drive this is often the discrepancy between a large asset base and net worth, and a very low income.

Although the law should be applied equally, it is quite clear that there is a special class of farm law in Saskatchewan. Apparently the drafters of the Child Support Guidelines were not aware of farming and what farmers deduct and as a consequence the courts need to revisit, in every case, a farmer's income.

There is some legitimacy to this. Farmers are in a unique position under *The Income Tax Act*. They report on a modified cash accounting basis. That is, income is reported when the cheque is received and cashed. This permits farmers to do things like defer income and incur expenses at different times. We are all aware that most farmers stock up on fertilizers and chemicals at year-end and will often receive deferred grain cheques thus moving income from one year to the next.

One must assume, however, that when the Child Support Guidelines were drafted that they were aware of the farmers' unique positions. The following chart details some of the cases and adjustments that have been made to farm income: Section 17 of the Guidelines allows the court to look at a pattern of income when there have been fluctuations in the spouse's income. The court is entitled to take the average income over the past three years in order to estimate current income for child support purposes. In most instances determining the income of a farmer will be best achieved by averaging the most recent three years of income information available given the normal fluctuations in farm income from one year to the next.

Item	Income Tax Return Amount	Comment			Add On
Taxable Income		16. Subject to sections 17 to 20, a spouse's annual income is determined using the sources of income set out under the heading "Total income" in the T1 General form issued by Revenue Canada and is adjusted in accordance with Schedule III.			
Capital cost Allowance Buildings		11. Include the spouse's deduction for an allowable capital cost allowance with respect to real property.			
		Add Back	Case		
		0%	<i>Doege v. Doege</i>	Zarzecny	
		0%	<i>Beeler v. Beeler</i>	Noble	
		0%	<i>Fisher v. Gerrard</i>	Wilkinson	
		For General Equipment:			
		0%	<i>Poff v. Fenell</i>	Wilkinson	
		15%	<i>Stokes v. Stokes</i>	Allbright	
		20%	<i>Fisher v. Gerrard</i>	Wilkinson	

Item	Income Tax Return Amount	Comment			Add On
		For Truck:			
		20%	<i>Fry v. Hendrickson</i>	Dickson	
		20%	<i>McDonald v. Gross</i>	Dickson	
		30%	<i>Oslowy v. Oslowy</i>	Wright	
		50%	<i>Wilson v. Wilson</i>	McIntyre	
		75%	<i>Simpson v. Palma</i>	Zarzecny	
Utilities on the home		There must be explanation for large increases.			
		50%	<i>Poff v. Fenell</i>	Wilkinson	
		50%	<i>Simpson v. Palma</i>	Zarzecny	
Wages to family		There must be proof the expense is reasonable			
		100%	<i>Poff v. Fenell</i>	Wilkinson	
		New Wife did accounting			
		25%	<i>Simpson v. Palma</i>	Zarzecny	
		The wages need to be paid:			
		100%	<i>McDonald v. Gross</i>	Dickson	
NISA amounts		100%	<i>Stokes v. Stokes</i>	Allbright	
		No special deduction of NISA amounts included in income			
Optional Inventory adjustment		Don't use:			
		100%	<i>Brockman v. Ofukany</i>	Gerein	
		100%	<i>Poff v. Fenell</i>	Wilkinson	
Personal Vehicle		20%	<i>Fisher v. Gerrard</i>	Wilkinson	
			For truck		
		Truck lease for son:			
		100%	<i>McDonald v. Gross</i>	Dickson	
Inventory		Don't add in:			
		0%	<i>Brockman v. Ofukany</i>	Gerein	
		0%	<i>Poff v. Fenell</i>	Wilkinson	
Fertilizer/Chemicals		Must show they are not genuine.			
		0%	<i>Fry v. Hendrickson</i>	Dickson	

Item	Income Tax Return Amount	Comment			Add On
General Expenses		Do not allow if a significant increase over prior years without explanation:			
		100%	<i>Fisher v. Gerrard</i>	Wilkinson	
		Do not allow a deduction to one's own company:			
		100%	<i>McDonald v. Gross</i>	Dickson	

When considering adjustments to farm income, reference should be made to what has occurred with that adjustment in the past three years.

Revision to farm income usually takes place in the following areas:

A. Capital Cost Allowance

One of the commonly encountered issues when determining the income of a farmer is the allowance of a claim for capital cost allowance (CCA). Farmers are allowed to deduct from their income the depreciation that has occurred with respect to their capital property including machinery and equipment. The reality of the deduction is that there may not have been an actual cash expenditure in the year the deduction is made, however ongoing capital expenditures are required to maintain a viable farming operation. The CCA adjusts a farmer's income downwards and does not always accurately reflect the income available to pay child support.

An individual who seeks to add CCA back into income, is asking the court to exercise its jurisdiction under section 19(1)(g) and (2) of the Guidelines. The Court must find that the spouse has unreasonably deducted expenses from income. Further the fact that a deduction is lawful under *The Income Tax Act* does not require the court to accept the deduction as reasonable.

The decision of McIntyre J. in *Wilson v. Wilson* contains a summary of the previous cases which have dealt with the issue of adding back in the CCA. The decisions have ranged from not adding any CCA back into the farmer's income to adding back 75% of the deduction into income. (It should be noted that the inclusion of the capital cost allowance in income is not something new under the Guidelines, the courts have been asked to include CCA back into income in many pre-Guideline cases, because the reality is that the CCA deduction distorts the amount of income available to pay child support regardless of whether the Guidelines apply).

McIntyre J. in *Wilson* made the following comments:

“When subsection 19(1)(g) speaks to the unreasonable deduction of expenses from income it does not require establishing that the spouse has acted improperly or outside the norm in deducting expenses. Section 19(2) explicitly recognizes that reasonableness is not governed solely by whether the deduction is permitted under *The Income Tax Act*. The deduction may be quite proper in so far as tax policy is concerned. The issue is whether or not the full deduction of expenses which may be permitted by *The Income Tax Act*, results in a fair recognition of the actual income that is available to that spouse

from that source of income. It may in some cases require a full exploration of income and expenses, capital acquisitions and the state of depreciable property before a decision can be made whether to add that capital cost allowance on property other than real property.”

The Court of Appeal in *Sjogren v. Pipchuk* (1997) 34 R.F.L. (4th) 280 (Sask.) stated that each case must be decided on its own merit; “What, if any, portion of the capital cost allowance should be added to establish available income must be based on the facts of each case.”

It seems that when the capital acquisitions exceed the capital cost allowance claimed the courts will be reluctant to add back the CCA into income as the spouse's taxable income reasonably reflects the disposable income for child support purposes.

In *Simpson v. Palma* [1998] S.J. No. 581, Mr. Justice Zarzecny summarized the case authority as follows:

“53. The most contentious and difficult area is the amount, if any, that ought to be imputed to Mr. Simpson's income with respect to the capital cost expense claimed on account of equipment. This issue has received considerable consideration in the judgment of a number of cases. Each individual circumstance must be carefully analyzed with the result that the cases impute income on account of capital cost equipment expenses claimed ranging from 0 to as much as 100% (see, for example, *Beeler v. Beeler* (1997), 161 Sask. R. 167 (Sask. Q.B.) - 75% add back sought, 0% allowed; *Nakonechny v. Nakonechny*, [1995] S.J. No. 590 (Q.L.) (Sask. Q.B.) - 50% added back; *Doege v. Doege* (1998), 162 Sask. R. 145 (Sask. Q.B.) - nil; *Gorgichuk v. Gorgichuk* (1997), 154 Sask. R. 273 (Sask. Q.B.) - 75% added back; *Seiferling v. Langmeier*, [1998] S.J. No. 84 (Q.L.) (Sask. Q.B.) - 15% added back; *Stokes v. Stokes*, [1998] S.J. No. 321 (Q.L.) (Sask. Q.B.) - 25% added back.) An exhaustive brief of the authorities and applicable considerations in this regard was conducted by McIntyre J. in the case of *Wilson*, supra, a case in which he ultimately added back in 50% of the capital cost allowance average deduction claimed on property other than real property.”

What will happen seems to depend largely on which member of the Court hears the case.

B. Optional Inventory Adjustment

An optional inventory adjustment is a method of averaging income for tax purposes. It allows a farmer to include in income any inventory up to the fair market value of inventory owned at yearend. The amount included in income must be deducted in computing income in the following taxation year. Inventory means property, the cost or value of which would have been relevant in computing a farmer's income from the farming business for a year if the income had not been computed in accordance with the cash method. Inventories will include grain and livestock produced or acquired, and held in the course of carrying on the farming business. An accounting on an accrual basis would identify the farm's production for the year, expenses specifically related to that production and would identify the changes in farm inventory. The optional inventory adjustments employed in the cash method of accounting distort the true picture. Wilkinson, J. in *Poff v. Fenell* felt that it was appropriate to exclude the optional inventory adjustments and made reference to the decision in *BLMG v. DJEG* [1998] M.J. No. 278 (QL)(Man Q.B.) where the court commented that the husband's use of the optional inventory adjustment for 1997 and the three previous years might be inappropriate in determining Guideline income.

As a comment the optional inventory adjustment should be reviewed more carefully than just adding it in to the income of a farmer. This item is used initially to increase a farmer's income when it is first used. For example, if a farmer had a \$10,000.00 loss in a given tax year on a cash basis they are entitled to use this adjustment to increase their income by deeming certain of their inventory to have been sold. The farmer must add the optional inventory adjustment into their income in the next year. For many farmers, the adjustment is both added in as income and deducted that same year as an expense so the adjustment does not distort their income. Adding the adjustment back in every case might artificially inflate a farmer's income.

The following chart demonstrates the inappropriateness of adding the adjustment back in every case:

Item	1995	1996	1997
Net farm income cash basis	-10,000.00	20,000.00	15,000.00
Optional inventory adjustment addition	15,000.00	15,000.00	15,000.00
Optional inventory adjustment deduction	0.00	-15,000.00	-15,000.00
Net Farm Income	5,000.00	20,000.00	15,000.00
Deemed income if deduction added back	N/A	35,000.00	30,000.00

If the court simply adds back the optional inventory adjustment without looking at the actual cash available, there may be an unfair result. Changes in the amount of the adjustment are important, if it is consistent then the adjustment does not give the farmer more money for paying support.

C. Personal Use Expenses

The adding back of certain expenses as personal use expenses should not be arbitrarily allocated in the absence of supportive evidence (*O'Hara v. O'Hara* (1997), 33 R.F.L. (4th) 37 (Sask. Q.B.) In *McDonald v. Gross* [1998] S.J. no. 301 Dickson J. attributed 20% of the expenses deducted as farm expenses as personal expenses and attributed them back to income.

D. Wages to Non-Arms Length Parties

When wages are being paid to either children or new spouses, the courts can look at the amount of those payments and then disallow the deduction if they are not legitimate expenses. The onus appears to be on the party seeking to pay those wages to prove that they are reasonable. For example, in the case of *McDonald v. Gross* Mr. Justice Dickson added in all of the son's wage into the father's income. The father in his affidavit indicated that although the son did work for what he was paid, the father did not need him to work and could have worked himself.

There must be some proof the expense is reasonable and necessary: *Poff v. Fenell*.

In an interesting case, *Simpson v. Palma*, the husband was paying his new wife to do, among other things, the accounting for the farm and helping around the farm. At the same time, the

expense was used to split income between the husband and wife. Mr. Justice Zarzeczny ruled that 75% of the wife's wages were reasonable for the work that she did and that 25% of it was not and should be added back into the husband's income.

E. NISA Amounts

In the case of *Stokes v. Stokes* Mr. Justice Allbright dealt with an argument made by the husband that his withdrawal from his NISA account was a one-time withdrawal and an exceptional source of income and as a consequence should not be considered in determining his income. Mr. Justice Allbright rejected that argument and included the NISA payment to the husband in assessing his income. He pointed out that the whole purpose of NISA was to help farmers equalize their income and stabilize their income. Given the nature of the program it is quite proper to consider the NISA payments.

F. Personal Vehicles

In the case of *Fisher v. Gerrard*, Madame Justice Wilkinson added back 20% of the depreciation taken on a truck purchased by the husband. The truck was expensive and excessive to the parties' needs and he derived personal benefit from it greater than that which he had allowed. In the case of *McDonald v. Gross*, Mr. Justice Dickson disallowed a truck lease for a son as a deduction.

G. Inventory

Sometimes the argument can be made that a farmer at year-end has inventory which could have been converted to income thus increasing their income significantly. This would apply particularly to grain on hand. As well, many farmers have deferred grain cheques for grain hauled in one year but showing up as income in the next year. In theory, a farmer could increase their income dramatically by liquidating their grain on hand and other inventories before the year-end. As a consequence, inventory should be added in.

This argument had been rejected by the courts in two cases. It was rejected by Mr. Justice Gerein in *Brockman v. Ofukany* and Madam Justice Wilkinson in *Poff v. Fenell*.

These decisions are correctly decided in our view. Unless there is some major discrepancy in farmer's business practices, most farmers will be carrying inventory year over year. If this argument is to be advanced it should be shown that the farmer has either deliberately reduced sales or has somehow departed from the usual standard of practice.

H. Fertilizer/Chemicals

Most farmers buy fertilizer and chemicals in the last month or two of any given year. This permits them to deduct the cost of the fertilizer from their 1998 income (for example) even though the inputs will be used to produce their 1999 income. An argument could be made that these artificial expenses they not have any impact on the 1998 income. This argument breaks down as well. If a farmer has a regular pattern of buying fertilizer at the end of the year, then their cash position does not change significantly. This argument was rejected in *Fry v. Hendrickson* by Mr. Justice Dickson. In that case the husband's fertilizer expense increased dramatically in one year over prior years. There were some plausible explanations and without some evidence that it was an artificial transaction Mr. Justice Dickson treated the expense as legitimate.

I. General Expenses

Sometimes the court will add back general expenses and miscellaneous expenses. If there is a significant increase of expenses of one year over another year without explanation, those expenses may not be allowed: *Fisher v. Gerrard*.

In the case of *McDonald v. Gross* Mr. Justice Dickson disallowed a deduction in assessing farm income that was paid to a non-arms length company owned by the husband.

J. Summary

As the many above noted cases indicate assessing a farmer's income is still very much a matter of individual discretion on the part of the court. On a policy basis one could suggest that the court's are too interventionist and are defeating the purposes of the Guidelines. One of the purposes of the Guidelines was simplicity. The extensive review of farmers' income has reincorporated discretion and uncertainty in a significant way. As well, this seems to invite yearly reviews with much more regularity.

IV. Truck Drivers

The life of a truck driver is different than the life of a farmer apparently.

Truck drivers often have a couple of different expenses which are sought to be reviewed. So far, these attempts have not been successful. The first thing is truck drivers who own their own trucks have very significant levels of capital cost allowance, however, their whole livelihood is based on their truck and the trucks are heavily used. but the depreciation used is quite real. This issue was faced directly by Mr. Justice Maurice in *Ruecker v. Ruecker*. In that case Mr. Justice Maurice accepted that depreciation and capital cost allowance should normally not be added in. He stated as follows:

"In this case, the respondent makes principal repayments, for business loans, on his equipment which are not deductible from his income and which exceed the amount of capital cost allowance he deducts, resulting in no extra cash flow. In paragraph 11 of the respondent's affidavit he states "...With the use of my truck, the vehicle will depreciate substantially and there will be very little, if any, recapture when I sell the vehicle in several years." There is no evidence to the contrary. This is not a case of dire financial need. I must conclude that the applicant has not discharged the onus on her of showing that the deduction of capital cost allowance by the respondent was unreasonable."

It is respectfully submitted that the case of the truck driver adding back in the capital cost allowance is entirely unrealistic. Trucks are very expensive and depreciate rapidly and truck drivers are consistently replacing their equipment. As well, they do not incur the same kind of capital accumulation that farmers do.

See also *Potter v. Potter* (June 1, 1998, Dawson, J.)

V. Small Business Owners, Companies and the Self-Employed

Section 18 of the Guidelines allows the Court to include all or part of a corporation's (and any related corporation's) pre-tax income or an amount commensurate with the value of the services the spouse provides to the corporation in the spouse's income. The court can resort to this section if the spouse's annual income as determined under section 16 does not fairly

reflect all of the money available to the spouse for the payment of child support. This section should be considered when a spouse is the sole or a significant shareholder of a corporation.

Wilkinson J. in *Beeching v. Beeching* [1998] S.J. No. 355 made this comment about applying section 18:

In cases where this Court has seen fit to include corporate income in a spouse's annual income applying s. 18 of the Guidelines, the spouse was the sole shareholder. In *Ivey v. Ivey*, [1996] S.J. No. 844 (Q.L.) (Sask. Q.B.; 153 Sask. R. 157) the presiding judge stated that the husband was "the master of his own destiny" and that "the dividends are there for his taking pretty well as he pleases". See also *Bartch v. Bartch*, [1997] S.J. No. 33 (Q.L.) (Sask. Q.B.). The nature of the corporation's business, its internal structure and ownership, its financial status and its historical practices are all relevant considerations in making the determination as to what additional income from the corporation would fairly reflect the money available to the spouse for the payment of child support."

In *Kelly v. Kelly* [1997] S.J. No. 604, Hunter J. was asked to impute income to the spouse on the allegation of the other spouse that there was more income available from the corporation than was actually paid out in dividends. Hunter J. refused to impute income and stated that not in every instance of a corporate entity must the income be paid out as dividends and that retained earnings should be fairly restricted. In this case she found that there had not been an undue accumulation of income retained within the company on an annual basis.

The only adjustment to a corporation's pre-tax income is one for amounts paid to persons with whom the person does not deal with at arm's length. The same standard is applied to a corporation as to a sole proprietor or a partner – income splitting will not be allowed unless the spouse can establish that the payments were reasonable in the circumstances. In *Beeching v. Beeching* the wife wanted to add back in capital cost allowance deducted from the corporation's income. Madam Justice Wilkinson refused to do this as the section allowing the imputation of income where expenses are unreasonably deducted refers only to a spouse and not to corporations.

In *Kramer v. Kramer* [1998] S.J. No. 506, the court disallowed a deduction for a bad debt of in excess of \$300,000.00 incurred by a corporation and added in the total income of wholly owned company in assessing the husband's income for the purposes of the guidelines. The Court stated:

12 Timothy is the sole owner of T.R. Kramer Overseas Limited, a company based in Cypress whose principal activity is the purchase and sale of industrial products. The company had an extremely good beginning and in its first financial statement for the period June to December, 1996, showed an after tax profit of \$144,449.00 U.S. A revised financial statement for the same period showed a loss of \$156,725.00 U.S. after a provision was added in for bad debts of \$306,190.00 U.S.

13 I believe it is obvious that that is a tax saving measure and that a "provision" for bad debts is not an actual bad debt. Furthermore, it strikes me as premature to register a loss, although it may be acceptable for income tax purposes. Accordingly, I am of the view that the profit of \$144,449.00 U.S. should be added to his income for 1996. The equivalent in Canadian dollars should be a rate of 1.38 being \$199,340.00. His imputed income for 1996 should then be \$166,758.00 plus \$199,340.00 for a total of \$366,098.00. If there are indeed bad debts as reflected in the subsequent financial

statements of T.R. Kramer Overseas Limited determination of future income can be adjusted accordingly.

When dealing with a corporation the Courts to this point seem to look at the efficacy of the business arrangements that have been made. If the payor spouse is only part owner of a corporation with another arms length partner, then it is much more difficult to include the company's net income into the payor's income. If the payor is the sole owner of the corporate entity, then the income is far more likely to be added into the payor's income in assessing the income level. If the payor's actions are reasonable and consistent then the Court may rely on the dividends only: *Kelly*. If there are new financial statements or major inadequately explained changes in the Company's finances, the court is more likely to add income in or refuse to accept major changes in income.

There are a number of other cases which have dealt with business situations a few of which warrant comment.

One common problem is where a party switches jobs or becomes self-employed. The general approach of the court has been to presume that their income is higher than claimed in the new business. In *Engbretson v. Pelletti* Madam Justice Wright considered a situation where the husband had become employed in his own business. He deposed that his monthly income was \$1,500.00 per month. He failed to provide the appropriate proof to the court and failed to provide documents the court expected to be produced. The court relied upon his average income of prior years and assessed his income significantly higher than that which was alleged.

A number of cases have dealt with rental properties.

In *Boehm v. Boehm*, Madam Justice Pritchard increased the husband's income by \$320.00 per month to reflect the fact that he was living in a four-plex in which he rented out 3 units and deducted the costs from income. This was the deemed rental on the income. One must question the addition of the value of the rental to income. Perhaps the expenses taken for the four-plex should have been reduced by a quarter.

In *Gaetz v. Gaetz*, Mr. Justice Gerein disallowed some rental expenses in a rental business. The rental expenses had gone from \$3,000.00 per year to \$23,000.00 per year in one year. Without adequate explanation for this, Mr. Justice Gerein disallowed \$8,000.00 of the deduction.

In the case of *Lamb v. Lamb* the husband had significant employment income but also had farm losses, which reduced his income for the purpose of the Guidelines. Mr. Justice McIntyre disallowed the losses and relied on the husband's employment income. The farm was a new business and it was too early to say whether there was a chance of profit or loss from the business. As a consequence, he would not permit the deduction.

In *Neisz v. Spagrud*, the husband had earned \$65,000.00 in 1997. He had quit his employment and had set up a business with his father. He quit the job partly on the basis that the job was not steady and there was a good chance that he would be laid off anyway. He deposed that his income would be \$2,000.00 and these were the draws from the new business. Mr. Justice Allbright imputed another \$1,000.00 per month to his income presuming he would do better in the future and that he would not have quit his job except if prospects in his new position were quite good.

In *Schaber v. Schaber*, the court relied on the actual taxable income of the party who had an interest in a business. It was argued that had the business been structured as a partnership

the husband's income would have been significantly larger. The court relied on what the actual income was under The Income Tax Act rather than trying to restructure the business.

Finally, in *Weibe v. Oviatt* Mr. Justice Dickson imputed an income to the wife for the purpose of establishing her obligation under the Guidelines. She had voluntarily quit her job to go work on her new husband's farm. The court used her expected income from her job in assessing her income.

VI. Conclusion

One hopes that over the next year or two the assessment of farm income becomes more consistent. Certainly, there is no justification for there to be such a wide range of results when dealing with capital cost allowance. The current court decisions have actually made the assessment of child support more difficult than it was under the pre-Guideline structure. Trying to “fine tune” cases especially farm cases may be defeating the objectives of the legislation.

Perhaps consistent rules will be adopted in the future.

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