Citation: 2008TCC340
Date: 20080623
Docket: 2007-1493(IT)I

BETWEEN:

JOHN JAMES,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

(Delivered orally from the bench on February 15, 2008, in Calgary, Alberta.)

Paris, J.

[1] This appeal deals with the deductibility of child support payments made by the Appellant to his ex-spouse in his 2000, 2001, and 2004 taxation years and what I will call a tax equalization payment made by him to her in his 2004 taxation year.

[2] The Appellant is also challenging late filing penalties, a repeat late filing penalty, and interest imposed for those years. I indicated to the Appellant at the outset of the hearing, this Court does not have jurisdiction to relieve from the interest charged on the reassessments.

[3] As is too often the case for taxpayers paying or receiving child support, the tax treatment of the Appellant's child support payments has given rise to a great deal of confusion and stress for the Appellant and his ex-spouse. In this case much of the confusion is due to the wording of the original order for child support given in March 1997. Ambiguity in the wording of the Order led initially to the Minister of National Revenue (“Minister”) refusing to allow the Appellant's claim for deductibility of payments made under the Order. Later, the Appellant was successful in convincing the Minister to allow the deductions for 1997, 1998, and 1999.

[4] This in turn led to reassessments of his ex-spouse, who had not reported the payments she received from the Appellant as income. Her appeal from those assessments was allowed by this Court in 2005, but inexplicably, the Appellant was never made a party to those proceedings, nor was he called as a witness. This, despite the fact that the Appellant was in ongoing discussions with the Canada Revenue Agency ("CRA") about the deductibility of the payments to him.

[5] The failure of the Respondent to join the Appellant to the appeal by his ex-spouse or to call him as a witness has led, in large part, to these proceedings. This could likely have been avoided if a full presentation of the evidence of both parties had been made at the hearing in 2005. There is no reason to believe this would not have been possible.

[6] I am unable to do anything at this point to rectify the problem, but I strongly urge the Respondent to use section 174 of the *Income Tax Act* ("*Act*") to join spouses or ex-spouses as parties in future in cases of this sort. The Appellant in this case was put through a long period of unnecessary stress, and the inability to resolve the issue of the tax treatment of the support payments for both him and his ex-spouse has negatively impacted their lives and exacerbated the tension caused by their acrimonious divorce. It is extremely regrettable.

[7] I turn now to the particular issues raised in this appeal. The Appellant claims that he is entitled to deduct payments that he made to his ex-spouse totalling $14,400 in 2000 and 2001 and $41,105 in 2004 under paragraph 60(1)(*b*) of the *Act*. He says those payments were made pursuant to an Order of the Alberta Court of Queen's Bench dated March 4th, 1997.

[8] The Respondent contends that the 1997 Order was varied by the Appellant and his ex-spouse either in May 1999 or in December 2000 by written agreement, which resulted in the creation of a commencement date at one or the other of those times within the meaning of that term in subsection 56.1(4) of the *Act*. This would mean that the payments made by the Appellant after that time were not deductible to him.

[9] The Respondent argues, in the alternative, that even if there was no post-April 1997 agreement to vary the child support amounts, $27,105 of the payments made in 2004 were not paid pursuant to the 1997 Order and, therefore, would not be deductible in any event. This portion of the 2004 payments is what I referred to earlier in these reasons as the "tax equalization payment."

[10] In order to resolve the issue of the deductibility of the support payments in each year under appeal, it is necessary to answer the following questions:

1) Was the 1997 Order varied by any agreement to change the child support amounts payable by the Appellant to his ex-spouse?
2) If so, what was the date on which the first payment of the varied amount was required to be made?
3) If the 1997 Order was not varied after April 1997, what amount of child support was the Appellant required to pay under that Order?

[11] With respect to the first question, the evidence showed that the 1997 Order required the Appellant to pay $1,200 “net of tax” for child support for the two children of the marriage.

[12] The Appellant's ex-spouse testified that in 1999 she approached the Appellant for an increase in child support. She said that in order to avoid the cost of going back to Court, they both agreed he would pay her more support starting in May 1999. She was unable to recall the amount of the increase. She also said that the Appellant refused to sign any document concerning the increased payments but made the increased payments every month thereafter by cheque. Then, in around 2001 she said she asked for more child support and he agreed to increase to $227 per month the amount by which he was supplementing the $1,200 amount set out in the 1997 Order.

[13] The Appellant said that he did not begin supplementing the amount of the child support ordered by the Court in 1997 until January 2001. He said at that time he agreed to pay his ex-spouse an extra $140 a month as and when he was able, depending on his income. He produced some bank statements for 2001 that showed a debit for cheques for $140 to his account which he said was for the payment of the supplemental child support.

[14] He said that there was no signed agreement concerning supplemental support, but produced a copy of an e-mail apparently from his ex-spouse dated December 15th, 2000, outlining an agreement under which the Appellant would increase child support by $140 a month and would pay her an additional $5,000 at a rate of $250 a month to cover child care costs she had incurred since 1996. The Appellant's ex--spouse testified that she did not recall writing or sending this e-mail. This purported agreement was not signed by either party.

[15] Some cancelled cheques from 2003 and 2004 for monthly payments of $227 by the Appellant to his ex-spouse were identified by her as the cheques given by the Appellant for the additional child support. Another reference to supplementary child support paid by the Appellant is found in a memo prepared by the Appellant's accountant, Mr. Forbes, in February 2004 which outlines a proposal to pay the tax equalization amounts to the Appellant, which will be dealt with more fully later in these reasons. Mr. Forbes wrote:

> "You currently have a pre-May 1997 agreement that provides for Elisa to receive $600 per month per child net of tax. Due to the date of the agreement, the support payments are deductible for income tax purposes to John and are taxable income to Elisa. John has been paying $1,200 per month to Elisa to date. It is our understanding that John has been making an uplift in payments since 1999, $227 per month presently on a voluntary basis per an oral agreement with Elisa."

[16] This memo was given to the Appellant and his ex-spouse for their consideration, and in an e-mail written by the appellant's ex-spouse on February 23rd, 2004, to the Appellant she sets out a number of concerns with Mr. Forbes proposal and at one point states that: “In 1999 you gave me an uplift in child support of $227 in keeping with your higher income. It's taxable to me."

[17] In some handwritten notes made on a copy of this e-mail, the Appellant wrote (quoted as read): "The uplift was to adjust for increased income in 1999. Initially, it was less. Now it is $227 a month. Why is it taxable?"

[18] The Appellant said he wrote the note in haste and was not focusing on the date the uplift payments began.

[19] In ensuing e-mail correspondence, some rather cryptic references to the $227 a month payments are made by each party. However, nothing in those later e-mail messages, in my view, is conclusive as to when the payments first began.

[20] The accountant, Mr. Forbes testified that he recalled being told of the 1999 start date for the uplift payments by the Appellant's ex-spouse. The Appellant’s ex-spouse denied this and said she had no contact with Mr. Forbes prior to receiving his memo.

[21] On the basis of all of this evidence, the Respondent firstly argued that there was a variation of the 1997 Order in May 1999. The Respondent did not argue that an oral variation of a pre-May 1997 Order for support would trigger a commencement date for that Order. Instead, the Respondent argued that the variation agreement was

expressed in writing, consisting of the references to the 1999 agreement found in the Forbes February 2004 memo, in the ensuing e-mail correspondence and in the Appellant's handwritten note on the copy of the February 23, 2004 e-mail.

[22] Counsel says that the cases of *Thomson v. The Queen*, 2004 TCC 772, *Alm v. The Queen*, 2001, 1 CTC. 2721, *Grant v. The Queen*, 2001, 2 CTC 2474, and *Biggs v. The Queen*, 2001 TCJ No. 768 stand for the proposition that written materials made after the date of an oral agreement which make reference to the earlier agreement can constitute a written agreement for the purposes in subparagraph (*b*)(ii) of the definition of “commencement date” in subsection 56.1(4) the *Act*.

[23] I do not agree that the cases cited are authority for this proposition. In *Alm*, *Thomson*, and *Grant*, the written material relied upon by the Court predates the payments the taxpayer was seeking to deduct. In this case, the written material relied upon by the Respondent post-dates the alleged agreement by almost five years.

[24] In *Biggs*, the conclusion that a retroactive written agreement would suffice as a written agreement for the purposes of the definition of “commencement date” was made in obiter, and is in my view, open to question. The true ratio of that case was that the initial Court Order for support which the retroactive agreement purported to vary was in fact no longer in effect when the latter agreement was made.

[25] More fundamentally, however, I find that the writings relied upon by the Respondent here cannot in any way be construed as creating a binding obligation. I think it is a fair inference to draw from the evidence that the Appellant did not at any time intend to bind himself to making the supplementary support payments to his ex-spouse, and that he made those payments on a voluntary basis as his income permitted. The evidence of his ex-spouse that the Appellant refused to sign anything concerning the supplementary support payments is very telling in this regard. I agree with Associate Chief Justice Bowman, as he then was, in *Foley v. The Queen*, 2000, TCJ No. 485 that the word "agreement" in the legislation denotes at least a *binding* obligation.

[26] For these reasons, I find that there was no written agreement to vary the 1997 Court Order in May 1999.

[27] The Respondent’s second argument was that the December 15th, 2000, e-mail from the Appellant's ex-spouse, Exhibit A-7, constituted a written agreement which varied the 1997 Order.

[28] The Appellant admits that he made supplementary payments of support to his ex-spouse starting in January 2001 and says he did so voluntarily, but says that they were not made pursuant to a written agreement, were not periodic and were not definite in amount. He says that the e-mail from his ex-spouse amounted only to a proposal and was not binding on him.

[29] In light of the evidence, I cannot find that the e-mail to the Appellant from his ex-spouse created a binding obligation that would constitute a written agreement for the purposes of the definition of commencement date in the *Act*. Once again I infer that the Appellant, in refusing to sign any agreement regarding support, did not intend to bind himself to making the payments. The fact that he did make the supplementary payments in and of itself did not bind him to continue those payments.

[30] The Appellant's ex-spouse also appeared to pay little attention to this e-mail apparently at one point denying she had written it. Also, when the parties returned to Court over the issue of child support in 2005, the changes to the Appellant's support obligations was made by means of a variation of the 1997 Order and not by means of a variation of any intervening written agreement between the parties. It appears, therefore, that neither party considered the December 15th, 2000 e-mail to be binding.

[31] As an aside, I also note there was no proof led to show that the other obligation on the Appellant set out in that e-mail, that is to pay his ex-spouse $5,000 in monthly instalments of $250, was ever carried out.

[32] As I stated earlier, the agreement referred to in subparagraph (*b*)(ii) of the definition of “commencement date” in subsection 56.1(4) must be one that creates a binding obligation regarding payment of additional support. That not being the case here, I find no agreement creating a commencement date was entered into December 15th, 2000, and the $14,400 support payments made by the Appellant under the 1997 Order for 2000, 2001, and 2004 are therefore deductible to him under paragraph 60(1)(*b*) of the *Act*.

[33] For 2004 the Appellant also deducted an additional $27,105 as child support payments. This was the “tax equalization” amount the Appellant paid to his ex-wife, believing that it was required by the 1997 Order by virtue of the reference in the Order to the child support payments being “net of tax” to his ex-spouse.

[34] The catalyst for this payment was the acceptance by the CRA of the Appellant's claim to be able to deduct the support payments in 1997, 1998, and 1999

taxation years. The claim was finally accepted in 2003 and this precipitated reassessments to the Appellant's ex-spouse because she had not included the support payments in her income. In order to preclude an appeal of the reassessments by her, something that could have obviously had negative tax consequence for him, the Appellant proposed to pay her an amount equal to the tax she was required to pay by including support payments in her income in prior years. The Appellant's ex-spouse indicated her willingness to accept this proposal, and the Appellant's accountant and an accountant hired by the Appellant's ex-spouse calculated this tax equalization amount. The payments totalled $27,105 in 2004. (Despite her acceptance of the payment, the Appellant’s ex-spouse did go on to appeal the inclusion of the support payments in her income and was successful.)

[35] In support of his claim for the deduction, the Appellant relied on the cases of *Guerin v. The Queen* 94 DTC 1356 and *Monette v. The Queen* 92 DTC 1622, where similar payments were found to qualify as support amounts under the *Act*.

[36] However, in my view, in those cases there was a clearly worded obligation requiring the taxpayer to pay tax on support amounts paid to his ex-spouse. Only in those circumstances can the amount of tax paid qualify for deduction as a support amount. The wording of the March 1997 Order in this case does not create a clear obligation on the Appellant to pay his ex-spouse's income tax on support payments. It is possible that by using the phrase "net of tax," the judge believed the Appellant's ex-spouse would thereby be relieved of paying tax on the amounts. In other words, he may have mistakenly believed that the stipulation "net of tax" would be binding on the Minister and would result in tax free treatment of support payments in the hands of the Appellant's ex-spouse.

[37] Unfortunately the transcript of the judge's reasons in the divorce proceedings does not shed any light on his intention in using the phrase "net of tax" in relation to the amount of child support payable.

[38] I also note that the parties themselves were unclear as to what the judge intended by the phrase "net of tax." The Appellant's ex-spouse took the position that it meant she didn't have to include the support payments in her income for tax purposes, and the Appellant was unsure what it meant. It was only in late 2003 with the assistance of his accountant that the Appellant formed the view that it meant he had to reimburse his ex-spouse for tax she was required to pay on those support payments.

[39] Ultimately, however, the Appellant's ex-spouse did not pay tax on the support amounts, and she repaid the tax equalization payment to the Appellant. This can be seen as further evidence that the Appellant was not required under the 1997 Order to pay the amount. In all of the circumstances, I find that the Appellant has not shown that the $27,105 he paid to his ex-spouse in 2004 was deductible to him pursuant to paragraph 60(1)(*b*) of the *Act*.

[40] The last item in dispute was the late filing penalties imposed in 2000 and 2004 and the repeat late filing penalty imposed in 2001.

[41] At the hearing the Respondent's counsel conceded that the evidence did not support the imposition of the repeat late filing penalty and that, therefore, that penalty should be reversed. The Respondent submits that the late filing penalties for the 2000 and 2004 years should, however, be maintained. The Appellant admitted filing the 2000 year tax return on November 14th, 2003, and the 2004 return on September 26th, 2005. This was beyond the time limit for filing those returns as set out in paragraph 150(1)(*d*) of the *Act*, and therefore, the Appellant will be liable for the penalty, unless he can show he was duly diligent in attempting to file the returns on time.

[42] The Appellant has not succeeded in making out this defence for either year. He explained that he did not file his returns because he believed he had no tax owing for those years. He said that he had consulted with his accountant to determine his liability and, where necessary, made payments to the CRA for the years in an amount he felt would cover any tax owing, but he did not file the returns until the dates indicated.

[43] This leads me to conclude that the Appellant was not prevented by any circumstances beyond his control from filing his returns, on time, nor did he take reasonable steps to file the returns on time. He simply chose not to do so on the mistaken belief that he was not required to file if no tax was payable. This does not amount to due diligence on his part, and the late filing penalties are therefore upheld. They will, of course, be adjusted to reflect any decrease in the tax due as a result of this decision.

[44] In conclusion, therefore, the appeal will be allowed in part on the basis that the Appellant is entitled to deduct $14,400 for support paid in 2000, 2001, and 2004, and the repeat late filing penalty for 2001 shall also be deleted.

[45] The Appellant has been successful with respect to more than half the amount in issue and I therefore award him a lump sum for costs in the amount of $300.

Signed at Ottawa, Canada, this 23rd day of June 2008.

"B. Paris"

Paris J.

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