The Imputation of Income: An art or a science?

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"Imputed income matters. The *reason* why income had to be imputed matters."[1] The imputation of income is a determination of fact, not a guess or a provisional amount while waiting for better disclosure or further review.[2] While the goal of the *Child Support Guidelines* is to maximize objectivity, predictability and consistency, Section 19(1) is one of the most litigated areas of the *Guidelines.* The law of imputation of income is a continuously evolving area in family law.

The methodology for imputing income for child support purposes applies equally for spousal support purposes.[3] Section 19(1) of the *Guidelines* includes a non-exhaustive list of nine enumerated categories to impute income, which include:

> (a) the spouse is intentionally under-employed or unemployed, other than where the under-employment or unemployment is required by the needs of a child of the marriage or any child under the age of majority or by the reasonable educational or health needs of the spouse;
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> (b) the spouse is exempt from paying federal or provincial income tax;
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> (c) the spouse lives in a country that has effective rates of income tax that are significantly lower than those in Canada;
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> (d) it appears that income has been diverted which would affect the level of child support to be determined under these Guidelines;
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> (e) the spouse's property is not reasonably utilized to generate income;
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> (f) the spouse has failed to provide income information when under a legal obligation to do so;
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> (g) the spouse unreasonably deducts expenses from income;
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> (h) the spouse derives a significant portion of income from dividends, capital gains or other sources that are taxed at a lower rate than employment or business income or that are exempt from tax; and

[1] *Trang v. Trang*, 2013 CarswellOnt 4069 at para. 58.
[2] *Trang v. Trang*, 2013 CarswellOnt at para. 51
[3] *Marello v. Marello*, [2016] O.J. No. 635 at para. 164.

(i) the spouse is a beneficiary under a trust and is or will be in receipt of income or other benefits from the trust.

It is always open to the Court to find new circumstances in which to impute income.[4] The circumstances reflect two main themes: (i) they either allow for the imputation of income to a payor who is able to generate income but refuses to do so (or who does not provide proper disclosure of income information), or (ii) they adjust the payor's income to compensate for anomalous income tax treatment.[5]

The Ontario Court of Appeal has made it clear that imputing income is one method by which the court gives effect to the joint and ongoing obligation of parents to support their children.[6] In order to meet this obligation, the parties must earn what they are capable of earning.[7] The fundamental obligation of a parent to support his or children takes precedence over the parent's own interests and choices.[8]

There must be a rational and evidentiary basis for imputing income, which must be governed by the principles of reasonableness and fairness.[9] It is a fact-specific exercise that depends on the circumstances of the family at issue. The justification for imputing income and the methodology applied to impute income must be specifically addressed by the Court in its reasons.

Although the imputation of income pursuant to Section 19(1) is a judicial exercise, parties will often agree to an imputed income. Judicial guidance is required with respect to the implications of such consent orders, temporary or final, on subsequent motions to vary an agreed upon imputed income.

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[4] *Riel v. Holland* (2003), 67 O.R. (3d) 417 (Ont. C.A.).
[5] *Bak v. Dobell*, 2007 ONCA 304 at para. 64
[6] *Drygala v. Pauli*, [2002] O.J. No. 3731 (Ont. C.A.)
[7] *Ffrench v. Williams*, 2016 CarswellOnt 2854 at para. 36
[8] *Ffrench v. Williams* at para. 37(a)
[9] *Drygala v. Pauli* 2002 CarswellOnt 3228

Variation of an earlier order based on imputed income

Different principles apply with respect to which party bears the onus in regards to imputing income in an original proceeding as opposed to a Motion to Change proceeding. In an original proceeding, the onus is on the party asking the court to impute income to establish an evidentiary foundation to support the request.[10] However, once a court imputes income to a payor, the onus no longer rests on the support recipient in a subsequent Motion to Change to establish that income should continue to be imputed to the payor, rather, the onus is on the payor to establish that there should be a change in the way their income is calculated. The presumption is that the original order imputing income was correct and therefore the moving party has to establish why his or her representations should now be accepted by the Court.[11]

If income is imputed, then the issue will generally be *res judicata* on a motion to vary or change support.[12] Although the court always has discretion with respect to the issue of *res judicata* and can consider fraud, fresh evidence, additional disclosure or issues of fairness, the principle of *res judicata* provides that generally, a matter cannot be re-litigated once it has been determined on its merits.[13]

The party seeking to vary an order that imputed income faces a difficult burden. In *Trang v. Trang,* Justice Pazaratz discussed the presumption that a finding of imputation of income made on an original application will not be disturbed on a Motion to Change:

> If "declared income" automatically prevailed on a motion to change support, it would defeat the purpose of imputing income in the first place. It might even be a disincentive for payors to participate in the initial court process. They could wait to see if the court imputes income, and how much. If dissatisfied with the amount, the payor could later return to court waving their tax returns, to suggest that the original judge got it wrong.

[10] *Berta v. Berta*, 2015 ONCA 918 at para. 63 citing *Homsi v. Zaya*, at para. 28;
[11] *Trang v. Trang*, 2013 CarswellOnt 4069 at para. 60;
[12] *Nejatie v. Signore*, 2014 CarswellOnt 17198 (See *Bemrose v. Fetter*, 2007 ONCA 637);
[13] *Nejatie v. Signore*, 2014 CarswellOnt 17198 at para. 38

> Support claimants should not be forced to go through this two-step process. Our family court system certainly can't afford it.
>
> Similarly, the onus should not fall on the support recipient to establish why income should still be imputed on a motion to change. That determination has already been made. The onus is on the support payor to establish that there should be a change in the way their income is to be calculated.

Where support is based on imputed income and a party initiates a Motion to Change, "a more comprehensive analysis is required" and the court must consider:

(a) Why did income have to be imputed in the first instance? Have those circumstances changed? Is it still appropriate or necessary to impute income, to achieve a fair result?

(b) How exactly did the court quantify the imputed income? What were the calculations, and are they still applicable?[14]

In order to vary an Order that was based on imputed income, the payor must offer evidence of changed circumstances that establishes either:

(a) It is no longer necessary or appropriate to impute income and the payor's representations as to income should now be accepted, even if they were not before; or

(b) Even if income should still be imputed, a different amount is more appropriate, given changed circumstances.[15]

[14] *Trang v. Trang*, 2013 CarswellOnt 4069 at para. 46
[15] *Trang v. Trang*, 2013 CarswellOnt 4069 at para. 52

In *Gray v. Rizzi*, 2016 ONCA 152, the payor had made no financial disclosure at the time of the original application and the trial judge granted a final support order based on imputed income. The payor then brought a Motion to Change under Section 17 of the *Divorce Act* advancing new financial disclosure concerning his income prior to the final order that he argued constituted a material change in circumstances. The Court of Appeal disagreed and held that "to allow a party who ignores his or her financial disclosure obligations to later satisfy the requirement and argue that the late disclosure constitutes a material change in circumstances would eviscerate the financial disclosure regime", citing *Trang v. Trang*.

Section 37(2) and 37(2.1) of the *Family Law Act* authorizes the variation of spousal and child support orders not only where there is a material change in circumstances but also on the ground that "evidence not available on the previous hearing has become available". Section 17 of the *Divorce Act*, however, does not recognize this alternative ground for a variation. The Court of Appeal in *Gray v. Rizzi* was quick to dismiss the notion that "evidence not available on the previous hearing" includes financial information that was "not available" because of a party's deliberate failure to meet his disclosure obligations."[16]

In *Ruffolo v. David*, 2016 CarswellOnt 2151, the trial judge imputed income to the payor because he had failed to provide sufficient disclosure. The payor later brought a motion to vary support and presented new evidence (tax returns, notices of assessment, and an accountants' report) that was not available at trial but obviously could have been. The motions court found a material change in circumstances and reduced the payor's support obligations retroactively. The Divisional Court overturned the decision based on the reasoning in *Gray v. Rizzi* and *Trang v. Trang* as the payor was effectively trying to re-litigate the issue of his imputed income. The payor could not

[16] *Gray v. Rizzi*, 2016 ONCA 152 at paras. 34 - 37

succeed at varying that order unless he could demonstrate that there had been a material change since the order was made.

If a Court imputes income to a self-employed payor on the basis of unrecorded cash sales and/or excessive deductions of personal expenses, and that payor maintains the same business activities and accounting practices, there is a presumption that the methodology for imputing income continues.[17] Further, if a payor's income is imputed and he or she continues in the same industry which results in his or her income naturally varying from year to year, a material change will not be found.[18]

In *Favero v. Favero*, 2013 ONSC 4216, Justice Chappell was not satisfied that the payor's historical pattern of income reporting had changed and acknowledged that the nature of the business engaged in by the payor by its very nature involved ebbs and flows in income from year to year. It was held that in the circumstances there was no material change to the Respondent's previously imputed income.

In *Siebert v. Siebert*, 2014 CarswellOnt 4481, an arbitral award had imputed income to the payor who operated two restaurants. The payor brought a motion to vary the arbitral award and the Court noted that the payor's imputed income based on his restaurant businesses would naturally vary and therefore did not find a material change. Despite his representations, the payor's lifestyle continued to remain relatively the same:

> "Fabian was found by Mr. Sadvari to have minimized his salary and utilized his restaurants for the payment of personal expenses. It clear from the evidence before me that Fabien's lifestyle has not changed but remains inconsistent with his stipulated income. That history continues. The Court should also gross-up the income to reflect what the actual income number would have been before income taxes are paid on it."[19]

[17] *Trang v. Trang* at para. 57
[18] *Siebert v. Siebert*, 2014 CarswellOnt 4481; *Favero v. Favero*, 2013 ONSC 4216
[19] *Siebert v. Siebert*, 2014 CarswellOnt 4481 at para. 120

The principles set out in *Trang v. Trang* also apply to payors who bring motions prior to trial to vary temporary orders that imputed income.[20]

A trial judge has discretion to vary a temporary order imputing income. However, care must be taken to ensure that the temporary order is without prejudice and subject to adjustment at trial, otherwise a court may be reluctant to disturb a consent order imputing income depending on the circumstances. The labeling of a consent order that is "without prejudice" in reference to temporary consent orders is a matter that is currently being clarified by the Divisional Court in *Musheyev v. Gilkarov*, 2016 CarswellOnt 9942. Hopefully, clarification will be provided as to the implications of parties agreeing to temporary "without prejudice" consent orders that impute income.

In *Trang*, Justice Pazaratz stated the following at paragraph 50:

> In most variation proceedings, it should be possible to establish why (and how) income was imputed in the original order. Those factual findings and calculations are usually set out in affidavits or transcripts (in uncontested proceedings) and written endorsement or judgments (in contested proceedings). This is relevant information which should be presented to the court on a motion to change. It is essential to an understanding of what factors the court considered when the previous order was made – and whether *those* factors have changed.

It may be impossible to establish how imputed income was calculated in a Consent Order and therefore apply the *Trang v. Trang* test as in many cases the income figure is simply a compromise. If *Trang* applies, parties will need to document the basis for the imputed income such as referencing the various components of the imputed income in the agreement or consent order in order to preserve a payor's right to later bring on a Motion to Change.

In *Barichello v. Labute*, 2016 CarswellOnt 13937, the parties agreed to a final support order imputing income. Applying the test in *Trang*, the payor failed to establish why on a Motion to Change his representations concerning his income should be accepted. It was not clear on the

[20] *Nejatie v. Signore*, 2014 CarswellOnt 17198

evidence what basis there was for imputing income to him in the original order. The Court dismissed the Motion to Change.

In *Clancy v. Hansman*, 2013 CarswellOnt 15957, the parties agreed by way of separation agreement that the husband's income be imputed at $200,000. The husband brought a Motion to Change the child support obligations set out in the separation agreement arising from the termination of child support for some of the children. The husband then argued that while the agreement imputed annual income of $200,000 to him, he never earned that amount of money and the compromise was that he only had to pay table child support of $3,000 per month based on an income of about $178,500 per annum. The husband requested that ongoing child support for the remaining dependent children be based on the lower income level. The Court disagreed and calculated his support obligations based on his agreed upon imputed income.

Gifts that establish a lifestyle beyond a basic standard of living

In the normal course, gifts are not included as income. In *Bak v. Dobell*, 2007 ONCA 304, the Court of Appeal outlined a number of factors in determining whether it is appropriate to include gifts in income:[21]

a) The regularity of the gifts;

b) The duration of their receipt;

c) Whether the gifts were part of the family's income during cohabitation that entrenched a particular lifestyle;

d) The circumstances of the gifts that earmark them as exceptional;

e) Whether the gifts do more than provide a basic standard of living;

f) The income generated by the gifts in proportion to the payor's entire income;

[21] *Bak v. Dobell* at para. 75

g) Whether they are paid to support an adult child through a crisis or a period of disability;

h) Whether the gifts are likely to continue;

i) The true purpose and nature of the gifts.

Income was not imputed to the payor in *Bak v. Dobell* because the intended duration of the gifts was limited; the gifts were made to a disabled child in the nature of support to an adult child to provide only a basic lifestyle; and the gifts could be terminated or reduced at any time. The important fact in *Bak v. Dobell* was that the payor was incapacitated and unable to earn an income.

In *Korman v. Korman*, the Court of Appeal recently recognized that the historical pattern of monetary gifts may be imputed to a support payor when the gifts do more than provide a basic standard of living. In this case, there had been a settled pattern of such gifts over many years and the gifts were substantial (between 1990 and 2009 the parents gifted at least $986,000). The Court distinguished *Bak v. Dobell* because in this case the payor was capable of earning an income and the monetary gifts helped him to maintain a certain lifestyle. The Court held that imputing income on the basis of a pattern of gifts does not impose any obligation on the donor to continue the gifts in the future. Rather imputing income on the basis of repeated and significant gifts recognizes the reality of the payor's situation, including the payor's history of past cash flow and their likely financial future. The Court noted that if the practice of making significant monetary gifts changed, it would be open for the payor to apply for a variation.

Even if the Court determines that it is appropriate for gifts to be imputed as income, an uncertainty that may arise is the amount of the gifts that should be imputed. For example, the trial judge held in *Korman v. Korman* that, "[w]hile it is *impossible* to know exactly how much the [Husband] will benefit from gifts or dividends, the amount of $120,000.00 strikes a r*easonable balance* between earnings and other cash flow the [Husband] is likely to receive."

In *A. (A.) v. G.(Z.)*, 2015 ONSC 4397, the finances of the payor and his father were intermingled during the marriage and since separation. The payor had a strong business background and his father always provided for the family directly and indirectly supplementing the income of the family. Since separation, the payor's father had been providing him with approximately $5,000.00 to $6,000.00 per month and his home and car were paid for by his father's company. The father would pay for the payor's credit card and the payor would also use his father's credit card for lavish purchases. These regular gifts were imputed as income to the payor.

In *Marrello v. Marello*, 2016 CarswellOnt 1728, the payor had no other significant source of money after separation other than gifts from his father. "In the case of the respondent, while he earned some income during the marriage, his source of funds was primarily his father, which continues." The payor received money from his father to pay his legal bills and assist with his living expenses. All the monies gifted, other than the funds needed for the down payment of a home and legal fees, were used to provide for basic needs and an improved standard of living. During the marriage, most of the monies brought into the family by the payor were gifts from his father. The Court held that these gifts ought to be imputed as income. The Court experienced difficulty in ascertaining the amount of those gifts as there were no records detailing the cash amounts that the Respondent has taken from his father. The Court discounted one-time payments such as the payment of legal fees and accounting fees in determining the level of income to be imputed.

Lifestyle as an Indicator of Income

Support payors may enjoy post-separation lifestyles that are not commensurate with their reported earnings. Lifestyle is not income or a standalone ground for imputing income upon which support can be calculated.[22] Canadians are not taxed on lifestyle.[23]

[22] *Bak v. Dobell* at paras. 42 & 43.

The Court of Appeal distinguishes between lifestyle *per se* and where certain trappings of a lifestyle can substantiate the inference that the payor has not fully disclosed his or her income and that income may be imputed for child support purposes.[24] When it comes to a lifestyle analysis, the credibility of the payor is a crucial factor.

The Court of Appeal in *Heard v. Heard*, 2014 ONCA 196, upheld a trial judge's decision in imputing income to a payor where the trial judge had relied on the husband's negative credibility and lifestyle to impute income to him:

> The respondent admitted at trial, as he has throughout the proceedings, that he has filed false income tax returns with the Canada Revenue Agency…His unlawful conduct eo3s negatively impinge on his credibility and if he is prepared to hide income from the authorities he may well be hiding income from the court…
>
> A second factor that supports the trial judge's conclusion on this issue is the reliance he placed on the husband's lifestyle. We cite but one example, at para. 49 of the trial judge's reasons:
>
> > Since separation, he has taken some exotic vacations including a trip to Fiji and Australia. He drives a BMW X5 which he paid for in cash and leases a Porsche Boxter for $575.00 per month.
>
> In our view, these factors — credibility and lifestyle — taken together amply support the trial judge's decision to impute income to the husband, and in the amounts he chose.

The Court of Appeal in *Hum v. Ma*n [1998] OJ. No. 3873 ordered a new trial because the trial judge failed to consider evidence concerning the payor's lifestyle and the likelihood of being able to afford that lifestyle based on his tax returns.

In *A. (A.) v. G. (Z.)*, 2015 CarswellOnt 10976, Justice Kruzick was tasked with examining the parties' post-separation lifestyles to arrive at an appropriate level to impute income to each party. The payor enjoyed an affluent lifestyle that did not match his declared income. The payor admitted at trial that since separation his lifestyle was much better when compared to his lifestyle prior to separation.

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[23] *Bak v. Dobell*, 2007 ONCA 304 at para. 40
[24] Ibid at para. 43

Adverse findings were made against the payor for his failure to provide many items of disclosure which would have provided the Court with insight into his lifestyle, including his failure to:

a) produce his passport although the payor admitted to travelling to the Middle East for business and pleasure;
b) provide any details about his business prospects;
c) answer the wife's expert's disclosure requests;
d) include a budget in his sworn Financial Statement;
e) produce credit card statements.

In the circumstances, a fulsome lifestyle analysis could not be conducted.

Unreported Cash Income

The allegation of cash income does not squarely fall within an enumerated category under Section 19(1). An analysis of unreported cash income can be complex, time-consuming and costly. Cash is often difficult to trace unless a second set of books is kept by the company. Bank statements should be reviewed for cash deposits and receipts to determine if purchases are paid by cash. Evidence concerning the nature of the industry and the context of the specific business may assist the Court in making reasonable assumptions with respect to the amounts to impute as income. In reality, Courts will never know the true cash income component and the only way that an accurate income figure could be arrived at would be through an audit of the business, which is beyond the means of most family law litigants and may not be worthwhile given the numbers involved. In the recent decision of *A. (A.) v. G. (Z.),* 2015 CarswellOnt 10976, Justice Kruzick acknowledged the reality of the imperfect disclosure process in relation to a business with cash sales:

> Russell testified that over and above reported income for Decorawall, it was discloed to her that the husband's Decorawall business had unreported cash

> income. Russell simply relied on what she was informed was the cash income component. In reality, it is possible the cash income component could have been significantly greater. We will never know.

Justice McDermot in *Sobiegraj v. Sobiegraj*, [2014] O.J. No 1588 noted the following common practice in businesses with a significant cash component:

> It is not unusual for a self-employed individual to minimize his or her income for tax purposes. Methods may include undeclared cash income or improper or questionable deductions of personal expenses from business income. Moreover, his or her partner or spouse will often participate in income reduction. For example, that spouse may accept income from and work in the business, or provide bookkeeping services for the business. So long as the marriage remains strong, the reduction of income serves the couple and their family well; tax liability is reduced and the couple and their children can maintain a fairly comfortable lifestyle with little declared income.
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> When the marriage breaks down, however, there may be what can be best described as a falling out amongst thieves. The spouse operating the business may continue to attempt to minimize his or her income, this time not only because of taxes, but because he or she seeks to reduce income for support purposes. The other spouse is often removed from any role in the business, but takes exception to the income minimization methods used during marriage, and in fact is more than willing to produce evidence that the business income has been artificially reduced as it now no longer suits his or her purposes. And income imputation is sought, largely based upon the evidence provided by the spouse seeking support who may have been previously involved in previous income avoidance schemes.
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> Whether or not a spouse participated in the income minimization, these cases are particularly difficult to settle and expensive to litigate. In reality, neither party is completely sure of what the income actually was during marriage. After separation, there is even less clarity as to what that income is, as the spouse

> seeking support then is shut out from the operation of the business and relies only on disclosure as received through the court process.

In *Siebert v. Siebert*, 2014 CarswellOnt 4481, the arbitrator had determined that the support payor was receiving about $25,000 in cash out of the business and attributed another $50,000 to him from cash tips. The payor admitted receiving cash advances from the business. The Court, on a motion to change, held that the payor was untruthful about his cash income and an adverse inference was drawn. Based on the expert report of a forensic accountant and the evidence of an independent restaurateur about the cash received in a similar restaurant business, the Court concluded that the payor's cash component of his business was between 11 to 12% each year, which was factored into the imputation of income. This case demonstrates that the use of expert evidence and fact witnesses who work in the same industry as support payors can provide valuable evidence when seeking to impute income on the basis of unreported cash sales.