

Marmer Penner Inc. Newsletter

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Deductibility of Legal Fees – Recent Cases

In a recent Tax Court of Canada case (*Melnyk v. The Queen 2008 DTC 2311*), the father was denied the ability to deduct legal fees that he claimed were incurred to earn child support on a child whose custody was divided with his former spouse. Canada Revenue Agency (CRA) argued that Mr. Melnyk incurred legal fees to reduce his child support payments rather than earn child support because Ms. Melnyk had never paid him any child support. The Tax Court agreed with CRA.

In a recent case handled by our office, a father with custody of two children incurred legal and accounting fees to determine his former wife's income. She had custody of their third child. The father sought to deduct legal and accounting fees on his tax returns. CRA denied this deduction on the basis that the father did not receive any child support.

As it happened, the father and mother had negotiated a settlement whereby the notional child support on one child owed by the father to the mother was reduced by the notional child support on two children owed by the mother to the father. As a result, a net payment was paid monthly by the father to the mother. CRA was correct that the father did not "receive" any child support, however, our argument was twofold:

- (a) The economic reality was that the father was benefitting from child support but that it was netted against his larger child support payments to the mother; and

- (b) It is irrelevant whether he received any child support since the onus required that the taxpayer show that he merely incurred legal fees to attempt to obtain child support.

CRA refused to accept our argument unless we found a case to support our position. We countered that there was no obligation on our part to find such a case, since the law was already on our side. Notwithstanding this, we did find such a case, *Rabb v. The Queen 2006 DTC 2674*. In that case, Mr. Rabb was the custodial parent for one child, while Ms. Rabb was the custodial parent for their second child. In 2003, Mr. Rabb paid \$8,266 dollars in legal fees to help determine Ms. Rabb's income for child support purposes. Pursuant to the *Child Support Guidelines*, each parent was obligated to pay child support to the other. However, as Mr. Rabb was the higher income parent, they netted the amounts payable each month and he wrote a net cheque of \$185 dollars per month to Ms. Rabb. In that case, the Tax Court accepted that notwithstanding the form of the payment, the substance was that there were child support payments going both ways, which resulted in only one payment once the offsetting obligations were netted.

Nearly one year after we provided this case to the Department of Justice, we were contacted by the Department of Justice who advised us that they were dropping their case on the eve of trial.

The lessons learned here are once again twofold:

- (a) Legal and accounting fees incurred to attempt to determine a spouse's income for the purpose of receiving support are deductible, whether or not support payments are actually received in the form of monthly cheques; and
- (b) Don't expect anyone at CRA or Department of Justice to read your correspondence in earnest until the eve of trial.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.