LEGAL REPORT

Taxation of Child Support

by Bruce Ryder

Single Mothers Organize To Fight Discrimination in Income Tax Act

As sure as the arrival of spring, the tax man cometh, but Susan Thibaudeau, Barbara Schaff, and a host of other single mothers across the country will not be answering the call to include as income the amount of child support they have received from their ex-partners. Their civil disobedience has landed them in the tax courts where they have argued, thus far unsuccessfully, that the relevant provisions of the Income Tax Act constitute discrimination contrary to their Charter equality rights. Thibaudeau and other single mothers have also launched a class action suit to recover damages from the government for taxes that have been collected through the allegedly unconstitutional provisions.

Inclusion-Deduction Scheme

Sections 56 and 60 of the Income Tax Act provide that periodic spousal and child support payments made pursuant to a court order or written separation agreement are fully deductible from the payer's taxable income, and must be included in the taxable income of the recipient. In virtually all cases (98%), the direction of support is from men to women.

The inclusion-deduction scheme was originally enacted in 1942, reversing the previous situation in which alimony payments were neither deductible to the payer nor taxable income to the recipient. The original rationale for the change was to provide some relief to men with alimony obligations who faced high war-time marginal taxation rates. The main rationale now offered in support of maintaining the scheme is that it provides an income-splitting subsidy that benefits parents and children on family breakdown. The female recipients of support are generally poorer than the male payers and thus frequently taxed at a lower marginal rate. Where the payer is in a higher tax bracket than the recipient, the inclusion-deduction scheme is preferable to taxing the income in the hands of the payer because it leaves more money in the hands of the broken family members to assist them in the transition to their new lives. The income-splitting subsidy is estimated to cost the government $250 million annually.

Charter Rulings in *Thibaudeau* and *Schaff*

In two separate rulings in *Thibaudeau* (1992) and *Schaff* (1993), Tax Court judges rejected arguments that the inclusion-deduction scheme discriminates against single mothers and their children. The judges found that the scheme creates no burden or disadvantage, but does create the potential for substantial benefit through income splitting. Thus, there was no "causal nexus" between the scheme and the relative poverty of households led by divorced or separated women.

The courts acknowledged that the inclusion-deduction policy operates equitably in practice only if the tax consequences of support payments are accurately predicted at the time the quantum of support is set in a separation agreement or by court order. In Schaff's case, the quantum of child support had been set without reference to tax consequences. In Thibaudeau's case, the family court judge had calculated child support in a manner that significantly underestimated her tax liability. As a result, both women were taxed more than $1,000 annually on money that was intended solely for child support. However, the courts said the proper remedy was not under section 15 of the Charter; it was the role of family courts to ensure that support obligations are calculated in a manner that takes full account of the tax consequences.

The Nature of the Discrimination

The Tax Court rulings that the inclusion-deduction scheme imposes no discriminatory burden on single mothers are questionable. First of all, the scheme places the risk of tax consequences not being accurately accounted for in setting the quantum of child support solely on the custodial parent. The possibility of returning to family court for a revision of the support order may reduce the risk of error, but the necessity of instigating such an action, and the lack of any guarantee of success, places a real burden on mothers in Schaff's and Thibaudeau's situation.

Second, the current system promotes and maintains the gender disparity in the standard of living between custodial and non-custodial households. The standard of living of men tends to rise after divorce or separation, while that of women and children tends to decline. The inclusion-deduction scheme is implicated in this phenomenon, because the custodial parent's child support expenses are not deductible. By allowing non-custodial parents (mostly fathers) to deduct child support payments from income, while limiting custodial parents (mostly mothers)

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to generally less favourable tax credits and family allowances, the tax system disproportionately subsidizes the child support obligations of men. Moreover, since all deductions operate as regressive subsidies, the scheme benefits most those least in need—namely, the wealthiest divorced or separated fathers.

Speculative Benefits

The *Thibaudeau* and *Schaff* rulings are now on their way to the Federal Court of Appeal and the issue will no doubt end up before the Supreme Court of Canada. Hopefully, the appellate courts will grapple more fully with the discriminatory aspects of the current scheme. However, as the recent Supreme Court decision in *Symes* (1993) illustrates, judges may be reluctant to decide complex questions of tax policy especially when their decisions may have contradictory and unpredictable results for members of disadvantaged groups.

What would be the impact of the removal of the inclusion-deduction scheme for support payments? Such a result would put more money in the hands of the relatively few single mothers, like Thibaudeau and Schaff, whose quantum of support has been calculated without adequate regard to tax liability. However, for most single mothers who receive support payments that include a "gross-up" to cover tax liability, a return to the pre-1942 situation will not put more money in their hands, and may actually create a risk of diminishing the child support they receive. This risk arises because fathers' ability to pay will be reduced by the removal of the deduction. The incentive placed on fathers to comply with their obligations will similarly be removed with uncertain effects. Most single mothers will be better off only if the $250 million increase in government revenues that would result from the abolition of the current inclusion-deduction scheme is redirected to the benefit of low-income households. Given the courts' inability to direct such a transfer of funds, the current equality litigation offers at best speculative benefits for most single mothers.

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CW UPDATE

The Month in Review

by Michael Rutherford

Indian Affairs To Be Dismantled in Manitoba

Department of Indian Affairs Minister **Ron Irwin** announced on March 9 that he had begun negotiations to dismantle his department in Manitoba and transfer its responsibilities to Manitoba bands. Irwin hopes that the transfer will serve as a model for the rest of the country.

Labour Reform in Saskatchewan

Saskatchewan may become the first province to require companies to pay benefits to part-time employees. The Saskatchewan government introduced the proposed changes to the Saskatchewan Labour Standards Act on March 11.

Damages Awarded in Tainted Blood Case

On March 14, a judge awarded **Rochelle Pittman** and her four children more than $500,000 after finding that the Canadian Red Cross Society, the Toronto Hospital, and the Pittman physician had a duty to warn her husband that he might have received an HIV-positive blood transfusion. Had he been told, **Kenneth Pittman** might have lived two years longer and might have avoided infecting his wife. The decision came the day before a provincial deadline requiring blood-transfusion HIV victims, or those infected by them, to accept a compensation package that would bar them from launching lawsuits.