

TAB 6

Income Disclosure Under The Guidelines

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New Developments in Child and Spousal Support



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INCOME DISCLOSURE UNDER THE GUIDELINES

What must be disclosed?

a) Financial Statements

Rule 13 governs Financial Statements. In essence, if the originating process contains a claim for support, a property claim, or a claim for exclusive possession, a Financial Statement must accompany it. In responding to the process, the respondent must also deliver his or her Financial Statement with the responding material. By virtue of Rule 13(10), the counter clerk is not to accept an originating or responding document unaccompanied by a Financial Statement. By Rule 13(1)(b), even if the responding party chooses not to plead, he or she is obliged to deliver a Financial Statement within the time limited to file responding material.

Rule 13(6)(a) requires a party who serves and files a Financial Statement to “make full and frank disclosure of the party’s financial situation”. If counsel believes that the other party’s Financial Statement does not contain enough information for a full understanding of the other party’s financial circumstances, counsel may then ask the other party to give the additional information. The other party then has 7 days to provide that information or face a motion for a production order. Please note that by Rule 13(13), the request to provide information is a condition precedent to questioning on the Financial Statement.

Financial Statements are required to be updated at various stages of the litigation. If the information contained in a Financial Statement is incorrect or has changed, the party having filed the Financial Statement is required to file and serve either a new Statement or written corrections or amendments together with the documents that substantiate them.

b) Documentary Disclosure

Rule 19 governs documentary disclosure. A party will be required to deliver an Affidavit of Documents if a request is made by the opposite party. The practice, under the *Family Law Rules*, is largely unchanged from the practice that obtains under the *Rules of Civil Procedure*.

c) Questioning

Rule 20 governs the questioning of a witness. Unlike the *Rules of Civil Procedure*, which confer an automatic right of discovery to litigants, the right is not absolute. If the litigant does not consent to questioning, an order must be obtained under Rule 20(5).

Rule 20 deals with the questioning of non-parties, questioning of parties outside of Ontario, confidentiality issues, and the marshalling of questioning.

d) The *Guidelines*

Section 21(1) deals with the additional information that an applicant or a respondent must deliver in an application for child support. Most basically, the documentary disclosure consists of the last 3 years' Tax Returns and Notices of Assessment (although by Rule 13(7) only the Notices of Assessment need be filed). If a party is a proprietor, partner, controlling shareholder, or a beneficiary under a trust, additional information must be provided.

Remedies for Non-Disclosure

a) Financial Statement

As mentioned above, Rule 13 mandates the delivery of Financial Statements in property, support, and exclusive possession matters. Even if a respondent does not file responding material, he or she is still obliged, by virtue of Rule 13(b), to deliver a Financial Statement.

If a party fails or neglects to file a Financial Statement, by virtue of Rule 13(16), the court may, on motion without notice, order that party to file a Financial Statement. As an additional sanction, if the court makes such an order, it must be accompanied by a costs order.

By virtue of Rule 13(17), serious consequences may befall a party who ignores a production order. The court may order the exclusion of the information that was not disclosed. The party may have his or her documents struck or his or her case dismissed. Indeed, that party may be subject to a contempt order.

b) Documentary Disclosure

Different sanctions may follow where an Affidavit of Documents is not delivered or is incomplete. The primary sanction, of course, is found at Rule 19(10)2. If a document is not disclosed, it will be excluded unless the court gives permission for its introduction. The *Family Law Rules* do not contain the saving provision found in Rule 53.08 of the *Rules of Civil Procedure*.

The sanctions are generally set out in Rule 19(10) and can range from the pronouncement of production orders to orders to strike or dismiss, to contempt orders.

c) The Guidelines

i) Failure to Deliver Documents

As mentioned above, the basic disclosure requirements are set out in s. 21(1) and (2) of the *Guidelines*. If a spouse fails to comply with the documentary disclosure requirements, there are two options available to the claimant spouse. He or she can obtain a production order under s. 22(1)(b) of the *Guidelines*. Alternatively, the claimant spouse can simply proceed with the claim. If the claimant spouse elects to proceed, by s. 23 of the *Guidelines*, the court may draw adverse inferences against the non-disclosing spouse and impute income to him or her.

If a production order was made, and the non-disclosing spouse fails to comply with the production order, more severe sanctions can be imposed. The non-disclosing spouse may have his or her pleadings struck. The claimant spouse could proceed

to hearing and, in such case, the court could draw adverse inferences and impute income to the non-disclosing spouse. The non-disclosing spouse could be cited for contempt.

The court hearing a motion for sanctions for failure to obey a production order may award costs against the non-disclosing spouse "...that fully compensates the other spouse for all costs incurred in the proceedings".

Disclosure

a) Generally

In one of the earliest cases decided under the *Family Law Reform Act*, the court stated that any party who does not comply with the letter and spirit of the disclosure requirements of the *Act*, must realize that a court may very well draw unfavourable inferences against that party if the Financial Statement is less than frank and complete: *Silverstein v. Silverstein* (1978), 1 R.F.L. (2d) 239 (H.C.J.). If the proceedings were unnecessarily prolonged because of deficiencies in the Financial Statement, a costs sanction may be imposed: *Silverstein v. Silverstein, supra*.

In *Mace v. Mathewson* (1997), 70 A.C.W.S. (3d) 513 (Ont. S.C.J.), the court stated that solicitors must also assume responsibility for the accuracy of Financial Statements that they prepare for their clients. It will be the responsibility of a solicitor to review the data with the litigant to ensure that the information is correct before it is placed before the Judge.

b) Self-employed persons

A self-employed person should expect that the court will look beyond his or her Tax Return to determine income for Guideline purposes: *Manis v. Manis* (2000), 101 A.C.W.S. (3d) 768 (Ont. S.C.J.). A self-employed person will bear the onus of proving the validity and entitlement to the deductions that he or she claims: *Fuller v. Fuller* (2000), 101 A.C.W.S. (3d) 1139 (Ont. S.C.J.). This is consonant with the intent of the *Guidelines* which imposes a duty upon a respondent to provide evidence of his or her income: *Orser v. Grant* (2000), 96 A.C.W.S. (3d) 644 (Ont. S.C.J.). In *Osmar v. Osmar* (2000), 8 R.F.L. (5th) 375 (Ont. S.C.J.), the court added back into income expenses which Revenue Canada had determined to be appropriate business expenses in their own audit.

A respondent who fails to provide appropriate financial information at trial will find little sympathy on appeal: *Cade v. Rotstein* (2004), 50 R.F.L. (5th) 280 (Ont. C.A.).

c) Imputing income - Failure to Disclose

By virtue of section 19(1)(f) of the *Child Support Guidelines*, the court can impute income to a respondent who fails to disclose. Frequently, the situation arises where a respondent appears to enjoy a lifestyle that exceeds his or her stated income. In such a case, the court can impute income where it is apparent that a spouse's declared income could not support his or her lifestyle: *Depace v. Michienzi* (2000), 5 R.F.L. (5th) 40 (Ont. S.C.J.). In *Orszak v. Orszak* (2000), 8 R.F.L. (5th) 350 (Ont. S.C.J.), the court imputed income where the respondent

failed to file income tax returns, failed to file business Financial Statements, and failed to comply with a production order. In *Neill v. Egan* (2000), 96 A.C.W.S. (3d), 87 (Ont. S.C.J.), the court imputed \$23,000 income to the respondent. This amount represented his budgetary needs disclosed by his Financial Statement. He had failed to produce financial information about his business.

d) Shareholders – Attribution of corporate income

Section 18 deals with the attribution of corporate income to a shareholding spouse in appropriate circumstances.

The attribution is not automatic. The court must first form the opinion that the shareholding spouse's annual income does not fairly reflect the money available to that spouse for the payment of child support: *Koester v. Koester* (2004), 50 R.F.L. (5th) 78 (Ont. S.C.J.) It is only after that threshold is met that the court may fashion its remedy.

By section 18(2), in determining the corporation's pre-tax income for the purposes of attribution, payments made to persons who do not deal with the corporation at arm's length will be disallowed unless the parent establishes that such payments were reasonable in the circumstances: *Tauber v. Tauber* (2001), 18 R.F.L. (5th) 384 (Ont. S.C.J.), affd 34 R.F.L. (5th) 450 (C.A.).

Two recent cases have set out *Guidelines* or criteria to be considered by the court. In *Brophy v. Brophy* (2002), 32 R.F.L. (5th) 1 (Ont. S.C.J.), the court canvassed the authorities on point. It concluded that the following questions should be asked:

- 1) Because of the separate legal entity of the corporation, should there be a general reluctance by the court to automatically attribute corporate income to the shareholder?
- 2) Is there a business reason for retaining earnings in the company?
- 3) Is there one principal shareholder or are there other *bona fides* arm's length shareholders involved?
- 4) What is the historical practice of the corporation for retaining earnings?
- 5) What degree of control is exercised by the spouse over the corporation?

In *Koester v. Koester*, the court added a number of additional considerations including any restrictions on the availability of capital, the nature of the industry, the economic forecast, and the level of debt or banking restrictions.

It follows that the courts are likely to attribute the pre-tax corporate income to the payor if such income can be taken without seriously undermining the finances of the corporation and it could be made available to the payor: *Kendry v. Carthcart* (2001), 14 R.F.L. (5th) 333 (Ont. S.C.J.); *Colafranceschi v. Colafranceschi* (2001), 15 R.F.L. (5th) 294 (Ont. S.C.J.). By contrast, where the corporation has substantial need to retain its earnings as a cushion against tough times in its industry, no attribution will be made: *Koester v. Koester, supra*. Where a company has been conservatively managed and the money is needed to finance its ongoing operations, only a portion of the pre-tax profits may be attributed: *Tauber v. Tauber, supra*; *Murray v. Murray* (2003), 40 R.F.L. (5th) 244 (Ont. S.C.J.).

The Ontario courts have not yet considered the alternate remedies of section 18(1). To date, the case law has focused on the attribution of corporate profits.

e) Disallowance of Expenses

In a host of cases, the court has disallowed alleged “business expenses” and brought them back into the payor’s income. The courts can impute income to a spouse who unreasonably deducts expenses from income. Section 19(2) expressly recognizes that reasonableness is not governed solely by whether the deduction is permitted by the *Income Tax Act*. In fact, in *Osmar v. Osmar* (2000), 8 R.F.L. (5th) 368 (Ont. S.C.J.), the court further reduced expenses deducted by a self-employed payor beyond the reductions originally demanded by Revenue Canada on an income tax reassessment.

Section 19(1)(g) is often employed to “claw back” into income expenses that have both a personal and business component. These frequently include claims for in-home offices: *Moran v. Cook* (2000), 9 R.F.L. (5th) 352 (Ont. S.C.J.). Expenses for travel, food, and entertainment will often be caught under section 19(1)(g). Frequently, counsel employ the forensic accountants to ferret out such unreasonably deducted expenses. For example, in *Davids v. Davids* (1998), 80 A.C.W.S. (3d) 1205 (Ont. Ct. Gen. Div.) affd 125 O.A.C. 375 (C.A.), the court concluded that the husband’s income was \$186,000 and not \$87,000 as he alleged. The court added back into his income a host of improperly deducted personal expenditures, salaries improperly paid to his parents, and income masked as corporate loans.

f) The Gross Up

Where a spouse has additional income as a result of improperly deducted expenses, the imputation is not equal to the amount of improperly deducted expenditure. Rather, it should be “grossed up” for tax: *Sarafinchin v. Sarafinchin* (2000), 189 D.L.R. (4th) 741 (Ont. S.C.J.); *Brans v. Brans* (2000), 13 R.F.L. (5th) 335 (Ont. S.C.J.). The gross up is justified since it equates the after-tax benefit derived by the payor to the salary of an employee: *Riel v. Holland* (2003), 42 R.F.L. (5th) 120 (Ont. C.A.).