**A- 623-96**

**CORAM:STRAYER J.A.**
**MacGUIGAN J.A.**
**McDONALD J.A.**

**BETWEEN:**

**HER MAJESTY THE QUEEN**

**Applicant**

**- and -**

**LARS ERIC LARSSON**

**Respondent**

**Heard at Vancouver, British Columbia, on Wednesday, April 23, 1997**

**Judgment rendered at Ottawa, Ontario, on Tuesday, August 5, 1997**

**REASONS FOR JUDGMENT BY:** **McDONALD J.A.**

**CONCURRED IN BY:** **STRAYER J.A.**
**MacGUIGAN J.A.**

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**REASONS FOR JUDGMENT**

**McDONALD J.A.**

This case deals with taxation of support payments which are paid to third parties. At trial, the Tax Court Judge found in favour of the taxpayer in part. The Crown has brought an application for judicial review to this Court, claiming that the Tax Court Judge erred in law in his disposition of the case with respect to taxation of directed support payments. It also appears that the Respondent has attempted to, in effect, seek judicial review of that part of the decision which went against him, as well as the Tax Court's decision with respect to costs.

For the reasons which I outline below, I am of the view that the

Crown's application for judicial review must be dismissed. I am also of the view that the taxpayer cannot seek judicial review of that portion of the decision which was decided in the Crown's favour without having brought his own application for judicial review.

**FACTS**

The taxpayer and his former wife separated. By order of the British Columbia Supreme Court dated November 14, 1989 (the "first order"), custody of the children was awarded to the taxpayer's spouse and the taxpayer was ordered to pay interim spousal maintenance in the form of monthly mortgage payments as well as interim child support.

Nearly two years later, the British Columbia Supreme Court issued a second order dated September 27, 1991 (the "second order") which provided for the sale of the matrimonial home and specific terms for the closing of the sale. The Court also ordered that the taxpayer was to pay lump sum spousal maintenance as well as maintenance arrears. In this order, the Court also went on to state that "any and all spousal and child support payments made by the Defendant [the taxpayer] to the Plaintiff in 1989 by way of mortgage payments on the former matrimonial property, are to be deemed periodic maintenance payments pursuant to the *Income Tax Act*."

In November 1993, more than two years after the second order, the taxpayer brought an *ex parte* application to the British Columbia Supreme Court for a further order ("the third order"). The third order provided that the second order be amended to include all mortgage payments made between the years 1989 and 1990, having the result that all such payments were deemed to be periodic maintenance payments.

Finally, on March 3, 1994, the British Columbia Supreme Court issued

a further order ("the fourth order") which provided that the first order:

> is hereby amended . . . to read as follows:
> THIS COURT FURTHER ORDERS that the Defendant [the taxpayer] do pay interim spousal maintenance for the support of the Plaintiff in the form of monthly mortgage payments on the matrimonial home commencing with a payment for the month of November, 1989, and such payments are to be deemed periodic maintenance payments pursuant to the Income Tax Act . . . s.60.1(2) and 56.1(2) and amending acts thereto.

**DECISION OF THE COURT BELOW**

The Tax Court was asked to consider: (1) whether the mortgage payments made by the taxpayer on his spouse's behalf should have been deductible; and (2) whether the arrears paid by the taxpayer in a lump sum should be considered to be regular maintenance.

On the issue of whether the mortgage payments made in 1990 and 1991 were deductible, the Tax Court Judge found in favour of the taxpayer. In reaching this conclusion, the Court stated that in his view, the *Income Tax Act* provisions relating to the taxation of support payments were "ambiguous." Faced with this ambiguity, the Court looked to the underlying purpose of the legislation as an aid in interpreting the relevant provisions. The Court concluded that as the underlying purpose of the provisions was to mitigate the increased financial burden that arises when one household ceases and two begin, the payments could properly be characterized as an allowance.

The Tax Court Judge went on to note that subsection 56(12) indicates that "allowance" does not include any amount received by a person unless that person has discretion as to the use of the amount. The amount paid in this case was deemed to be received by the recipient spouse as a support payment under the terms of the second and third orders. The Tax Court Judge relied on the fact that subsection 56.1(2) does not specifically state that it applies to amounts *deemed* to be received by a person. The Tax Court Judge went on to state:

> In my view, the only logical interpretation of s.56.1(2) when dealing with third party payments contemplated in s.60.1 is that the payments contemplated in s.56(12) are those actually received by a spouse but earmarked for payment to third parties and not those paid, with the consent of the spouse, to a mortgage creditor on the matrimonial home occupied by her.

In any event, the Tax Court Judge went on to conclude that the recipient spouse had discretion at the time the taxpayer and recipient spouse entered into the support agreement. The Tax Court Judge was of the view that this discretion was sufficient to characterize the support payment as "discretionary," thus bringing the payments within the deduction framework laid out in subsection 60.1(1) of the *Act*. The Minister of National Revenue seeks judicial review of this conclusion.

With respect to the lump sum payment of arrears, the Tax Court found that the payment was capital in nature and thus not deductible. The taxpayer has argued before the Court that this Court should review this part of the decision, while upholding that portion which the Crown disputes.

**ANALYSIS**

*1. The legislative scheme*

At all relevant times in this case, the *Income Tax Act* had a general system in place whereby spousal and child support payments were taxed in the hands of the recipient spouse and were deductible by the paying spouse. This was intended to reduce the overall tax burden borne by both spouses, as the support payment was deductible for the higher income-earning spouse and taxed at a lower rate in the hands of the recipient spouse.

This tax treatment was only available for periodic support payments which could be characterized as "allowances." The case law has established that, generally speaking, where a recipient spouse does not have discretion as to the use of the support payments, those payments will not be considered to be an allowance:

*Queen* v. *Armstrong*, 96 DTC 6315 (F.C.A.). Thus, directed support payments such as those made in this case will generally not be subject to the tax treatment outlined above, and will be taxed in the hands of the paying spouse.

One exception to this general principle was found where a spouse makes directed support payments pursuant to an agreement or court order. In this situation, the *Income Tax Act* specified that such payments shall be deemed to be an allowance for purposes of the act where the agreement or court order specifically mentions subsections 60.1(2) and 56.1(2) of the *Income Tax Act*. If those sections are mentioned, the amount is deemed to be an allowance and is deductible by the payor spouse.

Upon reading subsections 60.1(1) and 60.1(2), one is compelled to agree with the Tax Court Judge's observation that these provisions are ambiguous. The provisions are replete with references to other sections, reference to undefined terms, and are qualified by many circuitous subclauses. Indeed, subsection 60.1(2) is so unwieldy that its 1994 incarnation prompted one author to state:

> "The governing provision, subsection 60.1(2), is the quintessence of Canadian tax legislation: Long-winded ... , replete with double negatives, layered with qualifying clauses designed to block every avenue of fiscal escape, and crafted so that a minimum number of people can understand it in either official language." (Krishna on Income Tax, 5th ed, 1995 at page 552)[1]

While this is strong language, it is not entirely inappropriate.

Subsection 60.1(2) goes on to allow for deductibility of certain amounts where the court order or support agreement makes specific mention of subsections 56.1(2) and 60.1(2). The one clear thread from all of this seems to be that to ensure deductibility of support payments, the order or agreement should mention subsections

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[1] Although the author is commenting on the subsection as it read after the 1994 amendment, I find the commentary is equally apt when speaking of the version of the subsection under consideration in this case.

56.1(2) and 60.1(2).

*2. Deductibility of the mortgage payments made in 1990 and 1991*

In the case at bar, the British Columbia Supreme Court made a support order which directed the payor spouse to make his support payments in the form of mortgage payments for the home in which the recipient spouse was living with the children of the marriage. However, the fourth order was the only order in which subsections 60.1(2) and 56.1(2) of the *Income Tax Act* were mentioned.

The Crown contends that since the support payments were made directly to a third party pursuant to the first order, and the first order did not specifically mention the subsections 56.1(2) and 60.1(2), the resulting payments cannot be said to have been at the discretion of the recipient. In this situation, it is argued, the mortgage payments cannot qualify as an allowance.

In response, the taxpayer contends that the fourth court order was intended to apply retroactively. Under the fourth order, subsections 60.1(2) and 56.1(2) were specifically invoked, so the payments made under the Court order are properly deemed to be allowance payments.

As can be seen, much turns on whether the fourth order of the British Columbia Supreme Court was intended to apply retroactively. The question for this Court, then, is whether the fourth order ought to be deemed to have been made *nunc pro tunc*.

It is the usual rule that an order of a court is effective from the date on which it is made unless it provides otherwise. Thus, where a court does not explicitly state that it intends for its order to apply retroactively, it will be assumed that the order does not so apply. In this case, the British Columbia Supreme Court did not explicitly

state that the fourth order was to apply retroactively.

This cannot, however, be the end of the analysis. While one must assume that a court order is effective from the date on which it is entered, it is equally reasonable to assume that when courts make orders, those orders are intended to be of some force or effect at the time they are made. In the case at bar, the fourth order specifically contemplates the nature of mortgage payments made since 1989 by the taxpayer. At the time the fourth order was made in 1993, though, the matrimonial home had been sold and no more mortgage payments would be made by the taxpayer. It is clear on these facts that if the fourth order were not intended to be of retroactive effect, it would be moot. This is at least an indicator of retroactivity, and may even defeat the presumption against retroactivity.

In my view, it would be perverse to interpret a court's ruling in such a way as to render it moot from its inception. In the case at bar, if the fourth order is not interpreted retroactively, it is of no force or effect from the day it was entered. In such a situation, I can see no other reasonable interpretation than to assume that the British Columbia Supreme Court intended the fourth order to have been made *nunc pro tunc*.

Once the fourth order is deemed to have been made *nunc pro tunc*, all of the mortgage payments made pursuant to the first, second, or third orders are all deemed to be allowances under subsection 60.1(2) of the *Income Tax Act*. In this respect, the disposition of the case by the Tax Court Judge is correct: the mortgage payments made pursuant to the Court order, as amended are deductible by the taxpayer.

*3. Deductibility of lump sum arrears*

The taxpayer has argued that the Tax Court Judge erred in concluding

that the lump sum payments were properly characterized as capital in nature and were thus not deductible. It is my view that it is inappropriate to comment on this issue, as this issue is not properly before this court.

The application for judicial review of the Tax Court's decision was brought by the Minister of National Revenue. While the review is of the decision, the grounds for review are those set out in the Minister's application. In this case, the application for review was only with respect to the deductibility of the mortgage payments.

Had the taxpayer wished to dispute the Tax Court Judge's decision on the lump sum payment issue, it was entirely open to him to have brought his own application for judicial review. Under Rule 1620 of the Federal Court Rules, a motion could have been brought to have the two applications for judicial review heard together. I agree with the submissions of the Minister Representative that this rule at least implies that there is an obligation on the respondent in an application for judicial review to bring his own application for judicial review where the respondent wishes to review the decision on different grounds than those proposed by the applicant.

Consequently, I make no comment on the merits of the taxpayer's submissions with respect to the taxation of the lump sum payments. Had the taxpayer wished this to be a subject of judicial review, it was incumbent upon him to bring his own application for judicial review.

**CONCLUSION**

For the foregoing reasons, I am of the view that the application for judicial review should be dismissed.

"F.J. McDonald"

J.A.

"I agree
B.L.S."

"I agree
M.R.M."

**FEDERAL COURT OF APPEAL**

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