

Marmer Penner Inc. Newsletter

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Did Someone Forget the HST?

Benjamin Franklin once wrote: "In this world nothing can be said to be certain, except death and taxes." Few will argue with the certainty of death, so how is it that a certain tax appears to have gone missing from income calculations pursuant to the *Federal Child Support Guidelines* ("the *Guidelines*")?

Effective July 1, 2010, the 8% Ontario sales tax and the 5% GST were combined into a single 13% Ontario Harmonized Sales Tax ("HST"). HST is a tax that applies to the sale or delivery of most products and services in Ontario. Businesses with revenues greater than \$30,000 must register for an HST number and charge their customers HST on their sales and services, with some exceptions. The HST charged by the business is collected and must be remitted to the government. Most businesses which are registered to collect HST on their revenue can claim input tax credits to recover the HST that they have paid on their business expenses, costs of goods sold or services used in the process of conducting business.

Pursuant to Sections 19(1)(b) and 19(1)(g), the *Guidelines* allow the Court to impute additional income to a spouse who benefits from being exempt from paying federal or provincial income taxes or

deducting excessive expenses from taxable income. This additional amount that is added to a spouse's income as a result of paying lower income tax, or no income tax, is referred to as an income tax gross-up. An income tax gross-up adjusts an amount to a level that, after income taxes, leaves the earner with an equivalent amount of after-tax income. Although the applicability of the income tax gross-up is a legal issue, it has become a common component of *Guidelines* income calculations where a spouse inappropriately deducts personal expenses.

Frequently, when we are asked to prepare an income calculation pursuant to the *Guidelines*, we make adjustments for a spouse's personal or discretionary expenses that are expensed through their business, or that are deducted as improper employment expenses on their personal income tax returns. In order to adjust these personal amounts to the equivalent pre-tax income required to pay for these items, we are often asked to calculate the income tax gross-up thereon. The actual calculation of the income tax gross-up required as a result of the deduction of personal expenses in a business or improper employment expenses is generally not subject to controversy. If for example, Ms. Evader, a high rate taxpayer, deducts \$100,000 of personal expenses in her business, we would add the \$100,000 that was improperly deducted from her business to income along with a \$115,190 income tax gross-up. The income tax gross-up of \$115,190 reflects the fact that Ms. Evader needs \$215,190 ($\$100,000 + \$115,190$) pre-tax income to be left with \$100,000 of after-tax funds to spend on her personal expenses. Often this is where the income tax gross-up calculation stops and support for the parties is settled. However, what is forgotten in this calculation is the HST. In our example above, Ms. Evader not only saved \$115,190 of notional income tax by expensing personal items through her business, but also recovered the 13% HST by charging the expenses as business expenses and claiming the input tax credits. If Ms. Evader had properly paid for her personal expenses

out of her after-tax income, the cost would have been \$113,000 (\$100,000 + \$13,000 HST). It follows that the adjustments to income should be \$143,165 (\$13,000 HST + \$130,165 gross-up on the original expenses *plus* gross-up on the unpaid HST) rather than just the \$115,190 on the \$100,000 of personal expenses. If we keep forgetting about the HST, \$27,975 has certainly not been considered in Ms. Evader's *Guidelines* income.

This newsletter is not intended to substitute for proper professional planning. It is intended to highlight areas where professional assistance may be required or enough to discuss at the next hoedown. 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.