Ritias v. *Greenland*, 2002 NWTSC 16

Date: 2002 03 01
Docket: CV 05756

IN THE SUPREME COURT OF THE NORTHWEST TERRITORIES

BETWEEN:

VERNA RITIAS

Applicant

- and -

LARRY GREENLAND

Respondent

MEMORANDUM OF JUDGMENT

[1] The question on this application is how much consideration should be given to tax consequences when varying a child support order. This issue arises because of the changes to the income tax treatment of support payments enacted in conjunction with the introduction of the *Federal Child Support Guidelines* on May 1, 1997.

[2] This particular case comes under the *Territorial Child Support Guidelines*, promulgated under the *Children's Law Act*, S.N.W.T. 1997, c.14, but the tax treatment is the same as if this were an application under the Federal Guidelines. That is because the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c.1, addresses the treatment of child support orders generally, whether made under federal, provincial or territorial legislation.

Facts:

[3] The parties are the parents of one child. On May 29, 1995, an order was issued by this court requiring the respondent (father) to pay child support of $750.00 per month. Payments were sporadic and significant arrears accumulated. Last year the respondent brought an application to vary the 1995 order by bringing it in line with the Child Support Guidelines and to rescind the accumulated arrears.

[4] It should be noted at the outset that the *Territorial Child Support Guidelines* mirror the *Federal Child Support Guidelines* with the same provisions found in both. The amounts set out in the support tables are also the same under both guidelines.

[5] When this matter came before me in regular chambers, counsel informed me that they had come to an agreement on all issues save one. That issue is the calculation of arrears. Counsel agreed to address this remaining issue by way of written submissions only. Those were filed and this Memorandum of Judgment addresses this one issue.

Issue:

[6] The agreement reached by counsel varies the amount of support that should have been paid up until now. The parties agreed that the amounts should be varied to correspond to the child support table amounts for the level of income earned by or imputed to the respondent in each year. This resulted in the following variations in the child support that should have been paid and will be paid hereafter:

(a) amount payable from June 1995 to December 1999: $220.00/month;
(b) amount payable from January 2000 to the present: $316.00/month;
(c) ongoing child support: $316.00/month.

In addition the respondent agreed to pay a minimum of $100.00 per month toward any outstanding arrears.

[7] But what are the outstanding arrears? That is the issue.

[8] Based on the original child support order, at $750.00 per month, the respondent should have paid, up to December 31, 2001, a total of $59,250.00. The records of the Maintenance Enforcement Office show that the respondent actually paid, over the years, a total of $21,747.37. This would leave an unpaid balance of $37,502.63. However, if one uses the new amounts that the parties have agreed to, and calculates what would have been paid under those amounts, the total payable from June 1995 to December 2001, is $19,684.00. This means that the respondent has actually paid more than he would have been required to pay. But this fails to take into account the tax consequences applicable to child support payments and, as the applicant's (mother's) counsel put it, that means that one cannot simply do such a straightforward calculation.

[9] Prior to May 1, 1997, periodic child support payments made pursuant to a court order or written agreement were deductible from the taxable income of the payor and

were taxable as income in the hands of the payee. This system had its advantages, the primary one being the ability to effect substantial tax savings where there was a significant difference between the marginal tax rates of the payor and payee. It also, however, frequently resulted in a disproportionate displacement of the tax liability between the separated parents, usually to the detriment of female custodial parents: see *Thibaudeau* v. *Canada*, [1995] 2 S.C.R. 627. As a result, the tax treatment of child support payments was changed to a system whereby payments were neither deductible from the payor's taxable income nor included in the recipient's taxable income. These new rules, however, do not apply to orders made before May 1, 1997, unless there is an order, after that date, varying it. Variation of a pre-Guidelines order after May 1, 1997, attracts the new income tax regime and payments falling due after the variation are payable in after-tax dollars.

[10] The fixing of arrears is not treated the same as a variation, however, and the tax consequences could be significant. As noted by the Ontario Court of Appeal in *Cho* v. *Cho* (2001), 56 O.R.(3d) 150 (at para.18): ". . . where the court reduces the amount of arrears owing, the nature of the debtor's liability is not changed, it is simply reduced, and the payment remains deductible in the hands of the payor and taxable in the hands of the recipient." So payments on account of arrears owing pursuant to an order made before May 1, 1997, are deductible and taxable even if those arrears are varied pursuant to an order made after that date. This is illustrated in a practical way by an example taken from *Financial Principles of Family Law* (ed. by Freedman, Loomer, Alterman & White; 2001 looseleaf edition) at section 39.2(e):

> *Example*
>
> Betty and Barney signed a written agreement dated September 1, 1996 under which Barney is required to pay Betty child and spousal support. On June 30, 1997, the agreement is varied to increase the monthly child support to $1,500 per month. At the time the agreement is varied, Barney's support payments are in arrears by $1,700.
>
> After the commencement day (June 30, 1997) if Barney makes a $2,000 payment, the payment is considered to have been made first on account of child support (not deductible by him) and then as a payment on account of arrears (deductible by him). Therefore, only $500 ($2,000 - $1,500) of the total amount paid will be taxable to Betty and deductible by Barney. The balance of Barney's arrears will be $1,200 ($1,700 - $500). This amount will be deductible by Barney when paid.

Therefore, any amount paid on arrears would be deductible by the respondent when he pays them and taxable to the applicant recipient when received.

[11] In this case, the applicant has filed her tax returns each year and paid tax on whatever child support she did receive. This is one of those rare cases where the custodial mother actually has a significantly higher income than the father. It also appears that the respondent has not filed tax returns for several years. That seems to me to be quite irrelevant since, whenever he does, he will be entitled to claim the deduction for the payments that he has made.

[12] So this brings us to the crux of the problem. Is it fair to relieve the respondent of all arrears based on a recalculation which itself is based on amounts that assume no tax consequences, when there have already been tax consequences to the applicant for payments already received?

Discussion:

[13] It seems to me indisputable that a court, prior to the introduction of the Guidelines, always had the discretion to consider tax consequences when setting child support payments. That was often a significant factor. It was common to "gross-up" the amount of child support to account for the tax liability that the recipient would incur on the income. Now, under the Guidelines regime, that discretion no longer exists because it is not relevant. The child support tables set out varying amounts tied to the payor's income. The amounts are calculated according to a formula that takes into account spending patterns at different income levels and the impact of taxation.

[14] The *Federal Child Support Guidelines*, in Schedule I referring to the child support tables, makes explicit the importance of the relevant tax regime. Point number 5 in Schedule I is the following:

> 5. The amounts in the tables are based on economic studies of average spending on children in families at different income levels in Canada. *They are calculated on the basis that child support payments are no longer taxable in the hands of the receiving parent and no longer deductible by the paying parent*. They are calculated using a mathematical formula and generated by a computer program. (emphasis added)

Schedule I of the federal guidelines is expressly adopted by the *Territorial Child Support Guidelines* (see s.3).

[15] It is also indisputable, however, that a judge still has discretion when it comes to fixing or rescinding arrears. The principles relating to rescission are well-known: see *Haisman* v. *Haisman* (1994), 7 R.F.L.(4th) 1 (Alta.C.A.). In this case, the parties have, in effect, by their agreement, reduced the arrears to nil. It is only because of the different tax treatment accorded to support obligations before and after 1997 that I am asked to fix arrears in some other amount. I have no doubt I have the power to do that so as to try and do fairness between the parties. Tax consequences can be very much a factor to consider. Whether one does something different because of that depends on the particular circumstances. I recognize that orders have been issued varying pre-1997 support orders where no consideration was apparently given to tax consequences: as in *Michel* v. *Desjarlais*, 1999 CarswellNWT 22 (S.C.). There have also been variation orders where payments have been "grossed-up" for income tax purposes: as in *Barker* v. *Barker*, [1998] O.J. No.1888 (Gen.Div.). There are also cases where a pre-Guidelines order was not varied so as to preserve the old tax treatment: as in *Sampson* v. *Sampson*, [1998] A.J. No. 1214 (Q.B.). Each case depends on its own facts.

[16] The applicant's counsel submitted that in calculating arrears the amount should have some component recognizing the taxes that have already attached to support payments made. This can be done by either grossing up the guidelines table amounts or by discounting the amounts paid by the respondent. The justification for this, it was argued, is that the guidelines represent what the legislature has determined to be appropriate amounts of support based on the respondent's income when there are no tax consequences to either party. If the guidelines are to be used as the basis for setting arrears, then the arrears should be adjusted to reflect the reality that the applicant had less than the total amounts paid by the respondent available for support due to the taxes that had to be paid on those amounts. I agree with these submissions.

[17] In this case there is evidence that the applicant is in a high tax bracket. In 2001 her combined federal-territorial tax rate was 37.7%; in the years prior to that it was 42.05%. I imagine that the applicant may be able to have her tax obligations for past years recalculated but that is a highly speculative step at this point. And I am not at all sure that the post-1997 tax rules can be applied to payments that have already been made. Further, as noted somewhat rhetorically by her counsel, why should the applicant be put to the expense and bother of doing so when this problem arose because of the past failure of the respondent to meet his obligations? I agree with this as well.

[18] Respondent's counsel made two points in response to this submission. First, it was submitted that if the arrears owing of every payor subject to a pre-Guidelines order were determined with reference to the recipient's tax bracket, a great deal of uncertainty

and confusion would be introduced into the enforcement of such orders. Second, it was argued that it was open to the applicant to apply earlier to have the order brought into line with the Guidelines so as to have the benefit of the new tax regime. She did not do so.

[19] There is certainly merit in counsel's first point. After all, certainty and consistency are two of the objectives of the Guidelines regime. But this ignores the obvious linkage between levels of support payments (the "consistent and certain" amounts payable depending on income) and the tax treatment of those payments. The table amounts were set in part because of a certain tax regime. To ignore tax consequences would result in disparate treatment. The respondent has the benefit of no arrears owing because of a reduction due to the application of the Guidelines whereas the applicant has already paid taxes on money she received, money which was only part of the respondent's obligations.

[20] A further answer to this submission is that the problem will soon disappear. The confusion caused by differing tax treatments relates only to variations of orders and agreements made prior to May 1, 1997. Those will, over time, become fewer and fewer.

[21] With respect to counsel's second point, the fact that the applicant did not take steps to bring the order under the Guidelines is not a significant circumstance in this case. The same issue would have had to be confronted whenever the application had been brought and regardless of who brought the application.

[22] In my opinion, the problem caused by the change in tax treatment is one of balancing the financial books as between the parties. The respondent has gained the advantage of a recalculation of support obligations to a much lower amount due to a formula based on a non-tax regime. The applicant has, however, had the disadvantage of the old income-inclusion tax regime. This has had an actual cost to her. The way to balance things is to apply some "gross-up" when fixing arrears.

[23] The "gross-up" should reflect the tax consequences to the applicant for the years between the making of the order and today. That is because the respondent's obligation has been recalculated all the way back to the date the original order was made. The calculations were set out in the brief filed by the applicant's counsel:

Year	Varied Amounts	Gross-Up	Grossed-Up Amount
1995 (7 months)	$1,540.00	42.05%	$2,187.57
1996	2,640.00	42.05%	3,750.12
1997	2,640.00	42.05%	3,750.12
1998	2,640.00	42.05%	3,750.12

1999	2,640.00	42.05%	3,750.12
2000	3,792.00	42.05%	5,386.53
2001	3,792.00	37.70%	5,212.58
Totals:	$19,684.00		$27,787.16

When one deducts the amount paid ($21,747.37) from the grossed-up amount ($27,787.16), one is left with arrears of $6,039.79. In my opinion, this amount is fair. The respondent, of course, will still have the benefit of deducting payments already made by him when and if he ever gets around to filing his tax returns. He should also be able to deduct the payments he makes to satisfy the arrears (if the example given in paragraph 10 is correct).

Conclusion:

[24] The order of May 29, 1995, is hereby varied as follows:

1. Child support payable by the respondent is set at $316.00 per month, effective January 1, 2002. This is based on annual income of $35,200.00.

2. Arrears of child support, as of December 31, 2001, are fixed in the sum of $6,039.79.

3. The respondent is to provide to the applicant, by May 31st in each year, proof of his income for the previous year, including a copy of any income tax return filed by him.

[25] Considering the significant degree of compromise achieved by the parties in this case, there will be no costs.

J.Z. Vertes,
J.S.C.

Dated at Yellowknife, NT, this
1st day of March 2002

Counsel for the Applicant: Elaine Keenan-Bengts
Counsel for the Respondent: Margot L. Engley

CV 05756

IN THE SUPREME COURT OF
THE NORTHWEST TERRITORIES

BETWEEN:

VERNA RITIAS

Applicant

- and -

LARRY GREENLAND

Respondent

MEMORANDUM OF JUDGMENT OF
THE HONOURABLE JUSTICE J.Z. VERTES
